



New Perspectives for the Realization of “Global Financial City: TOKYO”

Takuya Nomura*

nomura.takuya.u8@jri.co.jp

〈Summary〉

- ◆ Against the backdrop of the growing turmoil in Hong Kong following the implementation of the Hong Kong national security law by the Chinese government, expectations for the realization of “Global Financial City: TOKYO” are rising in Japan.
- ◆ However, although the vision of Global Financial City has been advocated for many years in different forms, it is difficult to say that the intended goals were achieved. Indeed, it is unlikely that Tokyo will be able to increase its international presence by simply following the measures it has implemented so far. When considering concrete measures, it is necessary to look at them from new perspectives.
- ◆ First, concrete measures should be considered by focusing on important areas. Although the vision of Global Financial City consisted of a wide range of measures, the importance and priority of each have been unclear. For example, if Tokyo aims to acquire a position as an alternative market for Hong Kong, as seen in the case of the UK, which has increased London’s market share by focusing on RMB trading and Islamic finance, it should first consider measures focusing on that as one of its priorities.
- ◆ Second, for the time being, Tokyo should give priority to domestic reforms, rather than seeking an inflow of foreign resources. Attracting foreign financial institutions and highly skilled foreign professionals, which have been considered important measures in the past, is not easy to realize because the movement of people is restricted due to the COVID-19 pandemic and designing tax incentives is difficult due to the worsening national fiscal situation. In order to lay the groundwork for the attraction of foreign financial institutions in the future, as outlined in the government's “Action Plan of the Growth Strategy”, the

* Senior Economist, Financial Research Center (Economics Department, JRI).
© 2020 Japan Research Institute Limited.

government should, for the time being, give priority to implementing reforms aimed at enhancing the attractiveness of domestic financial and capital markets and strengthening the competitiveness of domestic financial institutions.

- ◆ Third, Tokyo should expand its range of financial products. In terms of effective utilization of Japanese household financial assets, it is needless to say that enhancing the asset management business is important, but in order to attract financial transactions from overseas, it is also important to expand the products handled in the Tokyo market. Specifically, we should aim to increase the share of offshore RMB trading and diversify the offerings of sustainable bonds, which has been behind China.

- This is a English version of “国際金融都市 TOKYO の実現に向けて求められる新しい視点 ” in JRI Research Focus (The original version is available at <https://www.jri.co.jp/MediaLibrary/file/report/researchfocus/pdf/12098.pdf>)

< Disclaimer >

This report is intended solely for informational purposes and should not be interpreted as an inducement to trade in any way. All information in this report is provided “as is”, with no guarantee of completeness, accuracy, timeliness or of the results obtained from the use of this information, and without warranty of any kind, express or implied, including, but not limited to warranties of performance, merchantability and fitness for a particular purpose. In no event will JRI, its officers or employees be liable to you or anyone else for any decision made or action taken in reliance on the information in this report or for any damages, even if we are advised of the possibility of such damages. JRI reserves the right to suspend operation of, or change the contents of, the report at any time without prior notification. JRI is not obliged to alter or update the information in the report, including without limitation any projection or other forward looking statement contained therein.

1. Growing interest in Global Financial City

In June this year, the Economic Growth Strategy Headquarters of the LDP's Policy Research Council released the Growth Strategy for Post-Corona Economy and Society and declared the realization of "Global Finance City: TOKYO" as one of the growth strategies. In addition, the Basic Policy on Economic and Fiscal Management and Reform Growth Strategy announced in July indicated the direction of "Aim to establish Global Financial City as an international financial hub in the world and Asia" and the "Realization of an international financial hub" was included in the agenda of the Action Plan for the Growth Strategy.

As seen from the above, interest in the vision of Global Financial City has been growing in Japan because of the disruption caused by the implementation of the Hong Kong national security law by the Chinese government, the expansion of demonstrations against it, and the abolition of preferential treatment for Hong Kong by the United States, Hong Kong, which had been the No.1 Global Financial City in Asia for a long time, has seen its position erode.

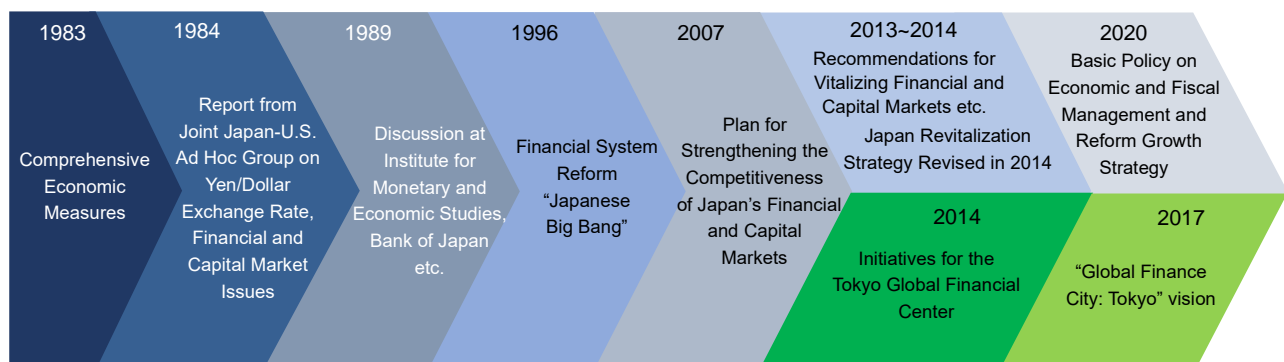
However, although the vision of Global Financial City in Japan has been examined many times over the years, it is still difficult to say that Tokyo has achieved desirable results. Even if Hong Kong's presence is seriously weakened, the vision will not be easily realized. Based on this awareness of the issues, this report reviews the measures implemented to realize Global Financial City, and summarizes the perspectives from which measures should be implemented to increase the international presence of Tokyo.

2. Measures and Results for Realizing Global Financial City

(1) Background

In Japan, the vision of Global Financial City has been advocated in various forms since the 1980s. It was triggered by Comprehensive Economic Measures of 1983, including "Internationalization of the Yen", and the report from Joint Japan-U.S. Ad Hoc Group on Yen/Dollar of 1984, that was aimed at developing free financial and capital markets, and it was positioned as part of financial liberalization at that time(Figure 1).

Figure 1. History of main measures aimed at Global Financial City in Tokyo (Image)



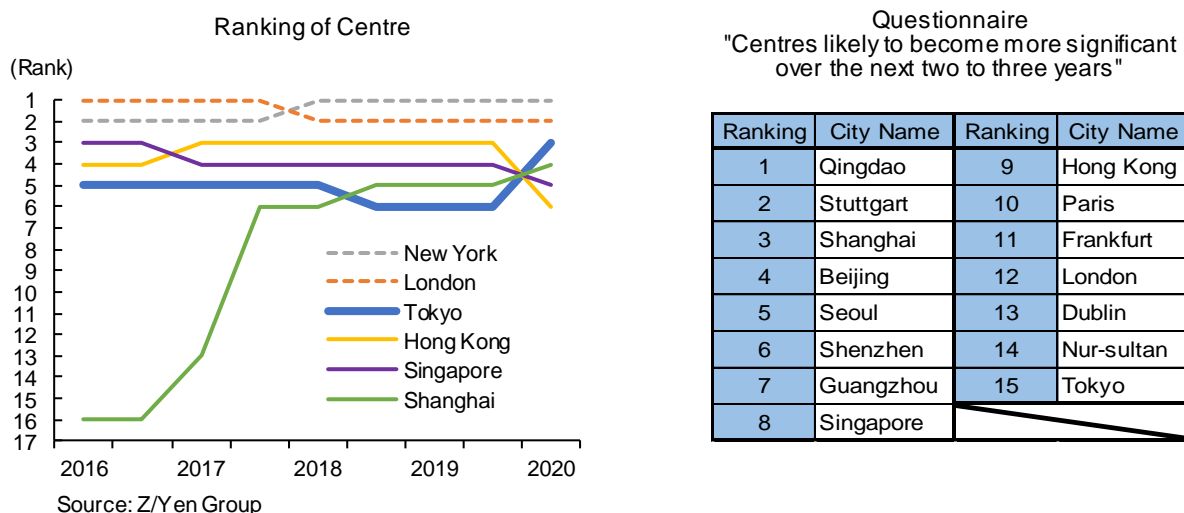
Source: Prepared by The Japan Research Institute, Limited based on various media reports

After the decline of Tokyo's position as a financial market became clear due to the collapse of the economic bubble, demands to raise its presence as Global Financial City increased. In 1996, the Financial System Reform called "Japan Big Bang"¹ and in 2007, the "Plan for Strengthening the Competitiveness of Japan's Financial and Capital Markets"² were announced. In recent years, the Ministry of Finance and the Financial Services Agency released the "Recommendations for Vitalizing Financial and Capital Markets" in 2013 and the "Follow-up and Further Recommendations for Vitalizing Financial and Capital Markets" in 2014. These recommendations were included in the "Japan Revitalization Strategy Revision in 2014" issued by the Japanese government in June of the same year. In 2014, the Tokyo Metropolitan Government released "Initiatives for Tokyo Global Finance Center" and expressed the intention to make Tokyo a financial hub equivalent to Wall Street in New York and The City in London. In November 2017, the Government also released the vision of "Global Financial City: Tokyo. These recent initiatives aim to effectively utilize Japanese individual financial assets and develop the financial sector into a growth industry, as well as to raise Tokyo's presence as Global Financial City. The concrete measures include developing domestic financial institutions, raising the standard of domestic finance professionals, and vitalizing financial markets, as well as attracting foreign financial institutions and highly skilled foreign finance professionals.

(2) Results of these measures

According to the "Global Financial Centre Index"³ released by Z/Yen Group in March this year, Hong Kong dropped to 6th place, while Tokyo rose to 3rd place to become No. 1 in Asia (Figure 2). However, among the assessment factors, the ranking in the questionnaire of "Centres likely become more significant over the next two to three years", which shows future potential, lists Shanghai 3rd, Singapore 8th, Hong Kong 9th, and Tokyo 15th, so Tokyo's rise in the overall ranking is likely to be a temporary phenomenon.

Figure 2. Global Financial Centre Index (As of March 2020)



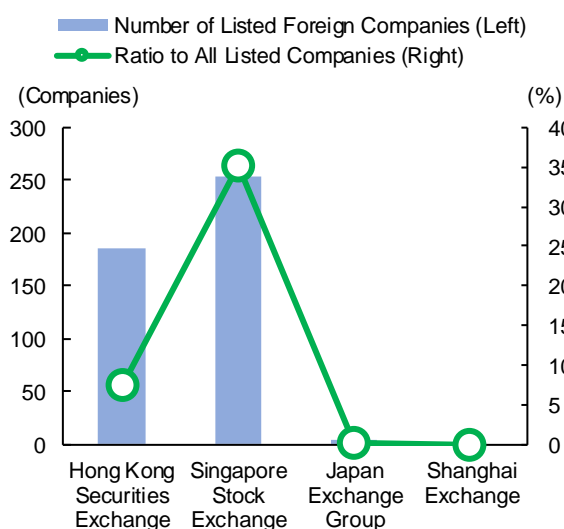
¹ Measures such as the mutual business entries among financial industries and liberalization of various fees were implemented.

² The plan, announced by the Financial Services Agency, included measures for financial systems, such as a review of firewall regulations imposed on banks, securities companies, and insurance companies, and expansion of the areas of operations for banks and insurance companies, as well as measures for financial instruments, such as allowing stock index-linked ETFs.

³ Announced twice a year by Z/Yen Group. Quantitative evaluations based on various statistics and qualitative assessments based on a questionnaire survey are taken into account in scores and rankings.

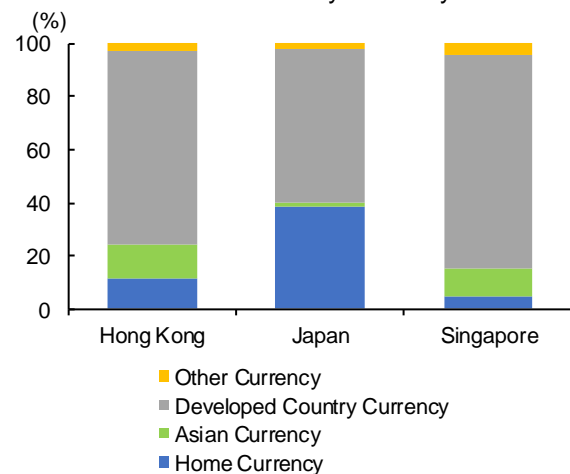
A comparison of the number of foreign banks⁴ that have obtained banking licenses shows that Hong Kong has 162 and Singapore has 138, while Tokyo has only 58. Looking at the number of foreign companies listed on stock exchanges in each city, Hong Kong has 186, accounting for 7.4% of all listed companies, Singapore has 253, accounting for 35.3%, while Tokyo (Japan Exchange Group's stock exchanges) has only 4, accounting for 0.1%. This fact shows a large gap in the degree of market utilization by foreign companies (Figure 3). Furthermore, looking at the share of foreign exchange transactions by currency in each market, while transactions in Asian currencies account for more than 10% in Hong Kong and Singapore, transactions in currencies of developed countries account for 96% in Japan. This means that Japan is not sufficiently capturing the rapid growth of Asian countries (Figure 4).

Figure 3. Number of Foreign Companies Listed on Stock Exchanges
(As of July 2020)



Source: Prepared by The Japan Research Institute, Limited based on World Federation of Exchanges

Figure 4. Share of Foreign Exchange (Relative) Transactions by Currency



Source: Prepared by The Japan Research Institute, Limited based on BIS

Note :As of April 2019. Developed country currencies: U.S.dollar/Euro/Yen/Pound/Canadian dollar/Swiss Franc/Australian dollar/New Zealand dollar; Asian currencies: Chinese Yuan/Hong Kong dollar/Indian Rupee/Korean Won/Singapore dollar/Taiwan dollar; counted when the currency is either sold or bought

3. Challenges for Global Financial City

In recent years, measures related to the vision of Global Financial City, like expansion of English use in administrative procedures, centralization of information on setting up of companies in "Tokyo One-Stop Business Establishment Center", and the establishment of "FinCity.Tokyo", a public-private partnership promotion organization, have been implemented. However, as mentioned above, it is difficult to say that the vision of Global Financial City has achieved the intended goals. Even if the situation in Hong Kong deteriorates further in the future, it will be tough for Tokyo to increase its presence as Global Financial City simply by following the existing measures. Tokyo needs to take a different approach when considering measures to realize Global Financial City. Specifically, the following three points are important.

⁴ Hong Kong: Licensed Banks + Restricted Licensed Banks (as of 9/8); Singapore: Qualifying Full Bank + Full Bank + Wholesale Bank + Merchant Bank (as of 8/30); Tokyo: Foreign Bank Branch + bank owned by one foreign bank (as of 9/1). If one foreign financial group has several licenses, they will be counted as one organization.

(1) Concrete measures should be considered focusing on priorities

The vision of "Global Financial City: TOKYO" released by the Tokyo Metropolitan Government in November 2017, states that "Taking seriously the fact that no outcomes were achieved despite the numerous times examinations were conducted, swift actions should now be taken regardless of how small their outcomes may be, and achievements built step by step. (Start small, think big)". Of course, it is also important to take the stance of starting with what can be done, but the vision of Global Financial City so far consisted of a wide range of measures, but the importance and priority of each have been unclear. Therefore, if Tokyo aims to acquire a position as an alternative market for Hong Kong, it should first consider measures focusing on that as one of the priorities.

For example, in the United Kingdom, under the Cameron administration in 2013, a public-private committee (Financial Services Trade and Investment Board) was established to study government strategies for enhancing the financial services industry. The committee identified nine priority areas and placed particular emphasis on the inclusion of renminbi transactions and Islamic finance. As a result, the London market now has one of the largest shares of offshore yuan trading in the world and has established a position as a major market in Islamic finance. This is an example that focusing on priority areas ultimately increased London's international presence, and similar directions are needed for measures in Tokyo.

(2) Domestic reforms should be prioritized now, rather than seeking foreign resources.

When considering concrete measures, it is necessary to take into account the effects of COVID-19 on them. At present, in order to prevent the spread of infection, the movement of people internationally is restricted, but the progress of digitization has made it possible to conduct business without the movement of people. In addition, as the national fiscal situation has been rapidly worsening due to the COVID-19 related measures implemented by the Japanese government, the feasibility of measures, such as reduction of the corporate tax rate to close the tax rate gap with Hong Kong and Singapore, has declined. Therefore, the government will be compelled to postpone attracting foreign financial institutions and highly skilled foreign professionals, which have been emphasized in past visions (Table 1 on the next page).

In order to lay the groundwork for the attraction of foreign financial institutions and highly skilled foreign professionals in the future, the government should, for the time being, prioritize the implementation of domestic reform aimed at enhancing the attractiveness of domestic financial and capital markets and strengthening the competitiveness of domestic financial institutions. These reforms will eventually increase Japan's international presence in financial markets. In addition to the establishment of Global Financial City, the government's "Growth Strategy" mentioned reform of the market structure of the Tokyo Stock Exchange, including restructuring the market segments, as a "Development of financial and capital markets in order to attract investors and increase corporate value" and ensuring equal footing with other companies in the same industry in global competition, including a review of firewall regulations imposed on banks and securities companies, as a "Review of regulatory restrictions on banks and other financial institutions" (Table 2 on the next page).

Table 1 Comparative Taxes on Corporation and Individual Income In Each Country

	Corporation Tax		Personal Income Tax
	Basic Tax Rate	Incentives and Exemptions *	Maximum Tax Rate
Hong Kong	16.5%	<ul style="list-style-type: none"> ➢ Up to HK \$2 million (Approx. ¥27.5 million): 8.25% ➢ In fiscal 2019/20, no tax below HK \$20,000 (Approx. ¥275,000). 	17% (Progressive Taxation) 15% (Standard Taxation)
Singapore	17.0%	<ul style="list-style-type: none"> ➢ Up to S \$10,000 (Approx. ¥775,000): 75% non-taxable ➢ Then up to S \$200,000 (Approx. ¥15.5 million): 50% non-taxable ➢ For startups, that meet several requirements, up to S \$100,000 (Approx. ¥7.5 million): 100% non-taxable ➢ Then up to S \$300,000 (Approx. ¥23.25 million): 50% non-taxable 	22%
Tokyo	23.2%	<ul style="list-style-type: none"> ➢ Up to 8 million yen per year for SMEs: 15% (Fiscal years beginning by March 2021), usually 19% 	45%
Shanghai	25.0%	<ul style="list-style-type: none"> ➢ high-tech companies that are focused on by the government: 15% ➢ For small enterprises, up to 1 million yuan (Approx. ¥15 million): 5% (effective tax rate) ➢ Thereafter up to 3 million yuan (Approx. ¥45 million): 10%(effective tax rate) 	45%

Source: Prepared by The Japan Research Institute, Limited based on various media reports

Note: calculated at 13.75 yen per HK dollar, 77.5 yen per Singapore dollar, and 15 yen per yuan

Table 2 Examples of Measures to Enhance the Attractiveness of Domestic Financial Markets and Strengthen the Competitiveness of Domestic Financial Institutions

Purpose	Examples of Measures
Development of financial and capital markets in order to attract investors and increase corporate value	Reform of the market structure of the Tokyo Stock Exchange (TSE). TSE will consolidate its current four markets into three in April 2022. The top-tier "Prime" Section will feature strict governance and liquidity requirements. It will also consider measures to encourage institutional investors to invest in the startup companies listed in the "Growth" Section.
	TSE will establish a new stock price index focusing on stocks with the highest level of governance and liquidity, instead of Tokyo Stock Price Index (TOPIX) that currently tracks all stocks listed on the First Section of the TSE.
Review of regulatory restrictions on banks and other financial institutions	In order to allow Japanese financial institutions to compete with foreign companies in the same industry and increase the attractiveness of domestic financial and capital markets, several measures like (a) deregulation of the scope of business of overseas subsidiaries of banks and insurance companies, and (b) removing information related to foreign corporate clients from the firewall regulations imposed on banks and securities companies, are under consideration. Being conscious of the need for a fair competitive environment, a review of firewall regulations, including for domestic customers, would be also considered.

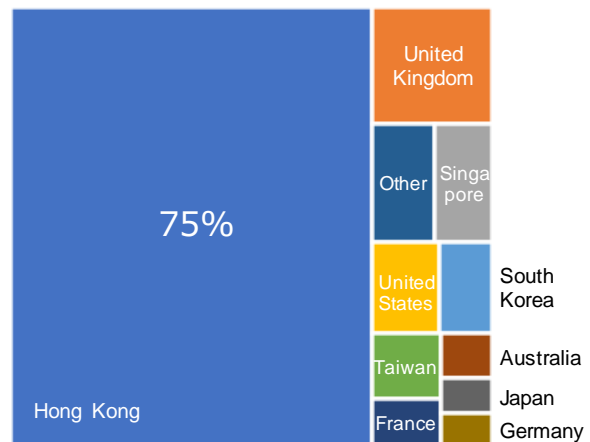
Source: Prepared by The Japan Research Institute, Limited based on Follow-up for "Growth Strategy"

(3) The list of financial products should be expanded.

In terms of effective utilization of Japanese household financial assets, it is needless to say that enhancing the asset management business is important, but it is also important to expand the range of products handled on the Tokyo market, in order to attract financial transactions from overseas, even in the midst of restrictions on the movement of people.

In particular, from the viewpoint of aiming for a position as an alternative market for Hong Kong, it is important to diversify the currencies those transactions can be executed in on the Tokyo market, including offshore RMB trading, in which Hong Kong currently holds an overwhelming share ⁵ (Figure 5).

Figure 5. Offshore RMB Trading
(As of June 2020)



Source: Prepared by The Japan Research Institute, Limited based on SWIFT

Giving its historical background and location, it is difficult to predict that Tokyo will be on a par with Hong Kong, but it might be able to increase its presence to a certain extent, as the United Kingdom has done in the past. For example, Japan does not have cross-border DVP links⁶ for foreign currencies and foreign currency-denominated assets, and is subordinated to Hong Kong, which has a multi-currency settlement system (RMB, US Dollar, Euro, Hong Kong Dollar). Although Japan will establish cross-border DVP links with Hong Kong in 2021, establishing similar links with other countries should be considered.

In addition, as ESG-related investment is attracting attention globally, it is important to establish a system to issue a wide range of sustainable bonds⁷ and encourage investment in them. According to the Global Green Finance Index, Shanghai is 21st and Singapore is 27th, while Tokyo is 33rd (Hong Kong is 36th), slightly below other cities.

In particular, China has been developing a green bond market since around 2016, and the amount of bonds issued in 2019 was 58 billion⁸ dollars, the highest in the world. Japan issued only \$7.2 billion (7th). Looking at the share of green bonds by use, energy-efficient buildings, low-carbon transport, and clean energy account for 92% in Japan, while in China sustainable water resources and waste disposal account for a certain percentage in addition to these three purposes.

⁵ Singapore accounts for about 3% and Tokyo for about 1%.

⁶ An initiative to link a securities settlement system with a payment system and achieve DVP - a mechanism to ensure that a security is delivered if, and only if, corresponding cash is paid - for a cross-currency transaction.

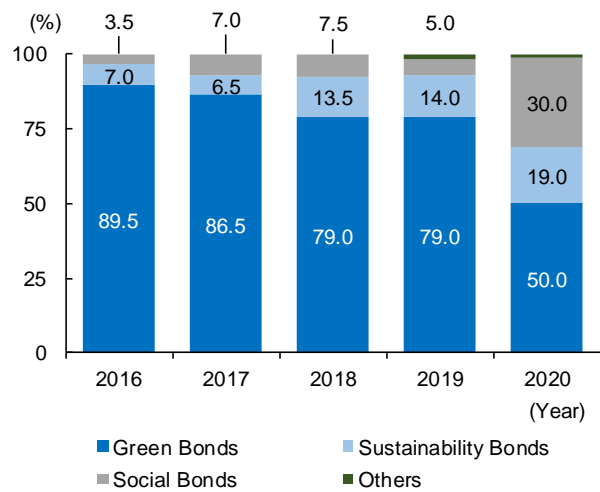
⁷ Bonds that are restricted to use funding for projects that contribute to environmental and social sustainability.

⁸ Among them, those meeting the international standard of "green bond" are 25.3 billion dollars and those meeting only the Chinese standard are 31.3 billion dollars. If it meets only the international standard, China will be the 2nd largest in the world (In that case, the United States would be the largest).

Globally, the amount of sustainability bonds and social bonds issued, other than green bonds, has also increased (Figure 6). This fact suggests the diversity of sustainable bonds is growing.

The Tokyo Metropolitan Government itself issued a Green Bond in 2017 and this was the first issue for a Japanese local government. Until now, this five-year bond for institutional investors has been issued 3 times. In order to vitalize the green bond market, it is important for local governments, or for example, companies engaged in public works such as railways, to actively continue issuing these bonds in accordance with their various uses of funds.

Figure 6. Breakdown of Sustainable Bonds



Source: Prepared by The Japan Research Institute, Limited based on BNP Paribas/Bloomberg

Note : In 2020, as of 5/15.

4. Toward the Realization of Global Financial City

Although an increase in Tokyo's presence as an international financial market has been a goal for the Japanese financial community for 30 years, it is not easy to realize Global Financial City, which is required to have relative competitive advantages against competitor cities in other countries. It is important to build up measures from a long-term perspective based on the recognition that Global Financial City cannot be easily realized in a short period of time.

However, the current situation of Hong Kong, which is suffering from political chaos and restrictions on movement due to COVID-19, is an opportunity for Tokyo to take significant steps toward the realization of Global Financial City. In the future, the Japanese government, the Tokyo Metropolitan Government and the financial sector are expected to work together to consider effective measures from the new perspective shown in this paper, after thoroughly examining the measures implemented thus far.