Introduction

0.1. OVERVIEW

Though focusing on the origins of international banking in Asia, the findings of this book provide new detail and analysis of economic globalisation. International banking was both affected by economic globalisation and had to respond to the form it took. International banks emerged in the period before 1914 when Asia, including Japan, was integrated into a rapidly growing international economy. In turn, these banks contributed to that integration by providing the means through which international trade was financed, international capital movements took place, and a payments mechanism put in place covering all nations and currency areas. The underlying mechanisms that facilitated the vast increase in human mobility, the exchange of commodities and manufactures, and the transfer of funds from areas of abundance to places of shortage tend to go unnoticed in comparison to the movements themselves and the role played by governments. The routine activities of a bank, and the use made of bills of exchange and telegraphic transfers, appear dull and uninteresting compared to the rise of Empires, the mass movement of people, and the creation of global transport links, but that does not mean they were of no importance. Without a means of crediting and debiting accounts worldwide and of transferring money in a non-physical form, the rapid global economic integration that characterised the half-century before the First World War would have been impossible. In the absence of direction from governments, there arose before 1914 a complex web of interconnection that simultaneously maximised the sources of credit available and ensured its distribution across the world despite the existence of different currencies. The system created also proved itself resilient to crises whether in the form of bank failures or localised wars.

This success was achieved not simply by European and then US banks establishing operations abroad and so spreading modern banking and finance around the world. Such a view fails to recognise the existence of long-established banking traditions and payments networks outside Europe and areas of European settlement. It was only by linking to local providers of credit and sources of demand that international banks were able to provide the service that they did before the First World War. These European and later US international banks were also quickly challenged by others created by local initiative. International banking was a business and when it was shown to be profitable, there were always others ready to emulate, adapt, and compete. In Asia, two banks, in particular, stand out in this regard: the Hongkong and Shanghai Bank (HSBC) had its head office in Hong Kong and competed very successfully with those European-based banks operating in Asia; similarly, the Japanese bank, the Yokohama Specie Bank (YSB), established a strong position for itself in the finance of Asian trade. By establishing a connection to London, and exploiting the divisions between British domestic and overseas banking, non-UK banks were able to access the facilities provided by the London money market and so compete with the European-based international banks. However, this opportunity was denied to the Indian-based Presidency Banks before 1914, so allowing those banks with London head offices to control the external financial relations of India in this period. It is these comparisons and contrasts between banking in India, China, and Japan in this period that prove to be very revealing in terms of the development of international banking in Asia before the First World War. It was in this era that the foundations for international banking in Asia were laid and help explain future success and failure.

This first era of globalisation began to disintegrate with the outbreak of the First World War. The conflict itself, and then its aftershocks that reverberated throughout the interwar period, had serious consequences for international banking. International banking had thrived in a period of relative economic and political stability but the magnitude of the shocks that took place between 1914 and 1945 were too great for it to cope with. The First World War had serious consequences for European banks operating in Asia, with those from Germany disappearing. In contrast, it boosted both the US and the Japanese banks. The period after the First World War was then both economically and politically difficult, creating serious problems for all banks. Trading and financial relationships within Asia broke down as did external links to both London and New York. Instead of the free flow of funds within Asia, and the use of London as a payments and balancing centre, banks focused on areas that were politically linked, whether long-established ones or ones newly created. What the study of international banking in Asia provides is evidence of how and in what ways the first era of globalisation came to an end, as individual countries retreated from the international scene, converted their imperial possessions into exclusive economic zones, or attempted to carve out a territory of their own. The casualty in all this was both inter-Asian trade and the role played by banks in maximising the mobilisation and use of savings.

In the era after the Second World War, the whole nature of international banking was transformed. Though there was a gradual liberalisation of international financial relations, until the 1980s there remained significant barriers to the free flow of funds around the world. Externally, these related to the controls imposed by governments on capital movements and the restrictions placed on access to foreign exchange. These barriers made it difficult for international banks to play to their strengths as these involved the provision of international trade credit and the use of offsetting transactions in the world's financial centres. Furthermore, internal controls imposed by governments limited the ability of international banks to operate freely in countries around the world because of national restrictions and regulations. Economic fundamentals such as the expansion of international trade and the ongoing revolution in transport and communications led to the global integration of economic activity but banking remained largely national. In order to survive, those international banks that had flourished before 1914 and survived between the wars were now forced to pursue a different agenda. The numerous British overseas banks, for example, either cultivated a local business or, more commonly, disappeared, being absorbed by nationally based banks. This was true in Asia where the Chartered Bank developed closer links with Indian customers as did HSBC in the Far East.

Finally, in the years after the 1970s, there were growing opportunities for international banking. Governments increasingly recognised the limitations of controls and the distorting effects they had upon domestic and international economic activity. As a result, restrictions on capital movements and access to foreign exchange were removed while the value of currencies was left to the market. International financial centres such as London and New York flourished, becoming both a base from which international banks could operate and also attract others from around the world in order to participate in the markets and networks they could provide. Nevertheless, most banking continued to be conducted on a national basis even when operated by transnational companies. The exception was the investment banks as these emerged with a global footprint. The raising of capital for governments and multinationals and the trading of securities, currencies, and derivatives were best conducted from a small number of international financial centres possessing the deepest and broadest markets from which such business could be directed and coordinated. For money-market transactions, London was the prime centre, whereas New York was dominant in capital-market business. Though Asian centres were very important, most notably Tokyo, Hong Kong, Shanghai, and Singapore, their failure to dislodge London and New York remains a puzzle given the explosive growth of successive Asian economies over the last fifty years, and the relative decline of both the United Kingdom and the United States over the same time period.

To understand why that is the case requires a knowledge of international banking from a variety of different angles. In particular, it is important to appreciate the technicalities of what banks did, how they did it, the differences between banks, and the role played by financial centres. This can only be done in a truly comparative study. The study of individual banks fails to capture the importance of the links that existed between separate banks as so many of their transactions involved simultaneous debits and credits, sales and purchases, or borrowing and lending within an environment that was both cooperative and competitive. Due to the overriding need of a bank always to meet its commitments, whether to make loans to its regular customers or repay its own depositors, they all shared a collective responsibility to preserve the confidence of those who used them. If this was not to be achieved at great expense through the locking up of capital in idle balances, it necessitated cooperation between banks so that temporary shortages and surpluses could be quickly equalised. This made banking a business that was different from all others. Conversely, banks were businesses that generated profits through competing for savings, making loans, and providing services in competition with each other. In this, banks were the same as all other businesses. Maintaining the balance between cooperation and competition was a process of trial and error leading at times to collusion, which served those who used banks poorly, or to too excessive risk taking, which led to bank failure and caused financial crisis.

It is also important to recognise how banks operated in different countries, under different circumstances, and under different managements. There was no ideal model which a bank could adopt and then follow rigidly so as to achieve the perfect balance between risk-taking and risk-averse behaviour. This is revealed when China, India, and Japan are compared and contrasted. Success in each necessitated adapting to local conditions and some banks were better able to do that than others. Banks changed over time and their survival depended on their ability to do so as well as the opportunities open to them. Certain banks in existence in Asia today can trace their origins back to the mid-nineteenth century, but that continuity is a product not of inertia but a willingness to adopt a different business model so as to suit a new set of circumstances. In the process, banks that may appear to be superficially similar are, in reality, very different because there was no single route to success in banking. For that purpose, it is important to recognise that some of the banks that were very important in Asia in the mid-nineteenth century no longer exist today, having failed to cope with the risks inherent in any financial business. The result is to move banking history away from a focus on the long-term survivors and the internal organisation that has contributed to their success and onto the interactions between banks, including the use they made of financial centres, and the ever-present fear of failure. It is this focus that may help explain why banking is both highly localised and highly globalised. Deposit banking in most countries is dominated by national banks even where monetary union has taken place. The United States and Canada retained their distinctive banking systems throughout the long period in which the US and Canadian dollars were interchangeable at par. Similarly, in Europe, the creation of a single currency has not led to pan-European banking groups, with even those operating in more than one country failing to create integrated networks. Conversely, other aspects of banking have become truly global as with the payments networks provided by such organisations as Visa, Mastercard, and American Express. Similarly, investment banking has been transformed into a global business over the last thirty years, reflecting the needs of the multinational companies that increasingly dominate manufacturing, mining, telecommunications, trading, and other related areas. The long-standing separation between international and domestic banking provides much evidence as to why banking remains both a local and a global activity and the limits and possibilities for future integration.

0.2. ASIA

British banks pioneered the development of international banking in Asia, following on from the lead established by the East India Company. These banks owed much to the efforts of British expatriates in India and East Asia with three distinct types emerging. There were those with Indian head offices but no direct connection to London, those with an Asian head office and a branch in London, and those with a London head office and an Asian branch network. These distinctions and their implications have never been fully explored before, though individual studies have been made of the Indian Presidency banks (no London branch), the Hongkong and Shanghai Bank (London branch), and both the Chartered and National banks (London head office). The contribution made here is to explore the links between these banks and each other including their relationship to the City of London, which was the leading international financial centre at the time.

Later in the nineteenth century, nationals of other European countries formed their own banks which both competed and cooperated with the British banks. These included not only the French, with an extensive Empire in Indochina, but also German, Belgium, Dutch, and Russian banks. These European banks were then joined by the first US bank to operate in Asia at the beginning of the twentieth century, namely the International Banking Corporation (IBC). The history of this US bank is very revealing about the degree of cooperation between international banks operating in Asia. Prior to the First World War, US commercial banks were prohibited from opening branches abroad. This restriction was circumvented in 1901 by the formation of the IBC. Though its head office was in the United States, its branches were all abroad. In the years before the First World War, it expanded into China but relied heavily on recruiting British staff, with experience in the region, to do so. It was also heavily reliant on its London branch as the centre of its international operations, rather than New York. It was the First World War that changed this relationship as this greatly boosted the connection between New York and Asia, especially Shanghai. This bank was then taken over by the National City Bank of New York (Citibank) as part of the latter's global expansion plans. What this reveals is how international banks setting up operations in Asia could do so by recruiting staff with the required experience and their connections, and even benefit from the existing financial network by opening a branch in London. Though this bank was American, its success was based on British staff and a London connection. This provides a valuable insight into the competition and cooperation that existed between these banks and explores the question of whether they were purely financial operations or served the interests of national governments. It is important to note that international banking in Asia was not simply a product of external influences, whether directed from London, Paris, Berlin, St. Petersburg, or New York or by expatriates resident in the area. The Japanese created their own international bank which not only established a branch in London but also expanded its operations to include both India and China. This Asian dimension to international banking in the region is often forgotten.

Each type of bank possessed different strengths and weaknesses and operated in different ways. Collectively, though, competition and cooperation between them provided Asia with a banking network that both facilitated regional economic integration and links to the global economy. The longer established British banks were, for example, challenged not only by others from Western Europe but also those from Russia and the United States. In turn, these European/American banks faced a growing Japanese challenge in the shape of the YSB, which established a major role for itself in the region. This role changed over time due to competition between the banks and the changing economic and political environment within which they operated. What also emerges is the importance of financial centres and the role that they played in international financial relations. There was a complex interplay between such centres as Bombay, London, New York, Paris, Shanghai, and Tokyo, involving both banks and money markets. Above all the link to London is of critical importance. This was one of the main advantages possessed by those banks that had a London head office, as with the Chartered Bank, or a London branch, as was the case with HSBC. Conversely, it was a link long denied to the Indian Presidency banks, so restricting the business they were able to do. However, this link was not the exclusive privilege of British banks. By establishing a branch in London, the YSB was able to compete with the British banks operating in Asia not only in Japan itself but more generally in both China and India. What this indicates is the separation between the success of banks and the success of financial centres, for the two were not identical. The London money market was accessible to all banks, whether British or not, and so could be used by foreign banks when competing with those British-based banks operating in their region. This is one of the major findings of this study.

The other major finding is the complicated nature of financial flows within Asia and the external links to both London and New York. The provision of credit was essential if intra-Asian trade was to develop, as well as imports from and exports to the rest of the world. The operation of international banks in the region was crucial to this as was the role played by both local financial centres and London. With the First World War, the position of London as a financial centre was undermined compared to New York as well as the local centres. Not only did Tokyo grow in importance but so did Bombay and Shanghai. This becomes clear when investigating international banking in Asia between the wars, especially from the perspective of the YSB as well as the growing activities of US banks in the area. This is then contrasted with the diminished power of not only the British and French banks but also the weakened importance of the City of London as a source of credit. It was in those years that the bill on London ceased to be an international medium of exchange, replicating its demise within Britain in the mid-nineteenth century. Instead, banks lent directly to customers from the deposits they collected locally, contributing to the compartmentalisation of the world economy experienced in the 1939s and only slowly eroded during the 1950s and 1960s.

0.3. CHAPTERS

The first two chapters seek to put international banking in Asia in perspective. The first takes an external perspective using a focus on London to understand the relationship between banks operating in Asia with an outside financial centre. What emerges is the complex nature of this relationship. Traditionally, London's connection with Asia has been seen through the lense of British overseas banks like the Chartered Bank, which was strong in India, and HSBC, which occupied a similar position in China. More detailed research casts doubt on this interpretation. Not only was HSBC not a London-based bank but the Chartered owed part of its position to the restrictions placed on the access Indian-based banks had to London. Banks from elsewhere in Asia were able to open branches in London or establish close working relationships with British domestic banks, so allowing them to compete effectively with British overseas banks. This was of vital importance as London possessed the world's most important money market through which banks could access cheap credit and settle transactions on a global basis. What emerges is that London's success as a financial centre was a product of both a cluster and a network and was increasingly divorced from British banking. What also emerges is the changing relationship between London and Asia, especially

OUP CORRECTED PROOF – FINAL, 20/5/2012, SPi

after the First World War, the abandonment of the Gold Standard in 1931, and then the Second World War. This calls into question the whole debate on 'gentlemanly capitalism' and the Eurocentric perception of imperial history.

The next chapter provides a detailed account of the establishment and operation of British banks in Asia before 1914. These were the first foreign banks to appear in Asia but there were enormous differences between them. Though originating among the British expatriate community in India, the Chartered Bank relocated its head office to London and this had profound implications for its future development. With Britain on the Gold Standard and silver depreciating in value, currency risks emerged which forced the Chartered Bank to restrict its operations in Asia, especially in China which retained silver as the basis of its currency. Furthermore, the Chartered Bank faced strong competition within India from the Presidency Banks, which had well-established connections with the expatriate business community. The result was that the Chartered Bank concentrated almost solely on its exchange business, exploiting its strong links between its main branch in the Indian financial centre of Bombay and its London head office. In contrast, HSBC was able to develop not only its international banking business, through its London branch, but also a large Chinese business as Hong Kong remained on the silver standard as was China itself. The result was that HSBC became closer to a universal banking model, being engaged in a diverse range of financial activities while the Chartered Bank remained a highly specialist institution.

As a result of the ongoing success of both HSBC and the Chartered Bank (as Standard Chartered), it has been largely forgotten that the pioneer of international banking in Asia was the Oriental Bank Corporation. This bank collapsed in the 1880s and its history has long remained under-researched. Prior to the development of British banks operating in India and the Far East, it was the East India Company that dominated international financial transactions both internally and externally. The Oriental Bank was the earliest British bank to challenge the East India Company and it did so successfully, becoming the largest bank in the region. Thus, its collapse was both spectacular and a major blow to British banks in the Asia. What becomes apparent is both the mistakes by management that led to the bank's demise and the contribution made by crop failures and monetary instability. Mistakes involved excessive lending beyond the margin that was safe in terms of the capital reserves. The bank was also exposed to the inability of plantation owners in Ceylon (now Sri Lanka) and Mauritius to repay loans because of the failure of the tea and sugar cane crops, respectively. Finally, the collapse in the value of silver, on which Asian currencies were based, compared to gold, which was the basis of an increasing number of Western currencies, also exposed the bank to large losses. The lessons learnt by British banks from the collapse of the Oriental Bank made an important contribution to British banking stability in Asia in subsequent years.

The failure of the Oriental Bank was to the benefit of HSBC, as it removed a strong competitor. HSBC was able to capitalise on this as it developed a robust business model based on the fact that its head office was in Asia. This allowed HSBC to both reduce its communication costs and minimise the delays involved in decision-making when making loans. By concentrating on the practical issues that made the difference between success and failure in Asian banking, the next chapter explains why HSBC became the dominant bank in East Asia before the First World War, though never unchallenged. HSBC's successful management of currency exchange was the key to explaining its success compared to other banks operating in the region, including British ones. However, the proximity of the head office to customers was also of major advantage for HSBC and this allowed it to develop aspects of its business other than international banking. The effect of this was to make HSBC better positioned than other international banks in the years after 1914 when both international trade and links to external financial centres were much less important.

As a counter to the significance placed on British banks in Asia, the next chapter explores the links between the French bank, the Banque de l'Indochine, and the role played by its branch in Hong Kong. Responding to pressure from the French government, this bank attempted to challenge HSBC in the Far East, establishing a branch in Hong Kong. However, this attempt was not successful and the reasons why reveal much about the success or otherwise of different banks in Asia. Lacking a large two-way trade between Asia and France, in contrast to that between Britain and Asia, the Bank of Indochina had problems matching financial flows. Also, as it was linked to Paris and not London, it lacked direct access to the London money market and the cheap credit available there. This forced it to open a branch in London indicating the strength of the City as a centre for international banking. After the First World War, this bank retreated to the safety of the French colony of Indochina, where it benefited from government support. What emerges is the way the Hong Kong branch of the Bank of Indochina gradually acquired an independent existence even though its initial purpose was to serve French interests in the Far East and to provide an important link in the regional activities of the bank. This was working satisfactorily before the First World War but then was increasingly undermined by events from 1914 onwards.

The Bank of Indochina was not the only challenger faced by HSBC in China before the First World War. As well as German, Belgium, and Dutch interests, a French/Russian combination formed the Russo-Chinese Bank. This bank had a strong French connection, having a branch in Paris, and opened branches in both Asiatic Russia (Siberia) and China. What this reveals is Russia as a European power expanding eastwards, and this included China because of a common land border. For this bank the expansion into China was little more than an extension of its domestic operations unlike the other international banks that developed in Asia at this time. It thus operated more as a domestic bank, accepting deposits and making loans, rather than being heavily engaged in the finance of trade and international financial flows. This emphasis grew over time and was reflected in a name change, becoming the Russo-Asiatic Bank in 1910, and the opening of a London branch. What emerges is that international banks were fragile creations when they lacked a strong geographical mandate. Under these circumstances, a retreat into providing national customers with a full banking service was always an attractive option, with a link to London allowing access to the international financial network.

Prior to the First World War, the principal challenge to both HSBC and European-based international banks in Asia came from the Japanese. Like the European banks the establishment of Japanese banks was also a product of migration and trade. Japanese expatriate communities were involved in setting up their own banks and Japanese merchants also required credit and payment systems. Unlike the First World War, which was a turning point for European-based international banks in Asia, it was the Second that provided that break for Japanese banks, though they were already of declining importance by the late 1930s. As a consequence of that war, Japanese expatriate communities were repatriated, Japanese overseas assets confiscated, and the foreign operations of Japanese banks closed. The effect was to emphasise the domestic over the international for Japanese banks for many years after the Second World War. Reflecting this change, the pioneer of Japanese international banking, the YSB, was renamed the Bank of Tokyo and was eventually absorbed by the Mitsubishi Bank in 1996. However, by then the largest domestic banks in Japan had extended their operations internationally.

Adding depth to the early history of the YSB is the detailed analysis of the finance it provided for inter-regional trade before the First World War. From a position in which the finance of Japanese trade was dominated by foreign banks, YSB, in particular, gradually reclaimed a large part of the business. This is revealed by an examination of the finance it provided for Japanese cotton imports from India. What emerges is a complex web of financial transactions that linked Kobe in Japan with Bombay in India, Lyon in France, New York in the United States, and London in England, as one flow was offset by another as credits from the sale of silk were matched by debits from the purchase of raw cotton. As a result, the YSB increasingly challenged the established British banks in Asia before the First World War. By establishing a branch in Bombay, YSB was able to create a two-way financial relationship between Japan and India involving flows of raw cotton and cotton textiles; a branch in New York had the same effect for silk as that was a major Japanese export to the United States. What was crucial for the success of both operations was the ability of YSB to discount its bills of exchange in London, which it was able to do through its City branch and links to domestic British banks. The result was that even the finance of the silk trade between Japan and the United States switched from a dependence on US credits to London finance in the early twentieth century. What also became clear is the way that YSB was drawn into riskier credit arrangements in order to meet the competition of other banks.

The activities of YSB in the interwar years are then explored in the next chapter. As a result of the First World War, YSB switched from relying upon London as the centre of its international financial flows to an increasing use of New York. However, both London and New York remained crucial not only for their external links but also for the finance of inter-Asian trade. This created serious problems in the 1930s with the international financial instability. Compounding this in the later 1930s was growing political instability as this made it difficult for YSB to access either the London or New York money markets. Beginning in the early 1930s, New York bankers started to reduce their exposure to Japanese banks because of perceived political risks and this became even greater towards the end of the decade. Similarly, in London, Japanese bankers found access to credit increasingly expensive after 1937 because of the worsening political situation in the Far East. The consequence was that YSB turned inwards, focusing its operations on those areas of Asia under Japanese control. What is so revealing is the disintegration of the global economy beginning with the First World War, and its replacement with national spheres of influence. This had profound consequences for the international banks operating in Asia.

The final chapter readdresses the emphasis on discontinuity for the first half of the twentieth century by tracing the continuity of correspondent links. For the overwhelming majority of banks, it was impossible to expand internationally in the same way as they did domestically, when permitted to do so. Problems of balancing assets and liabilities across different currency zones as well as managing and policing the operations of distant and widely spread branches were only some of the problems experienced by banks when they engaged in business beyond their national borders. At a more mundane level the profits to be made through maintaining offices in different financial centres, given the potential level of business generated, had to be balanced against the costs and risks involved, and the result was usually to discourage the opening of such branches. Nevertheless, it was important for banks to possess a means of accessing these financial centres both for the facilities available there and the access it gave to all other banks, either directly or indirectly. The solution was to form a correspondent relationship with a bank already located in these financial centres, either through having a head office or a branch there. These correspondent links provided a convenient and low-cost mechanism that allowed all banks to link to all financial centres at all times. Though disrupted by events such as world wars and global financial crises, these links survived, as the evidence from London shows. Such resilience was a major factor in the ability of the world economy to recover from the devastating blows it suffered between 1914 and 1945. Only with the emergence of ever larger banks in the late twentieth century was the importance of correspondent links eroded, as they could support international branch networks. It was these correspondent links that represent the true origins of international banking, though it is now entering a different phase.

0.4. GLOBALISATION

Globalisation creates winners and losers as does nationalism. International banking was a big winner in the first era of globalisation that took place between the mid-nineteenth century and the First World War. The services provided by international banks underpinned the process of globalisation and they benefited greatly from it. It was at this time that HSBC, the Chartered Bank, and YSB rose to prominence along with a host of others. However, it would be rash to see these banks as following a particular model or creatures of imperial design. Instead, they were a response to demands for international credit and a worldwide payments system. That era came to an end between 1914 and 1945, because these were years when globalisation was in retreat. In the years after the Second World War, the international banks that survived had to reinvent themselves in order to survive. As a universal bank, HSBC was best placed to benefit from this situation as it was located in the British colony of Hong Kong, which did not gain independence until the late 1990s. This provided it with a secure base of operations in a location which rapidly became an important Asian financial centre. The fate of most of the others was to either develop a geographical business or merge with a bank that already had one. In many ways the period between 1945 and 1975 represented the end for international banking, though the vital correspondent links remained. However, a new era dawned after the 1970s as a more liberal international financial regime encouraged banks to become directly involved in transborder operations. In the expectation that this international liberalisation is now unstoppable, even in the wake of the Global Financial Crisis which took place in 2007/8, banks, governments, and international agencies can learn much from studying the pre-1914 situation. The world of the future is never a repeat of the past, but that which existed before 1914 did devise mechanisms for coping with global instability while permitting free movement of capital and credit and a highly efficient global payments system.