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Yet Another "Empire?"

The World Trade Center Towers: they were the headquarters of Morgan Stanley, one of the world's leading investment banks, and of Cantor Fitzgerald, the world's leading trader of U.S. government bonds. They were also the work location of 9,000 Merrill Lynch employees. The Citicorp Building. The Prudential Tower. The New York Stock Exchange. These actual and recently uncovered potential terrorist targets in the United States are financial services companies and organizations. Add to them the threats to the World Bank and the International Monetary Fund, and one could conclude that seven out of ten terrorists prefer financial services.

This focus on financial services by those who envy and loathe America is surely no accident. It arguably betrays some of the Marxist, or more accurately Leninist, ideological underpinnings of Al Queda's ostensibly "Islamist" ideology. The Koran is not the book that stresses the centrality of "Finanzkapital," or of banking as part of the "commanding heights" of the economy.

Yet, this focus on financial services also pays a notable, if backhanded compliment to America's remarkable, and growing global reach in finance and financial institutions. For, in parallel with its business, technological, and military prowess, the U.S. has achieved an exceptional position in international finance and financial services.

The global competitive position of U.S. financial services firms is particularly strong in investment banking, i.e., in securities underwriting and marketing, corporate restructurings, and merger and acquisition advice. (Table 1) U.S. firms are also dominant in securities trading, brokerage, research and custody, as well as in mutual fund and institutional money management, and in venture capital and private equity. Goldman Sachs, Citigroup, JPMorgan Chase, Merrill Lynch, Morgan Stanley, Lehman Brothers, and Bank of America Securities have over 40% of the world's investment banking business. (Dealogic table on investment banking market share, quoted in Jenkins, 2004)

Their three non-American peers among the top-10 in the world have a 16% market share. They are CreditSuisse-FirstBoston (CSFB), Union Bank of Switzerland (UBS), and Deutsche Bank Securities. Moreover, UBS and CSFB are "Swiss-American." CSFB has U.S. origins and a U.S. center of gravity, First Boston having been the investment banking arm of Bank of Boston until it was severed by the Glass-Steagall Act in 1933, with Credit Suisse not taking control until 1998. UBS employs almost as many people in the U.S. as in Switzerland and was the buyer of American brokerage house Paine Webber.

American firms also conduct more than half of the world's mutual fund and institutional asset management activity (Table 3), and at least 85% of the assets managed in the most recently popular financial service, hedge funds, are managed by American companies. (Calculated from Institutional Investor, May, 2004) State Street, JPMorgan Chase, and Bank of New York dominate securities custody and services worldwide. (Financial Times, Various supplements on securities custody.)

U.S. banks are once again leaders in international government and corporate wholesale banking, after a 1970s boom and a 1980s bust. International overexpansion in petro-dollar recycling in the 1970s was followed by the "developing country debt crisis" that brought failure and consolidation to many former American banking leaders. But the survivors, notably Citigroup, JP Morgan Chase and a radically re-worked Bank of America, were able to rise again – aided both by the booming 1990s U.S. economy and by aggressive moves into capital markets and securities floatation as the legal wall between investment and commercial banking crumbled.

American banks have also been joined in the business of financing trade and commerce across borders, and even within non-US markets, by heretofore “industrial” companies like General Electric, Ford, and General Motors. These firms’ financial affiliates, once merely support operations for sales of goods such as jet engines, industrial equipment, autos, and trucks, have grown into international capital market, leasing and even credit card powerhouses in their own right. (Table 1; Company annual reports; Value Line; Wrighton, 2004)

Retail banking remains largely a "national" or, in Europe a “regional” business, although in many instances more as a result of government protectionism and regulation than because of underlying competitive forces -- given American leads in consumer payment, electronic lending and investment systems, and technologies. Even so, U.S. financial services companies have achieved notable global positions in some retail banking segments such as credit cards, with American Express and Visa having achieved truly global spreads, albeit typically in joint ventures with local, foreign institutions.

Although European and Japanese insurance companies are prominent on the lists of “the world’s largest,” only a few, such as Switzerland’s Zurich Financial Services and more recently France’s AXA and Germany’s Allianz, are very multinational. It is America's AIG that is by far the most global insurer. Prudential U.S. also has a good 40% of its business abroad and, having moved into asset management, now owns the largest foreign-owned money management firm in South Korea.

Much of European international expansion in insurance appears to have been motivated less by firm-specific advantages in insurance per se, than by the defensive necessity of acquiring firms with modern asset management capabilities, most of whom are American firms. European insurers have acquired U.S. asset managers in order to parry the decline and replacement of traditional life insurance products by mutual funds and other savings vehicles.

Money management is also still a nationally fragmented business, in part due to national pension fund regulation and law. But America's mutual and hedge funds, and its institutional managers -- based on their position in the world's largest and first-developed equity and corporate fixed-income culture -- clearly set the pace. While America accounts for some 30% of the world’s GDP, money management centers – with New York and Boston in second and fourth place worldwide among them – account for more than half of the world’s institutional equity management activity. (Table 3) Given that the United States constitutes the world’s largest government bond market, and is home to the vast majority of corporate bond issuance, U.S. predominance in world fixed-income management is also almost a given, although the existence of several very large European and Japanese insurance companies with billions of dollars in bond assets suggests more competitive parity in this business.

Some History

Few people living inside the United States probably give much thought to the fact that the longest-lived and most widely seen American "brand" in the rest of the world is almost certainly not Coca-Cola nor McDonalds, but rather the U.S. dollar. The vast majority of the world's trade and investment, licit and illicit, legal and illegal, is financed in dollars. Nearly 90% of the world’s foreign exchange trades involve dollars. (Bank for International Settlements as cited in Hughes and Guha, 2004) If one wants to buy oil, or weapons, or have a decent standard of living in Communist Cuba, or buy first-class tickets on U.S. airplanes aimed at tall buildings, one must somehow have obtained dollars. And those who sell agricultural or mineral commodities, or oil, or weapons, or drugs, almost always demand dollars in payment. Thanks to its unparalleled liquidity and purchasing power stability ("In Greenspan We Trust"), the dollar has a brand-acceptance other currencies do not.

Many of those dollar payments and receipts are made with U.S.$100 bills, one of the most popular media for international transactions, along with American Express cards and traveler’s checks and (U.S. developed) Visa cards. Ben Franklin is probably the most viewed American of all time, although in Japan and China he gets competition from Colonel Sanders, of Kentucky Fried Chicken fame. Other dollar transactions are made via bank transfers, or electronically, but at their origin, all were created by the U.S. Federal Reserve, printed by the U.S. Mint, and processed through U.S. banks.

Prior to the late 1950s and the origin of the Euro-dollar market, there was a direct link between this global preference for dollars and U.S. financial institutions. Dollars supplied in trade finance came from banks that were located in the country where dollars were made, and dollars earned were deposited in the U.S.

International trade and financial flows denominated in dollars were the province of U.S. banks, hence the extensive network of branches around Latin America established by what is now Citibank in the early twentieth century, and in Argentina and Brazil by the Bank of Boston, set up to finance the wool trade with the mills of Lawrence and Lowell. Nevertheless, prior to World War II, and even for some time after, as the Empire and Commonwealth lingered on, it was the British Pound, the City of London, and British financial institutions that dominated international trade and finance. Britain was not just a small island off the coast of Europe in those days, but, with an empire including today's India and Pakistan, most of Africa, Canada, Australia, Malaya, Singapore, and Hong Kong, it accounted for at least a fifth of the world economy.

Reconstruction in Europe and the "dollar shortage" of the 1950s, however, led to dollar dominance of world finance, and to U.S. bank dominance as well. Despite the extreme fragmentation of the United States banking market, due to prohibitions on inter-state banking and the legal separation between investment and commercial banking required in the U.S. but not elsewhere, six U.S. commercial banks accounted for three-fifths of the "world's" banking assets (as measured by the total of the world's 12 largest banks) in 1960. Three others among the top 12 were British. (Table 2)

Eurodollars, Petrodollars, and the First U.S. International Banking Boom

In the late 1950s the Soviets set up a bank in Paris (the "Moscow Narodny Bank" or "Moscow People's Bank") to keep the dollars earned from renewed, post-war Soviet oil exports from being subject to U.S. legal jurisdiction and possible seizure. Thus was born the Eurodollar market. Once the advantages of this un-regulated, offshore market in dollars became evident, non-U.S. banks and foreign branches of U.S. banks entered the business of taking and lending these "Eurodollar" deposits. Unhampered by U.S. government tax withholding, deposit insurance, bank inspection, fractional reserve, deposit-interest-rate-ceiling, or other regulations, offshore banking allowed deposits to yield more, and loans to cost less, than they did when made directly in the U.S. Eurodollar markets boomed. The direct link between the global utilization of the U.S. currency and U.S. financial institutions was broken.

Notwithstanding, the very size and geographical scope of U.S. banks and securities firms compared to European and Japanese counterparts during the 1960s and early 1970s enabled them to grow and prosper while losing little share of global financial markets, other than primarily domestic business. (Table 2)

Thanks to new American government regulations in the late 1960s aimed at shoring up the value of the U.S. dollar prior to the breakdown of the Bretton-Woods fixed exchange rate system in 1971, as well as to the increasingly revealed advantages of the unregulated Euromarkets, much of the actual business of U.S. banks shifted offshore. U.S. banks large and small set up London offices in great numbers in order to take and lend dollars in the Euromarkets. (The number of foreign bank offices in London increased from 88 in 1967 to 580 as of 1998. Michie, 2004. See also Kim and Miller, 1983, p.21) Thus, the birth and rapid growth of the Eurodollar markets assured the continued dominance of the City of London as the premier center of many aspects of world finance, but increasingly by virtue of U.S. banks taking deposits and booking cross-border loans in their London branches. (Michie)

The sudden wealth of the oil-producing countries following the quadrupling of oil prices in 1973, and the already existing global networks of Citicorp, Chase Manhattan, Bank of America, Manufacturers Hanover and other U.S. banks, meant that OPEC's new "petrodollars" were deposited disproportionately in foreign subsidiaries of U.S. banks, especially in those London offices. The U.S. banks' Latin American (and Asian – Citicorp had long been present in the Philippines and elsewhere) connections then facilitated their lending to the major oil-importing countries, the suddenly needy borrowers of dollars. Non-U.S. banks joined in the business of U.S. dollar intermediation, but American banks remained dominant on the global scene through the mid-1970s.

Although the U.S. dominated cross-border banking, the rapid growth of Western Europe following the establishment of the European Common Market led to rapid growth in the asset base of many Continental European banks and financial institutions. Japan's "super economic growth" of the era was also accompanied by a rise to "giant" status of Japan's leading banks. The growth of these banks was driven not only by the increasing wealth of retail consumers, but by much closer links between banks – many of which were “universal” banks combining commercial and investment banking and even insurance -- and non-financial corporations in Continental Europe and Japan than had been the norm in the U.K. and the U.S. It was also facilitated by government policies that reserved almost all local growth to local banks, and essentially excluded American banks from acquiring extensive commercial deposit or lending networks.

By 1980, European and Japanese universal banks had grown to such an extent that a challenge to earlier international British and American banking and financial supremacy seemed in the offing, as five Continental and two Japanese banks appeared among the world’s top twelve, and the number of U.S. banks among the “”top 12” fell to three, while their assets fell to under 30% of the world’s “top 12.” The Japanese were now neck and neck with the British at 15% of the “top 12’s” total assets, and the Continental Europeans were up to 45% -- up from but 18% a decade earlier. (Table 2)

Bank Decline and the Rise of Capital Market Institutions

The 1980s brought several challenges to the global competitiveness of U.S. banking institutions. The most visible was the “developing country debt crisis.” When it turned out that Mexico, Brazil and others could not repay the hundreds of billions of dollars of “petrodollar” recycled loans, one result was the radical downsizing and/or disappearance of many of the previous U.S. champions, including Manufacturers Hanover, Chemical Bank, and, although the name survived for another day, the one-time world leader, Bank of America. Even global Citicorp had a near-death experience. The 1990 list of the world’s top twelve leading banks included *no* American banks… and seven Japanese. (Table 2)

Less visible was the challenge to commercial banking in the U.S., and eventually worldwide, by a wave of different financial institutions who were busily developing securities markets and investment vehicles that allowed asset holders, lenders and borrowers to bypass banks altogether. The United States government, in a move to promote competition in the securities industry, began disallowing the charging of industry-wide fixed commissions on securities sales on large transactions in 1971, a process which culminated in the full deregulation of commission rates on April 1, 1975. (Hayes, 1984; U.S. Securities and Exchange Commission, 1998)

Known on Wall Street as the “Big Bang,” this injection of competition into the investment banking and stock-brokerage business touched off a wave of innovation. Suddenly “gentlemanly” practices were no longer enough to ensure the survival of the once-genteel securities houses. Desperately seeking innovation, the securities and investment banking groups saw that they could invade the markets of the commercial banks by promoting “dis-intermediation,” the substitution of the issuance of debt and equity securities for bank lending, and the sale of cash management, investment and mutual funds as a substitute for bank deposits.

At nearly the same time, in 1974, the U.S. government passed the pension fund reform known as ERISA, which facilitated the funding of company and government “defined benefit” pension plans, and the choosing of “defined contribution” plans by company employees. An investment business that had previously been the province of a comparative handful of banks, trust companies and insurance firms managing money for wealthy individuals and families “within the context of broader relationships,” was transformed. (Casey, Quirk & Acito, 2003) The result was an enormous, ever growing demand for investment, mutual fund, and pension-fund management services and vehicles, not to mention the development of a “bond and equity investment culture” on the part of millions of individual affluent and middle class U.S. investors as they realized their own responsibility for their retirement savings and planning.

The “first market” for the development of non-bank-dominated capital markets and investment management thus occurred in the U.S. Not surprisingly, U.S. financial services institutions were the first movers in this new market. They were able to build competitive advantages that often served them well elsewhere, as other countries followed the U.S. with their “Big Bangs” and pension fund reforms. They, too, realized that ageing populations’ retirement needs could not be met by traditional government “pay-as-you-go” social security plans alone.

Just how strong were the competitive advantages of the U.S. investment banking firms and asset managers became revealed in the aftermath of the U.K. “Big Bang” that occurred twelve years later in

1986. Issuance and dealing in bond, equity and other investment banking activities, such as advice on mergers and acquisitions and corporate financial restructurings, were hardly in and of themselves a U.S. invention. The City of London, along with its earlier historic role as the center of international banking and trade finance, had long been the center of the British Empire's and indeed the world's long-term bond and equity finance needs. Venerable houses such as Barings had achieved fame, if not always fortune, via their issuance of the bonds that financed the 19th century development of the U.S., Argentinean, Canadian and Indian railroads, and the South African and Australian mining industries. Other famous City "merchant banking" names included Morgan Grenfell, Kleinwort-Benson, Grieveson–Grant, S.G. Warburg, Schroder- Wagg (for whom I once worked during two of the dozen years I was based in Geneva, Switzerland) and, of course, the famed House of Rothschild, all once mighty pillars of the City, and of the world's capital market.

Almost none of these and other City securities names survive as freestanding institutions. Once exposed to the winds of global competition, and to the scale, technology, international networks, and performance standards already established by the American "bulge bracket" houses like Goldman, Morgan Stanley, Merrill Lynch, and Salomon/Smith Barney (now part of Citigroup), they found themselves with little choice but to seek salvation in the arms of those firms, or more typically, by being acquired by European banks who could see the capital market dis-intermediation wave coming at them, and who wished to build up their own securities and asset management defenses. A few of the old City capital market firms soldier on as niche divisions of other financial institutions, e.g., Kleinwort as part of Dresdener Bank of Germany, but only two non-U.S. firms that bought City of London merchant banking positions are generally considered serious competitors to the U.S. investment banking groups today: Deutsche Bank, the purchaser of Morgan Grenfell, and Switzerland's UBS, purchaser of Warburg in the UK, and of Brinson Partners and Paine Webber in the U.S. Transatlantic UBS has almost as many employees in the US, 25,000, as it does in Switzerland. (Lenzner and Serafin, 2004)

Dis-intermediation and Dollar Capital Market Financing Everywhere

It is perhaps ironic that the seeds of the current global capital market dominance of U.S. investment banks, and even the revival of the leading U.S. commercial – now "universal" -- banks were more than partly sown by the resolution of the "developing country debt" crisis. When it became clear that borrowing countries could not repay their "petrodollar" debts in the mid-1980s, the solution hit upon to their continued need for access to foreign dollar capital was the re-funding of unpayable, short-maturity bank debt with longer-term, U.S. treasury-backed, dollar-denominated "Brady bonds" (named after the then-U.S. Treasury Secretary). In addition to providing continued access to developing countries of money for their import-financing needs, the new, dollar-denominated bond market broadened yet further the scope for investment banking firms capable of underwriting, trading and maintaining securities markets. U.S. commercial bank intermediation between dollar depositors and dollar borrowers was largely supplanted by ever broader and deeper capital market transactions.

Once the emerging markets began to revive, helped by their new access to bond financing arranged largely by U.S. investment banks, they also began to privatize their state-owned enterprises. U.S. investment banks and their European offices had already participated in privatizations in Europe during the days of Margaret Thatcher's revival of the once-state dominated U.K. economy, and even in the post-Mitterand privatization and/or international mergers of some of France's once-state companies. But the 1980s and 1990s privatizations of Mexico's Telmex, Argentina's state oil company, YPF, Brazil's telecommunications sector, and many other firms were tailor-made for the skills of the U.S. investment banks. The emerging market privatizers needed U.S. dollars. Who better to market emerging market corporate debt and equity issues to holders of dollars than U.S. investment banks?

The recovery of less developed country borrowers evolved into emerging market growth "miracles" in the 1990s. Then Communism collapsed in Europe and Russia. Once again, vast amounts of dollars were needed to finance emerging market growth, and transitions from Communism.

International, cross-border banking revived. Borrowing governments had, however, learned that issuing longer-term bonds was a better strategy for maintaining solvency than relying on short-term bank debt. The bitter experience of the 1980s debt crisis also led to much more effective economic policies in a wide range of (now) emerging countries. S&P, Moody's, and Fitch country-credit ratings for Korea, Mexico, Malaysia, Thailand, Chile, and then Slovenia, the Czech Republic, Hungary, Poland, and still more recently Russia crept, then leapt upwards, and a new global, dollar capital market came into being.

Although it was still but a trickle compared to debt issuance, Eastern European privatizations started to involve U.S. investment banks in the former Communist countries as matchmakers and M&A advisors, and eventually as issuers of dollar debt and the occasional dollar equity IPO and U.S. NASDAQ or NYSE listing.

The growth was interrupted by the Mexican "tequila" crisis of 1994-95, and the Asian, then Russian debt and currency crises of 1997 and 1998, with further hiccups in Brazil in 1999 and still-unresolved problems in Argentina. Still, a half-dozen years later, most of those problems seem but a distant memory.

The result can be read in contemporary headlines: "Brazil, Turkey are Expected to Unveil Big Bond Sales Amid Bullish Conditions" (Pruitt, 2004); "China Picks 7 [Investment] Banks to Arrange Sovereign Global Bond Sales" (Wall St. Journal, August 30, 2004)

The investment banks predominant in those billions of dollars of issues are Goldman Sachs, Morgan Stanley, Merrill Lynch, Lehman Brothers, Bear Stearns and the investment-banking arms of Citigroup and JPMorganChase. CSFB, Deutsche, and UBS are there, especially for Euro denominated debt, but the American firms are well in the lead. (Thomson Financial, 2004)

U.S. Financial Supermarkets (Formerly Known as Banks) Revive

Although many U.S. banks prominent in international, cross-border lending and branching did not survive the developing country debt debacle of the 1980s, the few that did learned to prosper another day. Citibank, buoyed by its retail operations, its global scope, the 1990s U.S. boom economy, the acquisitions of investment banks Salomon and Smith Barney, and insurance firm Travelers, came back to the very top rank of the world's largest "banks" by 2000 (Table 2). Chase Manhattan acquired investment bank JP Morgan, became JPMorgan Chase, and thus rejoined the top rank of the world's banking/ financial services institutions. The Japanese, weighed down by domestic recession and their non-performing real estate and construction loans of the 1990s were forced not only to retreat from their global aspirations of the 1980s, but also to merge into a few large, almost purely domestic groups in order to survive.

European banks continue their importance among the world's leaders, but even they can ignore neither the U.S. as an economy, nor the shift in financial services from traditional banking toward capital market operations. Most of those banks, like Deutsche, HSBC and UBS had seen fit both to dramatically increase their U.S. presence and their investment-banking, capital-market activities, precisely in order to serve the competitive, dollar-based international corporate and government needs of the early 21st century.

As for traditional, syndicated cross-border global bank lending, U.S. banks JP MorganChase, Citigroup, and Bank of America accounted for 73% of the global loan book of the world's top ten banks in the first half of 2004, and for 50% percent of all global lending. (Thomson Financial, June 30, 2004)

Equity Issues and IPOs

Global capital raising in the form of new equity issues and initial public offerings is still a relatively small part of total world capital market transactions: two or three hundred billion dollars or so per year (up from 100 billion a couple of years ago), versus the perhaps six trillion of debt financing (of which some four trillion were in bond and securities issuance and the rest bank lending). (Lehman Brothers, September 9, 2004. Calculated from Figures 6 and 7)

Equity issues are also highly subject to the vicissitudes of economic cycles. Still, equity issuance is one of the fastest growing parts of the world capital markets. The U.S. investment banking houses easily account for some two-thirds of this activity worldwide. (Thomson Financial, 2004) Much of this issuance is concentrated, to be sure, in the United States, Britain and the "Anglo-Saxon" world. It is notable, however, that some of the "all-time biggest IPOs" in Europe, including those of ENEL, the Italian electric utility, Deutsche Telecom, France Telecom, and Telecom Eirann (Ireland) were brought to market by Goldman Sachs and Merrill Lynch. (IPOHome, 2004) Moreover, the underwriters of the burgeoning IPOs, at least the dollar denominated, international IPOs that lead to listings in New York and London on the NYSE, NASDAQ, and LSE by Korean, Chinese, and Indian companies, tend to have the usual, predominantly American names such as Goldman Sachs, Morgan Stanley, and Merrill Lynch. (CBS Marketwatch, 2003)

Venture Capital/ Private Equity

Venture Capital is a modest segment of the world's financial services industry in volume – some $20 billion invested in 2003 in the United States; about the same in Europe, and half that amount in Asia. (Thomson Venture Economics, 2004) Notwithstanding, Venture Capital for start-up and growth firms, and its close cousin, Private Equity financing and restructuring of existing companies, plays a vital role in turning ideas and innovation into enterprise. Like Mutual Funds, the very first Venture Capital funds and firms were created in the United States, specifically in Massachusetts in the 1950s and 1960s. They came to maturity first in the U.S. as American Research and Development's investment in Digital Equipment (DEC -- now part of Hewlett-Packard) and other Route 128 firms helped to transform acorns into seedlings and then into corporate oaks. Others like Hambrecht and Quist and Venrock followed, primarily as midwives to the explosion of California innovation in Silicon Valley. Occasionally, large, successful technology companies like Intel set up Venture investment groups as well aimed in part at taking "call option" shareholding positions in new firms with new technologies that could perhaps be someday of interest to the corporate parent.

Venture Capital then spread to Europe, first to the U.K. with its sophisticated capital markets, then to 'English-speaking' Scandinavia, and finally to the Continent as European firms and governments eventually came to realize that there were limits to the growth and dynamism that could come from the very large, venerable – and often bureaucratic and slow moving – private corporations and state-owned firms that had been the base of post-WW II reconstruction and growth. Would-be entrepreneurs came to chafe under the European tradition under which the only path to small and medium-size enterprise success was <u>via</u> closely held family enterprises supported by traditional bank financing. Although this "European" model of entrepreneurship has hardly been replaced among Germany's "Mittlestand" and France's "PMEs," venture capital alternatives became more and more available, often from American-based, international VC firms like Advent International, active in 25 countries and itself a spin-off from one of the earliest and still most prominent Boston VC/Private Equity companies, TA Associates.

The rise of East Asia, and especially the end of the dominance of state-owned enterprise in the Peoples' Republic of China, created new opportunities not only for public offerings and privatizations, but for Venture Capital/ Private Equity ownership positions and financings as means not only of creating new enterprises, but of preparing existing firms for eventual life as public companies. The evolution of Venture Capital in Asia has been extensively examined in a report to the World Bank by economists at Berkeley. (Kenney, Han and Tanaka, 2002) Once again, American firms figure prominently in the story, although Hong Kong, Taiwanese and other companies experienced in financial services were quick off the mark. Also, many U.S. firms either did not have the patience or ability to deal with months and years of negotiations, government interventions, and the sometimes idiosyncratic practices of their Chinese and other Asian counterparts. Notwithstanding, a number of U.S. VC companies, San Francisco's Hambrecht and Quist and Intel's venture group in the lead, have become highly prominent in many Asian markets.

The symbiotic relationship between American VC/Private Equity firms and American investment banks also continues in Asia, as Goldman and others bring the IPO's of the firms "prepped" for their public company debuts by the venture capitalists to market, a development that will now be yet broader with China's approval of a new Goldman Sachs brokerage joint venture with a Chinese partner whose aim is to begin underwriting stock and bond sales in the *internal*, Chinese Yuan market. (CBS Marketwatch, 2004)

Asset Management

For every IPO'd venture, or equity issue by a privatized firm, or offer of emerging market debt, or sale of a European government bond midwifed by the "sell-side" investment banks, there must be a "buy-side" purchaser. More often than not, it is American pension, mutual fund, hedge fund, insurance company, or "private banker" catering to the "HINWIs" (High Net Worth Individuals) of the world who are on the opposite side of the capital market activities of American-dominated oligopoly of investment banking and brokerage. Indeed, there is a significant overlap among "sell" and "buy" side actors: Citigroup, Bank of America, Morgan Stanley (and Switzerland's UBS, and Deutsche Asset Management) and other investment or "universal" banks all have major asset management businesses.

We have already noted the overall dominance of American money management firms in the world asset management business, partly because of America's pioneering role in the development of funded pension plans following ERISA in 1974. (Table 3) There are at least two more dimensions worth considering in an assessment of American competitiveness in this segment of the financial services industry: foreign money managed by U.S. firms in the U.S., and non-U.S. money managed by subsidiaries of U.S. asset management firms abroad.

Money management, was, of course, hardly invented by the U.S., even if mutual funds and legislation promoting funded pensions were. Switzerland and the U.K. have long hosted trust institutions and private banks specializing in managing funds, primarily for high net worth individuals and families. Indeed, the survival and growth of Swiss banks like UBS in the modern world of capital-market dominated dis-intermediation owes much to this tradition.

Many non-U.S. money managers long invested client-funds that ultimately ended up in American securities. But, by the 1970s and 1980s it became clear for many clients that, as the saying went in Geneva in private banking circles: "If you want to hide your money, have it managed in Switzerland. If you want to make it grow, go to the U.S."

Since reported figures typically include only total assets under management (AUM) for different firms, it is difficult to even guesstimate how much in the way of assets of non-U.S. owners is actually managed by U.S. firms or their foreign branches. Anecdotal evidence however points to the existence of many funds, especially hedge funds, that are actually managed by U.S. firms or personnel, but that are available only to non-U.S. investors and are registered offshore, George Soros' Quantum Fund, registered in the Netherlands Antilles, and not available to U.S. investors, being perhaps the most famous, or infamous, example.

Other figures that hint at the extent of foreign assets under U.S. management come from occasional U.S. Treasury reports on Foreign Portfolio Holdings of U.S. Securities. (U.S. Treasury, August 2004) The total value of foreign holdings of U.S. portfolio securities as of June 30, 2003 was estimated at just short of five trillion dollars. Some 1.5$ trillion constituted holdings of long and short term U.S. government debt, which could well have been direct "unmanaged" purchases by foreign governments and entities. However, some significant part of the $1.5 trillion in foreign holdings of U.S. equity securities and $1.2 trillion of long-term U.S. corporate debt held by foreign is surely counted by U.S. money mangers in their AUM figures. (U.S. Treasury, August 2004, Table 17, p.50.) For comparison, the total AUM of Fidelity of Boston is around $1trilllion. (Table 1)

Another hint is given by estimates of Arab oil exporter's funds invested in the U.S. "America-friendly" oil exporters such as Kuwait, the United Arab Emirates, Oman, Qatar, Bahrain and Saudi Arabia and their citizens have been investing a considerable portion of their "petro-dollars" in the U.S. ever since they were showered with oil wealth in the mid-1970s. An unknown, but considerable amount has been and is managed by Boston-based institutions. The official U.S. statistics speak of some 85$ billion dollars of portfolio investment by these countries as of June 30, 2003. However, the Treasury notes that these numbers do not include much larger amounts invested indirectly via anonymous accounts in Caribbean offshore centers ($212bn in U.S. equities from all sources), the U.K., Switzerland, Luxembourg, and other countries. Sources allegedly close to the Saudi government speak of much larger amounts, i.e., of some $400 billion of Saudi portfolio investment in the U.S., a considerable portion of which would certainly be managed by, and all traded through U.S. institutions. (Hsu,T.C., 2003) This report also states that, contrary to rumors at the time, almost all of these funds remained in the United States after September 11, 2001. Whatever the exact sums, it is clear the American firms are "money managers to the world."

American firms, with Citigroup, Merrill Lynch and Fidelity in the lead, have also been in the forefront of attempting to transport American fund management capabilities and the U.S. "investment culture" to other countries. Citigroup has built on its local banking presence as a means to manage local pension funds in a host of nations. Fidelity and Merrill appear to have had success with the "U.S. model for export" in

Europe, although – Merrill in particular -- less so in Japan. (Businessweek, 2002, BBC, 2002) Still, as the rise of capital market versus bank financing proceeds around the world, and as government pay-as-you-go pension schemes need supplementing or replacing by funded plans for beneficiaries, the U.S. asset managers also appear well placed to play a disproportionately important global role.

Durable Supremacy or "An American Bubble?"

Can the pre-eminence of American financial services institutions last? Could it become even greater? Or will European, Japanese, Asian or other institutions grow and erode the U.S. advantages in investment banking, capital market transactions, asset management, venture capital, cross-border lending, credit cards, lease financing and other innovations?

There are a number of reasons for believing that American institutions – and the UBSs and CSFBs who in effect "become American" - - will continue to expand their role in the world's financial transactions. First, U.S. institutions have wide and deep first-mover advantages compared to their non-U.S. competitors. Not only have they pioneered the vast majority of the "alternatives to traditional banks," they have developed the technological, marketing, managerial, and worldwide network infrastructure to exploit those advantages. Secondly, dis-intermediation has much further to go outside the U.S. (The Economist, 2004) It looks ever more the case that the U.S. "past" of the replacement of banking by capital market and asset management institutions – at least in commercial, as opposed to retail financing – is Europe and Asia's future. Merge defensively as they might, nationally or across borders, traditional banks whose strengths are based on close ties to local and regional relationship traditions are going to remain vulnerable to the competitive winds blowing from less-expensive capital market transactions. Retail customers may remain because of inertia and the psychic benefits of personalized hand-holding, but large and even small businesses who must compete in wider and wider economic spaces like the European Union and the Pacific Rim, will go to the most experienced midwives of low-cost capital market sources of funds.

The "equity culture" also has much further to go outside the United States. "Pay-as-you-go," un-funded government pension plans are simply not viable in the 21st century. Alternatives must be found, and no one has yet found a better one than the funding and investing of savings for retirement as pioneered in the U.S. Opportunities for U.S. asset managers thus abound.

Could anything halt or seriously impede the competitiveness of U.S. financial institutions in the new capital-market dominated world?

U.S. financial dominance would certainly be harmed were the world to fall out of love with dollar as its principal trading currency and store of value -- and there are those who look at the very large U.S. trade deficit, funded by record inflows of capital from Japan, China, elsewhere in Asia, and Europe and the Middle East, and predict such disenchantment, viz Martin Wolf's many columns in the Financial Times. (columnists @ www.ft.com) Still even the Euro cannot be a true global competitor until and unless Europe as a whole develops capital markets of a liquidity and breadth that only the U.S. has today. And European financial services firms would have to develop the equity, bond and debt market, advisory, venture capital, asset management and other skills that are today primarily in the hands of U.S. institutions.

Last but not least, the American financial services leaders have the world's most dynamic and innovative business and technology base of customers and suppliers in their home market. Terrorist attacks and host-country protectionism can occasionally blunt the global expansion of U.S. financial services firms, but their skills and networks not only fuel the trade and investment of the advanced countries, but have also brought China and other emerging markets into the world economy. And they can bring other poor countries into the world of higher standards of living and better lives.

Table 1 Leading U.S. Global Competitors in Financial Services

Organization & Principal Activities	Total Assets ($bn, 2003)	Number of Countries with Offices	Percent of Business Outside U.S.
Citigroup Commercial Banking, Investment Banking, Credit Cards, Asset Management, Insurance	1264	> 100	35
J.P. Morgan-Chase Commercial Banking, Investment Banking, Securities Custody, Asset Management	771	> 50	37
Bank of America Commercial Banking, Asset Management, Investment Banking	736	35 (clients in 150)	
American International Group Life & Property Insurance, Asset Management	678	98	> 50
Morgan Stanley Investment Banking, Brokerage	603		
Goldman Sachs Investment Banking, Brokerage	404	> 20	38
Merrill Lynch Investment Banking, Securities Brokerage, Asset Management	495	34	
Lehman Brothers Investment Banking, Asset Management	312		31
Fidelity Investments Asset Management (Mutual Funds)	964	> 13	
Capital Group Asset Management, Mutual Funds, Variable Annuities	814	19	16
GE Financial Services	536		
Insurance			16
Consumer (GE Capital Bank)			> 75
Commercial		47	40
Prudential Financial Insurance, Asset Management, Real Estate	320	> 30	20
American Express Credit Cards, Asset Management, Banking (outside U.S.)	175	> 90	40 (Credit cards)

Sources: Morgan Stanley Capital International, 2004; Company Reports and Websites; Institutional Investor.

Table 2
Top 12 Banks' "World Market Share," 1960 – 2000
(Ranked by Percent of Total Assets of World's Largest Banks)

1960	Assets	%	1970	Assets	%	1980	Assets	%	1990	Assets	%	2000	Assets	%
BankAmerica	11.9	16	Bank Am	29.7	16	Citicorp	114.9	10	Sumitomo	407.9	10	MizuhoHld	1304.3	14.4
Chase	9.3	13	Citicorp	25.8	13	BankAm	111.6	10	DaiIchi	426.9	10	Citigroup	902.2	10.0
Citi	8.7	12	Chase	24.5	13	BNP	107.3	10	Mitsub	412.8	10	Deutsche	882.5	9.7
Barclays	7.5	10	Barclay's	15.8	8	Caisse	105.9	9	Mitsui	407.5	10	BkTokyoMit	716.9	7.9
Man Han	6.1	8	NatWest	12.9	7	CrediLyon	98.2	9	Sanwa	401.5	10	JPMChase	715.3	7.9
Chemical	4.5	6	Man Han	12.7	7	Soc Gen	90.2	8	Fuji	398.3	10	HSBC	674.4	7.4
Royal Can	4.4	6	BNP	12.3	6	Barclay's	88.6	8	CredAgric	303.0	7	BayHypVer	672.7	7.4
Morgan Gty	4.4	6	Banc Nat. Lav.	12.2	6	Dai-Ichi	88.5	8	BNP	289.7	7	UBS	671.1	7.4
MidlandUK	4.3	6	Morgan	12.1	6	Deutsche	88.5	8	IndusBoJ	289.2	7	BNPParibas	651.5	7.2
Lloyds	4.4	6	WestBanc	11.4	6	Nati West	82.6	7	CredLyon	285.2	7	BnkAmerica	642.2	7.1
Can Imperial	4.3	6	CredLyon	11.1	6	Mitsubishi	76.4	7	Deutsche	267.7	6	ING	610.4	6.7
Bnk Montreal	3.6	5	Chemical	11.0	6	Chase	76.2	7	Barclays	260.0	6	CredSuisse	609.3	6.7
	73.5	100		191.7	100		1128.9	100		4149.7	100		9052.8	100

	1960	**1970**	**1980**	**1990**	**2000**
Japan	**0**	**0**	**15**	**67**	**22**
Europe	**22**	**40**	**58**	**33**	**53**
US	**61**	**60**	**27**	**0**	**25**
Canada	**17**	**0**	**0**	**0**	**0**
	100%	100%	100%	100%	100%

Source: World Market Share Data Base, as reported in Franko, 2002, Franko 1991, and Franko 1989.

Table 3
Leading Cities in Asset Management, 1999
($bn assets under management ranked by institutional equity holdings)

Rank	City	Country	Assets	%
1	London	UK	2461	21%
2	New York Metro	US	2363	20%
3	Tokyo	Japan	2058	18%
4	Boston	US	1871	16%
5	San Francisco	US	726	6%
6	Los Angeles	US	569	5%
7	Paris	France	458	4%
8	Philadelphia	US	419	4%
9	Zurich	Switz.	414	4%
10	Denver	US	340	3%
			11679	100%

Source: Thomson Financial, Target Cities Report 2000.

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