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978-0-521-14404-9 - Capitals of Capital: The Rise and Fall of International Financial Centres,
1780–2009

Youssef Cassis

Excerpt

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Introduction

International financial centres have come to represent a major economic stake. Indeed, the advantages that they bring, especially in terms of jobs, incomes and wealth concentration, to the countries and cities that host them seem highly desirable – even though they come at a price, the most visible to date being the strengthening of inequalities.¹ Such benefits apply above all to the most important centres: New York and London, or even Frankfurt, Paris, Zurich, Tokyo, Hong Kong and Singapore, to name but the leading ones. However, there are far from insignificant benefits for the numerous secondary centres in developed countries confronted with the competition and challenges of the post-industrial era, or for those in emerging economies to which they offer further prospects of enrichment and development.

The extent to which defending and promoting these centres has reached today reflects the importance of these stakes, which are far from solely the concern of pressure groups from the financial sector. Politicians also enter the fray whenever national interests are concerned. Did the then British Chancellor of the Exchequer, Gordon Brown, not provide the best example of this by making the preservation of the City's international competitiveness one of the five conditions for the pound sterling's entry into the European Monetary Union? The financial crisis of 2007–8 has not fundamentally changed the deal. A leading international financial centre will remain an essential attribute of a modern, post-industrial economy. The more discreet – because of bankers' fall from grace – but no less committed support given to the City of London by the same Labour government in the repositioning battle taking place in the aftermath of the crisis bears witness to the fact.

These stakes are also mirrored in the increasing number of publications devoted to this subject over the last twenty years or so. Their authors, usually economists or financial analysts, have endeavoured to define and classify international financial centres and organise them into a hierarchy. In so doing, they have sought to establish, both analytically and prescriptively, the conditions underlying the centres' successes and failures.

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[More information](#)

2 Capitals of Capital

Until now historians have not really followed this trend – yet it is hardly a new phenomenon. Without going back over ancient history, the mere mention of today's main international financial centres evokes an often brilliant and at times turbulent past that for some of them goes back to the eighteenth century, or even earlier, and above all that provides an abundance of lessons to help understand their recent development.

Historians have obviously not lost sight of this past's significance; but until now they have only analysed it within a specific framework. Their interest has focused on isolated financial centres, first and foremost the City of London, and on specific institutions, like banks, the capital market or even, to a lesser extent, stock exchanges and insurance companies. No historical study has been undertaken to date on the main international financial centres as a whole from the beginning of the industrial age up to now, with Charles Kindleberger's pioneering study in 1974² being particularly concerned with the emergence of these centres on a national level and mainly focusing on banks. This book attempts to fill the gap.

What is an international financial centre? David Scholey, chairman of S.G. Warburg & Co., a renowned City merchant bank nowadays incorporated into UBS, acknowledged in 1987 before an audience of young Swiss bankers that, 'Although we would like to pretend otherwise ... the financial markets are, basically, pretty simple things. All they require is a surplus of capital ... a roughly offsetting deficit of capital ... and an intermediary or intermediation process ...'³ The definition is clear, even if its last point is worth explaining. A financial centre can thus be considered the grouping together, in a given urban space, of a certain number of financial services. Or in a more functional way, it can be defined as the place where intermediaries coordinate financial transactions and arrange for payments to be settled.

In both cases, this concentration can chiefly be explained by what are usually called external economies – in other words, cost reductions that firms can make not through their internal organisation (for example, economies of scale linked to growing mass production), but thanks to the effects of the competition, proximity and size of the sector or the place in which they are developing. For a financial centre, what really matters is the liquidity and efficiency of markets; the diversity and complementarity of financial activities; professional services (primarily legal and accounting); technological expertise; workforce skills; and, arguably above all, access to high-quality information.

This concentration can be found at national, regional (in the sense of a grouping of several nations in one part of the world) and world levels, depending on the extent of the geographical area served by one financial centre or another. All the international centres do not, therefore, have

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[More information](#)

the same functions or the same importance. Consequently, their more or less explicit hierarchical order has become one of the main themes of the literature devoted to this subject. Back in 1981 for example, the American economist Howard C. Reed proposed an initial ranking of international financial centres, at intervals of ten or fifteen years from 1900 onwards,⁴ based on a set of quantitative criteria, such as the number of foreign and multinational banks or the relative amount of non-residents' banking deposits existing in a centre. For 1980 he divided the eighty centres under consideration into five ascending categories: forty were classified as host international financial centres, twenty-nine as international financial centres, eight (including Frankfurt, Hong Kong, Paris and Zurich) as supranational financial centres of the second order, New York and Tokyo as supranational centres of the first order, and just one, London, as the supranational centre par excellence. Such an approach has its limits. Admittedly, it allows a large number of centres to be compared, but, in the end, the indicators used give only very limited information on the centres' true nature.

Subsequent analyses have put forward a number of variations on this theme. Geoffrey Jones, for example, has slightly adjusted Reed's model by using a more qualitative selection method and by reducing the categories from five to three: the national financial centres, which he calls subregional and whose relations with the other centres are essentially of a bilateral nature; regional financial centres that cater to the needs of one region of the world; and global financial centres, whose vocation is truly worldwide.⁵ Richard Roberts suggests a fairly similar subdivision, adding offshore centres to the three preceding categories.⁶ Other classifications are more functional: Gunter Dufey and Ian Giddy, for instance, distinguish between traditional financial centres, based in large capital-exporting countries; financial entrepôts serving as hubs for international capital flows; and offshore centres that work on behalf of non-residents.⁷ The list is not exhaustive.⁸

A different approach has been adopted in this book, above all because its purpose is different. It does not aim to draw up a ranking, taxonomy and history of all the international financial centres over the last two centuries. Such a task would in any case be impossible, if only because of the lack of documentation available prior to the mid-twentieth century. Instead, this book concentrates on the most important centres – those that truly make up *capitals of capital*. Given the transformations in the world economy, their number has remained remarkably stable, yet without being rigid. In Europe, barely half a dozen centres have really made a difference in the financial field since the end of the eighteenth century: London and Paris; Berlin, followed by Frankfurt after the

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Youssef Cassis

Excerpt

[More information](#)

4 Capitals of Capital

Second World War; then, to a lesser extent, Zurich (which can be combined with Geneva), Brussels (especially before 1914), Amsterdam (before 1800 and during the 1920s) and perhaps Luxembourg (as an offshore centre). At world level, New York should of course be added from the end of the nineteenth century and, much more recently, Tokyo, Hong Kong and Singapore.

The aim of this book is to undertake a historical and comparative analysis of the role of the international financial centres over the last two hundred years or so, with particular emphasis on the dynamics of their rise and decline. It is not merely a matter of ranking them according to predefined selection criteria, since the reasons for a centre winning or losing influence – a world leader or a less important centre – are complex. They can only be understood within the economic, political, social and cultural context of a particular age. And to grasp how these general factors have influenced a centre's development, it is necessary to investigate its inner workings and operations.

An international financial centre's importance depends primarily on its financial capacity and on the way in which this is implemented by its institutions and markets. It can be gauged from the amount of capital exported by the country that hosts it; from the development of its capital market; from the size of its main financial institutions, even if it is not always easy to separate their international activities from their national ones; from the presence of foreign banks in this centre, as well as from the spreading of domestic banks outside their borders; and finally, from the network of both formal and informal relationships developed by its main players. On top of this come all the services provided by a centre, varying in range according to how important the centre is. So, in addition to banks and capital markets, there are insurance companies, finance companies, commodity markets and professional services.

These institutions and markets' operations, organisation and interaction – nowadays called the financial architecture – fall within a framework that is predominantly national. The banking system prevailing in each country, especially its degree of specialisation, plays a key role in this respect. Here the classic contrast lies between the German model, dominated by universal banks, and the British system, in which deposit banks are complemented by a more active capital market.

An equally crucial and variable role is played by central banks. Before the First World War, those in existence – after all, this was not the case in Switzerland before 1907 or in the United States before 1913 – were not all prepared to act as lenders of last resort, thus they were unable to fully assume their role of central banks; after the Second World War, many having lost their independence, the question of their relationship

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[More information](#)

with the state became the dominant issue. The financial architecture is also influenced by regulations and the control exerted by governmental authorities over banking and finance, which vary considerably in scope according to the time and the country, from near total *laissez-faire* at one extreme to almost complete state control over financial institutions and circuits at the other. Finally, it is necessary to take into account the monetary conditions under which the various centres operate. The role and status of the national currency – a strong or weak currency, a reserve currency or even the leading currency at world level – have a positive or negative impact on the influence exerted internationally by each financial centre, the effects varying according to the exchange rate regime – fixed exchange rates or floating exchange rates – and its relative stability.

The rise or decline of an international financial centre cannot be understood independently from the economic and social environment of the country in which it operates; from the weight carried by the financial sector in this economy; from the preference given to it compared with other activities, especially industrial, by the political authorities; and from the political influence that the financial elites are able to exert. There are so many elements, whose balance can never be taken for granted, which serve to remind us that in the end it is men – far less women, even if they have increased in number over the last twenty years – from grandees of finance to office clerks via salaried managers, who are the driving force behind the international financial centres. All these factors, both institutional and human, create an atmosphere that is unique to each centre and that is vital to its success, even if it is neither quantifiable nor always easy to detect. This expresses itself in the way that a centre's premises are laid out, its traditions, its unwritten rules, its interpersonal relationships, its attitude towards the outside world and its unique culture.

The development and interaction of these various factors, themselves influenced by changes occurring in the world political and economic order, explain the ups and downs in fortune of the main financial centres. Periods of war or peace, of revolution or counter-revolution, of prosperity or slump, of the speeding-up or slowing-down in trade, of technical innovations – none of these affect different countries, and thus different financial centres, in the same way. These parameters form the analytical grid used here to approach the history of these centres.

The book is divided into six chapters that follow a chronological order whose various – and inevitably debatable – stages cover the major phases of the world's economic and political history. For each of these periods, there is a corresponding hierarchy of international financial centres. This work endeavours, among other things, to identify changes in this hierarchy and to explain the reasons for them.

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Youssef Cassis

Excerpt

[More information](#)

6 Capitals of Capital

Writing a history of international financial centres represents a challenge for the historian. How can international operations, which make up the subject of this book, be separated from national activities? What is the exact purpose of the study? It is not a history of the banks, and yet it is not possible to exclude those that have been the key players in all the centres. The same could be said of the capital markets that have formed the very essence of these centres, of the stock exchanges that have set their pulses and of a good many other agents, institutions or markets. The history of the financial centres encompasses the history of all financial activities without being that of any of its constituents in particular. Hence its relevance, as well as its difficulty. When all is said and done, it is perhaps another way of writing the history of banking and finance – a way that helps us grasp both its global nature and its intimate association with its environment.

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[More information](#)

1 The age of private bankers, 1780–1840

For Walter Boyd, an ambitious young Scottish businessman determined in the early 1780s to cut a figure on a larger stage, London, Paris and Amsterdam were at that time the three great international financial centres upon which Europe's trade depended. Where to seek one's fortune? Boyd opted for Paris. He settled there in 1785 and in the space of a few years became one of the capital's most influential bankers, but had to flee to London in 1792. After brilliant initial successes in issuing loans for the British government, he went through some difficult years, eventually recovering his fortune only after Waterloo.¹

Walter Boyd's route illustrates fairly well the changes that occurred within the leading international financial centres during the French wars, as well as the new international hierarchy which formed at the beginning of the nineteenth century: the pre-eminence of London; the resurgence of Paris, which emerged as the second major market; and the eclipse of Amsterdam, relegated to the rank of a lesser centre, along with cities like Brussels, Frankfurt, Hamburg and Geneva, in a hierarchical order that was not easy to determine. This hierarchy was obviously not of a permanent nature. It nevertheless left its mark on the whole of the nineteenth century, despite the coming of Berlin, which to some extent replaced Frankfurt after 1870, and then the emergence of New York at the turn of the twentieth century.

Our Scottish banker's reversal of fortune also shows the extremely turbulent nature of the 'age of revolutions'² – the Industrial Revolution, which started in England around 1780 and subsequently spread to the United States and north-western Europe, and the political revolution, triggered by the fall of the Bastille in 1789, which spread to most of Europe thanks to the strength of its ideas and that of the French revolutionary armies. Nowadays the notion of 'revolution' tends to be put into perspective: economic growth never exceeded 2% in England during the Industrial Revolution,³ and in many respects the Ancien Régime persisted in Europe until the First World War, particularly owing to the influence of the landed elites.⁴ Whether emphasis is placed

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Youssef Cassis

Excerpt

[More information](#)

8 Capitals of Capital

on breaks or on continuity, it is undeniable that the changes that took place between the 1780s and 1830s profoundly transformed the western world.

Similarly, the revolutions, wars and reconstruction that followed clearly constituted a watershed in the history of the financial centres, not only as far as their international ranking was concerned but also their internal organisation, on account of new institutional arrangements being introduced and some players being replaced. We will examine these developments, which took a different course in each of the main centres. But whatever these differences, business was conducted everywhere through the same type of financial institution: the private banks, joined by – and the distinction was not always very clear during this period – merchant firms, stockbrokers and other financiers. Unless working on an individual basis, all of those involved formed associations in the shape of partnerships.

It was the private banks that above all characterised financial centres during the early decades of the nineteenth century, which for them constituted a real golden age. With the exception of central banks, joint-stock banks only started to matter from the 1840s. Significantly, a private bank in the nineteenth century and during most of the twentieth century was a bank whose owners were also managers; and, more often than not, these were family firms, though people from outside the firm could also become partners. Their legal form was generally that of partnerships and general partnerships, with partners having unlimited responsibility; but there were also limited partnerships and even joint-stock companies, whose directors retained the major part of the capital. The private banks were, therefore, defined by their type of ownership rather than by their activities. It is only since the last quarter of the twentieth century that the notion of private banking has designated a specific profession – portfolio management on behalf of wealthy individuals. This term formerly designated commercial banks, as well as merchant banks, wealth managers and even universal banks. Specialisation in one activity or another resulted either from a strategic choice made by the partners or from the way, whether official or unofficial, that a given banking system functioned. In the main financial centres, these activities were in any case very closely linked to commercial activities. At the turn of the nineteenth century, the main function of an international financial centre was that of financing international trade, along with the complementary activities of currency exchange, insurance and shipping. The issuing of loans on behalf of foreign governments, which would grow increasingly important during the nineteenth century, was still subordinate to trade finance.

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Youssef Cassis

Excerpt

[More information](#)

The age of private bankers, 1780–1840

9

The grandeur and decline of Amsterdam

Amsterdam's decline was apparently rapid, brutal and without any real parallel in the history of financial centres. Contemporaries attributed it to the Napoleonic Wars and the French occupation. They believed that the old order would be restored upon the return to independence in 1813. But Amsterdam never recovered its position as the world's pre-eminent trading and financial centre that it had occupied in the seventeenth century and during most of the eighteenth century.

Trade and finance

In fact, Amsterdam's decline was a longer-lasting phenomenon. Its position as the world's trading and financial centre originally derived from the Netherlands' economic prominence, just like the position of the centres that would succeed it in the nineteenth and twentieth centuries – London and New York – derived from their own country's economic prominence. The Dutch took the lead from the end of the sixteenth century, as world trade shifted from the Mediterranean to the Atlantic, and this became particularly apparent through the Netherlands' higher level of urbanisation than that of other European countries, its more productive agriculture, more advanced industry and more developed international trade.⁵ In 1700 the per capita income of the Dutch exceeded by 50% that of the English, the next in line.⁶ The Netherlands' commercial supremacy was built above all on the role of entrepôt played by Amsterdam, with goods and foodstuffs flooding in from all over the world to its port, at that time the world's foremost. There the goods were sorted, treated, sometimes processed, distributed and then for the most part re-exported. These trading activities lay at the root of the development not only of an important service sector, dominated by shipping, insurance and financial transactions, but also of a significant manufacturing sector comprising, besides shipbuilding, the processing of raw materials into export products, such as sugar, soap, tobacco and printed calicos.

The foundations of this system were undermined during the eighteenth century as the centre of gravity of world trade gradually shifted towards London. Opinions differ as to when the Netherlands' commercial decline began. Some trace it back very far, to the 1670s, whereas others place it in the 1730s, which is more likely, with ups and downs during the subsequent half-century until the war with Great Britain between 1780 and 1784, which dealt a fatal blow to the country's trade. This decline was due mainly to international competition, particularly

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Youssef Cassis

Excerpt

[More information](#)

10 Capitals of Capital

between the Netherlands and Britain, as well as to the fact that the direct trading links being established between countries meant that Amsterdam's role as an entrepôt was becoming redundant. Various remedies were considered to enable it fully to regain this role, including abolishing customs tariffs and making Amsterdam a free port in 1751, but all in vain.⁷ In around 1780 London certainly overtook Amsterdam as a trading centre, judged by the number of ships entering its port, not only in relation to goods traffic but also to auxiliary services, such as insurance or even the acceptance of bills.⁸

Amsterdam asserted itself as the world's financial centre even though its commercial supremacy was crumbling. Its capital financed international trade or was invested in loans on behalf of foreign governments. This was partly the result of strategic choices on the part of the city's merchants, on the lookout for new business opportunities. From the seventeenth century, the leading merchants accepted bills of exchange; in other words, they undertook to pay the respective amount upon the bills' maturity date on behalf of other merchants and businessmen. In the eighteenth century, trade financing gradually became dissociated from trade itself. First, an increasing number of merchants worked on commission rather than on their own account; or to put it another way, they did not take the risk of purchasing and then reselling the goods but acted as brokers, putting purchasers and sellers in touch with each other and earning a commission on the price of their service. This solution enabled them to commit less capital, clear more stock and use their surplus in credit transactions. Second, numerous merchant houses gave up physical trade in order to specialise in financing it by accepting bills of exchange. According to contemporaries, the volume of acceptances reached 200 million florins towards 1750. In both cases, these financial activities were linked less and less to the port of Amsterdam and more and more to international trade.

Amsterdam's rich merchants also turned to what would become the most prestigious activity of international financial centres: issuing foreign loans. From the middle of the seventeenth century, the Dutch had lent considerable sums to foreign states, including Austria, Sweden and Britain, before investing heavily in the British public debt from 1688. But the development of a genuine capital market dates from 1713, when the Netherlands embarked on a policy of neutrality. From then until the end of the Seven Years War in 1763, foreign loans amounted to an average of 4 million florins per year (i.e., a total of 200 million) and flowed almost exclusively to Britain and Austria. They then increased markedly (to an annual average of 8.3 million between 1763 and 1780) and flowed to the whole of Europe, notably with issues on behalf of