

## Financial Centres: What, Where and Why?



## Financial centres

- What are they? There are many different types and classifications based on their functions.
- Where are they located and why are they located there. They have certain location characteristics and are not situated randomly.

## A general definition of financial centres

- Financial centres are geographical locations with an agglomeration of banks (including headquarters, branches, subsidiaries) and other financial intermediaries.
- Their general functions are to:
  - Balance savings and investments over time
  - Transfer money from savers to investors
  - Act as a medium-of-exchange
  - Act as an interspatial store-of-value

## The end of geography?

- With improvements in information communication technology, some have argued that finance can locate anywhere and that computers can perform the functions of financial centres making them obsolete.
- Although it is true that a financial centre is a "space of flows," its location is still important
- Recent technology along with the internationalisation of finance have not done away with financial centres but have simply changed their functions and their degree of specialisation.

## Financial Hierarchy

- Financial centres are part of a hierarchical organisation of finance, communications and management. These form a spatial hierarchy which consists of:
  - Regional centres
  - National centres
  - International centres

## Financial Hierarchy

- North America provides an example of this hierarchy.
  - Calgary is a regional financial centre.
  - Chicago and Toronto are national centres.
  - New York City is an international centre

## International financial centres

- In order for a centre to be considered an international financial centre, it must have a concentration of all of the following five banking activities:
  - Financing foreign trade, such as issuing credit for import
  - Currency exchange, such as foreign exchange (FOREX) trading
  - Transferring funds across political boundaries (foreign currency deposits)
  - Foreign borrowing and lending
  - Foreign investment

## International financial centres

- New York City is an example of an international financial centre, whereas Boston is not because it does not have a significant concentration of all of these financial activities.

## International financial centres

- Five other meanings for “international financial centre” are:
  - A source of global financial influence
  - The zenith of a hierarchy in a financial system
  - A market with peculiar regulations
  - A geographic area for financial operations
  - An external currency market

## International financial centres

- International financial centres can be further characterised as follows:
  - A city which facilitates domestic capital-flow to the outside world (London, New York City)
  - A city, due to its location and facilities, serves as a foreign lending and trading centre for foreign currencies (Hong Kong, Singapore)
  - A place, due to its favourable tax laws and banking regulations, acts as a haven for foreign lending and borrowing (Bahamas, Cayman Islands, Channel Islands)
    - These are often called “offshore” financial centres.

## Offshore financial centres (OFCs)

- Four types of OFCs are:
  - Primary centres
  - Booking centres
  - Funding centres
  - Collections centres

## OFCs: Primary centres

- A primary centre is the most developed offshore financial centre.
- Primary centres play a dominant intermediary role in their market area.
- They are the hub for international banking and finance in their market area and provide a variety of financial services .

## OFCs: Booking centres

- A booking centre channels outside funds in that its intermediation is for nonresidents.
- Booking centres need only to meet the basic requirements for financial infrastructure. This is because their main drawing cards are their highly favourable tax systems.
- Examples: Bahamas, Cayman Islands

## OFCs: Funding centres

- Funding centres channel outside offshore funds into local areas.
- Examples: Panama, Singapore

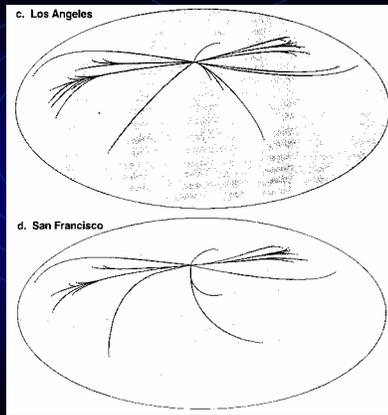
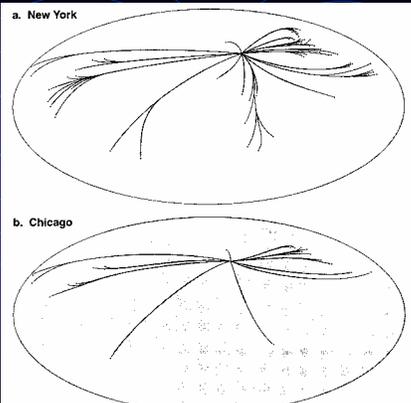
## OFCs: Collection centres

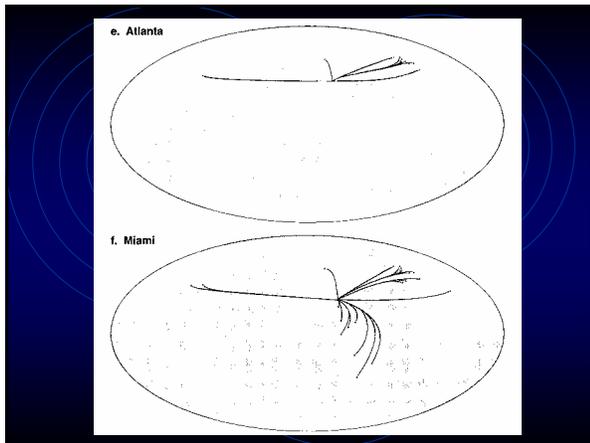
- Collection centres differ from funding centres in that they accumulate and channel funds from within their market to outside areas.
- They have market areas with high surpluses due to low absorptive capacity.
- Example: Bahrain

## Host centres

- Another type of financial centre is the host centre. These attract a large number of foreign financial institutions from many countries which enhances their own financial infrastructure.
- The host centre is not an isolated category. There are overlaps with the other categories. A regional, national, or international centre may be a host centre.

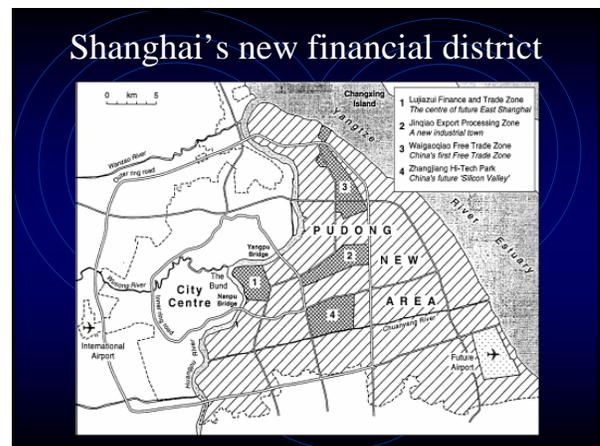
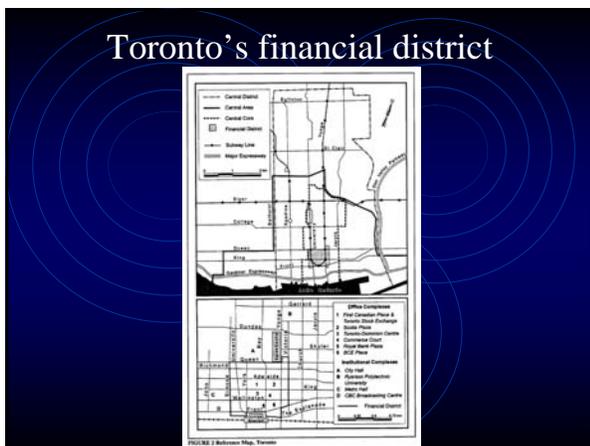
Source countries of foreign banks in six largest U.S. international financial centres





An even more specific definition of financial centres

- Geographically speaking, so far financial centres have been treated as whole cities or places. Yet these agglomerations occur in even more narrowly defined places. Though they may be part of a network that is global in scale, financial centres generally occupy a specific, compact area within a city.



## Lujiazui financial district (Shanghai-Pudong)



## Why are financial centres where they are?

- Many variables influence the present location of financial centres. These include:
  - Historical factors
  - Political factors
  - Economic geographical factors

## Historical factors

- Many of today's financial centres were/are important mercantile cities. Finance was involved with long distance trade because of the uncertainty of import trade. Many commercial centres became financial centres as merchants and industrialists moved into finance. This was a common trend.
- Examples: Florence, Genoa, Bruges, Antwerp, Amsterdam, London, New York

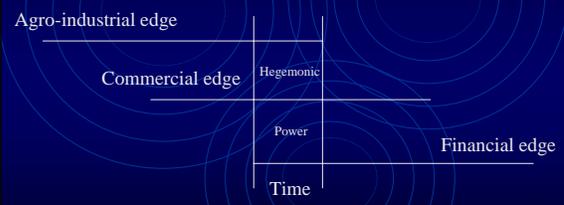
## Historical factors

- Since finance is relatively location conservative, due to its agglomeration economies, cities that contained financial communities in the past tend to still have them today. Financial communities even tend to be located in the same area within their respective cities.
- Example: "Square Mile" (London), Lower Manhattan (New York City), Bay St. (Toronto)
- Exception: Shanghai (Le Bund to Lujiazui)

## Historical factors

- The location of financial hegemony can be associated with the hegemonic power of a particular nation-state.
- According to Immanuel Wallerstein, a hegemonic power is a nation-state that has simultaneous industrial, commercial and financial supremacy in the world-system.

## Hegemony



## Hegemony

- Three nation-states have been hegemonic powers during the 500 year history of the capitalist world-system.
  - United Provinces of the Netherlands (1625-1672) anchored by Amsterdam
  - United Kingdom (1815-73) anchored by London
  - United States (1945-1967) anchored by New York City

## Hegemony

- Notably, London, New York and to a lesser degree Amsterdam, are still important financial centres possibly because of their enduring finance.
- Is China going to be the next hegemonic power with Hong Kong or Shanghai-Pudong as its hegemonic city?

## Political Factors

- Political factors play an important role in the location of financial centres. This is because in order for one to operate as efficiently as possible there are certain political requirements. These include:
  - Free market environment
  - Some political independence
  - Minimum non-prudential banking regulations
  - Free entry of foreign banks and bankers
  - Strong legal systems (property rights, contract enforcement, functioning court system, bankruptcy processes)
  - Peacetime environment

## Economic geographical factors

- A financial centre allows for easier mediation of financial activity over space.
- $n - 1$  links as opposed to  $n(n - 1) / 2$  links



## Economic geographical factors

- With the internationalisation of finance, one factor that still influences the location of financial centres are the time zones.
  - For example, the three largest centres, London, New York and Tokyo, are all in significantly different time zones allowing for a global organisation of finance.
  - Financial centres in general are situated in such a way so as to maintain 24hr electronic trading.

## Factors affecting concentration/dispersal in the financial city system

- Whether financial centres concentrate or disperse is mainly due to the following factors:
  - Size of financial communities
  - Need for reducing uncertainty
  - Degree of localisation of investment opportunities
  - Amount of information required in relation to its value
  - Size of regional markets
  - State of communications

