Tokyo has recently reinvigorated its long-held goal of transforming the city into a global financial hub. The global importance of the Tokyo Stock Exchange and the Japanese yen, as well as the sheer size of Tokyo’s economy, are key arguments in favor of Tokyo becoming the number one financial city in Asia. However, Tokyo has many competitors in Asia and in the past has struggled to create an attractive business climate for foreign firms.

In the 22nd issue of the Debating Japan newsletter series, the CSIS Japan Chair invited Tomoo Kikuchi, associate professor at Waseda University, and Sayuri Shirai, professor of economics at Keio University, to share their perspectives on whether Tokyo can become the next financial hub in Asia.
As of February 2021, the Japan Exchange Group, which operates the Tokyo Stock Exchange (TSE) and Osaka Securities Exchange, has listed companies with a combined market capitalization of US$6.54 trillion and is the fifth largest exchange operator worldwide after the New York Stock Exchange (NYSE), NASDAQ, Hong Kong Exchanges (HKE), and Shanghai Stock Exchange. All of the above operators in Asia are similar in size by market capitalization, comprising roughly a quarter of the NYSE.

Tokyo has three advantages it can draw on to become the next financial hub in Asia. First, Japan sits on a mountain of cash—¥1008 trillion (US$9.25 trillion)—that can potentially be invested in securities to finance companies based in Tokyo with a global outreach. Japanese households keep 54 percent of their assets as cash in contrast to 14 percent by U.S. households or 35 percent by European households (eurozone). If Japan can channel these cash savings into investment, it would substantially increase the assets of Japanese households, contribute to revitalizing consumption, and end the deflationary economy.

Second, the potential for Japan Inc. and foreign companies to expand globally is higher than ever before. Japan’s net foreign assets amount to ¥365 trillion, the largest in the world. Japan has held this position for the past three decades, but the main contributor has changed from equity investment to foreign direct investment in the last decade. This shows that Japanese companies have expanded their global value chains rapidly, with many deriving more than half of their revenue outside of Japan. The time has come for Japanese companies to be transformed into truly multinational companies and invest overseas in partnership with foreign companies.

Third, Japan can leverage its position as a key ally of the United States to build a common vision and share intelligence for the Indo-Pacific. To this end, it must be in the U.S. interest to support further internationalization of the yen to share its global responsibilities. Since the rest of the world relies so

Japan’s goal of developing Tokyo into one of the major global financial centers has been pursued for a long time as a part of its economic growth strategy—since the 1980s by the Japanese government and since 2014 by the Tokyo metropolitan government. This vision reflects the idea that Tokyo deserves this status due to the sheer size of its economy and stock market, as well as the important role played by the Japanese yen in foreign exchange transactions and foreign reserves. Over time, however, these comparative advantages have been eroding, especially since China became the second largest economy after the United States in 2010. In addition, the Japan Exchange Group (which owns the Tokyo Stock Exchange) has been lagging behind the Shanghai and Hong Kong Stock Exchanges in terms of market capitalization since last year, while the top two positions continue to be dominated by the New York Stock Exchange and NASDAQ by a large margin. In recent years, moreover, currencies such as the Australian dollar, the Canadian dollar, and the Chinese renminbi have gained popularity. The world is also paying attention to the ongoing experimentation of digital renminbi, which is scheduled to be issued at the time of the 2022 Beijing Winter Olympic Games.

To become a top global financial center, at least one of the following two conditions should be met: the presence of large, diversified, and dynamic domestic financial and capital markets (as found in New York), or alternatively, historical experience in global asset management businesses and foreign currency exchange–related services (as found in London). The use of the English language also adds to the strength of New York and London. Over the past five years, China has been gaining traction among global investors because it is developing diverse financial centers in Beijing, Shanghai, and Shenzhen with a growing number of technology-intensive start-up and unicorn companies funded by the expanding venture capital industry. Also, an increase in the number of middle- and high-income people, along with the associated growth of institutional investors and the asset management industry in China, has accelerated the pace of financial and capital market
much on the U.S. dollar, the Federal Reserve needs to consider the repercussions of its monetary policy on the liquidity needs of emerging economies to prevent potential sovereign defaults and financial crises. If Japan can supply more liquidity and capital for investment in the Japanese yen to emerging economies, it would ease the pressure on the U.S. dollar and contribute to the above advantages of Japan.

However, as of May 12, 2021, there are only four foreign companies out of the 3,756 companies listed in the TSE. This appears to show the relative unattractiveness of Tokyo as a market for foreign companies compared to previous periods. For example, there were 125 foreign companies out of 1,752 listed in the TSE at the end of 1990. The TSE was more vibrant and international in the early 1990s, when Japan’s share of global GDP was the highest, reaching 18 percent in 1994. However, this share of GDP declined to six percent in 2019, while that of China rose from 6 percent to 16 percent in the same period.

Obviously, the TSE is a stock market for companies operating in Japan. However, this exclusive connection to the domestic economy is a characteristic not shared by its competitors in Asia today. There are 99 foreign companies out of 754 companies listed in the Singapore Stock Exchange. The HKE has 2,550 listed companies, out of which 292 are H shares—shares of companies incorporated in mainland China—and 176 are red-chips stocks—shares of mainland China companies that are incorporated outside mainland China. In other words, a significant portion of shares traded in the HKE have a strong link to mainland China. Similarly, the Singapore Stock Exchange lists many foreign companies that have chosen Singapore as a base for their operations in Association of Southeast Asia Nations (ASEAN) countries. Both the HKE and Singapore Stock Exchange derive their dynamism from the vast potential of the growing Chinese and ASEAN markets, respectively.

Tokyo should not assume its capital market is considered unattractive only because of the lack of tax incentives, bureaucratic red tape, language barriers, corporate culture, or the lack of support for expatriates and their families living in Tokyo. The main unattractiveness of Tokyo is its limited domestic growth potential due to Japan’s population decline. Therefore, Tokyo must transform itself as a base for business outside Japan if it is to become the next financial hub in development, thus providing good investment opportunities for global investors. In contrast, Japan has been facing low economic growth and low inflation for more than two decades with limited acceptance of foreign immigrants and high taxes. Thus, it is challenging for Japan to gain advantages over the United States, the United Kingdom, and China. Tokyo is also unlikely to take over Hong Kong, which continues to function as a gateway to mainland China, due to differences in language and culture, limited availability of information about China’s economy and markets, and geographical distance. The rising rivalry between the United States and China and the growing importance of the U.S.-Japan alliance may amplify this prospect. Singapore might be in a better position in terms of circulating some global funds from advanced economies and the Asia-Pacific region to the mainland (and the other way round) given a large population of overseas Chinese citizens, limited language barriers, and geographical proximity.

Given this background, Japan must present a clearer vision as to what types of financial services Tokyo could offer competitively to the Asia-Pacific region. On this front, two possibilities can be examined: (1) circulating domestically and globally abundant money to finance the development of emerging and developing Asia, and (2) taking the lead in fostering the sustainable and green finance market to help transform the region into a low-carbon economy in the face of growing energy demand. The first possibility has not materialized, as Japan’s financial investment continues to be destined toward advanced economies such as the United States, Europe, and Australia. Japan’s capital remains risk averse as compared with those of the United States and Europe due to strong bias toward debt securities over stocks. These facts appear to hamper Tokyo in becoming a regional financial center due to the limited availability of higher-risk investment needed to finance infrastructure and social projects in the region.

As for the second possibility, Japan still has a chance to succeed, because many countries have just begun to decarbonize their economies by setting a net zero carbon emission target by 2050 (or 2060 in China). The sustainable and green financial markets remain underdeveloped and need to grow further to support innovation and investment activities in key areas including semiconductor, renewable energy, clean hydrogen, and batteries, as well as carbon capture.
Asia. The fundamental challenge for Tokyo—including the central and metropolitan governments—in becoming a city that attracts globally operating companies is to transform its identity as Japan’s capital into a regional capital and start identifying and functioning as an integral part of Asia.

utilization, and storage. To do so, governments will need to promote corporate non-financial information disclosure and standardization; form a consensus on taxonomy (defining environmentally sustainable economic activities) that helps to allocate funds to truly green and transition activities; and install institutional and legal frameworks that prevent greenwashing practices. The European Union is already taking the lead. China, Singapore, Hong Kong, and the United Kingdom are moving fast to develop top sustainable and green finance hubs. In the face of intensifying competition, there is no time for Japan to relax.
ABOUT THE AUTHORS

TOMOO KIKUCHI is an associate professor at the Graduate School of Asia-Pacific Studies at Waseda University and an adjunct senior fellow in the S. Rajaratnam School of International Studies (RSIS) at Nanyang Technological University. Previously, he worked at the National University of Singapore, Nanyang Technological University, and Korea University and held visiting positions at the MIT Sloan School of Management and the Keio University Global Research Institute. He is interested in how the global financial market contributes to economic growth and causes cross-country income differences. His papers have appeared in journals such as the *Journal of Economic Theory*, *Theoretical Economics*, and the *Journal of Money, Credit and Banking*. He has edited many books and journal special issues on trade, finance, and investment in Asia and is an associate editor of the *Journal of Asian Economics*. He frequently writes for newspapers such as the *Straits Times* and *Nikkei Asia*. He obtained his PhD in economics from Bielefeld University in Germany.

SAYURI SHIRAI is a professor of economics in the Faculty of Policy Management at Keio University. She is also a senior adviser to the UK-based Equity Ownership Services (EOS) at Federated Hermes. She was a member of the Bank of Japan’s Policy Board in 2011–16. She received her doctorate from Columbia University’s Department of Economics. She has written numerous books and papers on monetary policy, digital currency, and the global and Japanese economies.

ABOUT THE EDITOR

HANNAH FODALE is a research associate with the Japan Chair at the Center for Strategic and International Studies, where she focuses on projects involving U.S.-Japan relations and security in the Indo-Pacific region.
RELATED RESOURCES

CSIS RESOURCES


“Assessing Abe’s Economic Statecraft,” August 31, 2020, Matthew P. Goodman

“American Business Confidence in Hong Kong Sinks,” July 22, 2020, Shining Tan and Yilin Wang

RECENT DEBATING JAPAN ISSUES

“RESOLVED: The United States and Japan Are Aligned on Climate Strategy” (March 2021)

“RESOLVED: Japan Should Increase Pressure to Support Democracy in Hong Kong” (February 2021)

“RESOLVED: Japan Is Ready to Become a Formal Member of Five Eyes” (December 2020)

JAPAN CHAIR RESOURCES

RECENT EVENTS

“My Vision for the Japan-U.S. Alliance,” featuring Prime Minister Yoshihide Suga (April 16, 2021)

“Strategic Japan: The Future of Japan-China Relations” (April 5, 2021)

RECENT PUBLICATIONS


STRATEGIC JAPAN WORKING PAPERS

Read the 2021 working papers here

THE ASIA CHESSBOARD PODCAST

Listen to the latest episodes on Apple and Spotify

FOLLOW US ON SOCIAL MEDIA

Twitter @JapanChair

Facebook CSIS Japan Chair

To Subscribe to Debating Japan and receive invitations to Japan Chair events, Click Here

For more information on the CSIS Japan Chair, please visit https://www.csis.org/programs/japan-chair