Chapter 6
A Case Study on British International Banks: The London Office of the Hongkong and Shanghai Banking Corporation, 1875–1889

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Abstract The years 1875–1889 saw changes caused by improved transportation, communication and the long-term declining trend in the value of silver that led to the rise of the Hongkong and Shanghai Banking Corporation (HSBC). The HSBC's success could be attributed mainly to its adoption of the "on an even keel" policy. The London Office of the bank played an essential role in implementing this policy. In this chapter, I used chiefly the correspondence of David McLean, the manager of the London Office from 1875 to 1889, in examining the actualities of business activities in the London Office of HSBC. This chapter divides into four sections. Section 1 analyzes the finance trade business. Section 2 examines the relationship of HSBC and its correspondent banks. Section 3 considers the deposit-taking activities while Sect. 4 deals with cooperative relationship between British international banks. This research revealed that HSBC strengthened its financial networks in London in responding to changes in international payment system as well as the growth of its trade finance business. Moreover, it showed that the dynamics of competition and cooperation between international banks were significant in shaping the international payment system between Asia and the West and vice versa. By the middle of the 1880s, HSBC proved an unwavering position in international capital movement between East Asia and Britain.

Keywords International banking of Asia · HSBC · Even keel policy · Interest Bills · London

The years 1875–1889 saw changes caused by improved transportation, communication and the long-term declining trend in the value of silver that led to the rise of the Hongkong and Shanghai Banking Corporation (HSBC) and the fall of the Oriental Banking Corporation. Most currencies of Asian countries were based on silver until the end of nineteenth century. As the exchange rate of silver in terms of gold had been stable before 1870s, British international banks conducting foreign exchange business between Asia and gold using countries had given little consideration to

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T. Nishimura and A. Sugawara (eds.), *The Development of International Banking in Asia*, Studies in Economic History, https://doi.org/10.1007/978-4-431-55615-2_6

the risk associated with fluctuations of gold-silver exchange rate. It was under these circumstances that the banks that did not seek a workable solution in coping with the exchange problem had either to reduce the scale of their business or to become bankrupt.

The rise of HSBC depended on its adoption of the "on an even keel" policy. This is a phrase of Thomas Jackson, the chief manager of HSBC at that time (Collis 1965, p. 61). It properly showed the distinctive feature of this policy. In other words, the bank had to match the assets and liabilities in both gold and silver, respectively. Therefore, this strategy required wide-ranging changes of banking operations involved foreign exchange business. Although Professor King used this phrase as the subtitle of the first volume of the official history (King 1987), he paid little attention on foreign exchange practices and fund management of HSBC. The impact of silver depreciation on foreign exchange business of international banks operating in Asia has drawn considerable attention from scholars in Japan.[1] While these studies deepened our understanding of international banks' trade finance business, they did not answer the question concerning how HSBC carrying out the policy in tackling silver problems.

The London Office of HSBC played an essential role in implementing the "on an even keel" policy.[2] By 1875, there were seven British international banks operating in Asia, HSBC was the only bank that had its head office in Hong Kong but not in London. When HSBC started its business in 1865, it opened London Office as a branch and placed more importance on local business in China. With the establishment of London Consultative Committee in 1875, London Office became a center of authority of almost the same importance as the head office in Hong Kong. In this chapter, I will delve into the actualities of business activities in the London Office of HSBC, especially, of the following three aspects. Firstly, the changes of foreign exchange operations of trade finance during the 1870s and 1880s. Secondly, the relationship between HSBC and the other international banks. Lastly, how HSBC connected to London money market. The main archival source used here is the correspondence of David McLean,[3] the manager of the Shanghai Branch from 1865 to 1872 and the manager of London Office from 1875 to 1889. D. McLean was an outstanding banker and made great contribution to HSBC's early development. His correspondence was valuable in analyzing the banking business of HSBC in the 1870s and 1880s.

[1]Kitabayashi's study focused on the business crisis of the HSBC occurred in 1886 and pointed out the limitation of this policy (Kitabayashi 1992). Ishi (1999, pp. 15–123) showed the rise and fall of international banks in China and Japan by examining the banking transactions of the Yokohama branch of Jardine Matheson & Company, one of the most influencial British trading companies in East Asia. Ishi (1998, pp 133-162) examined the banking transactions of Jardine Matheson & Company as well, but her study concentrated on banking business in China.

[2]Although the general development of the London Office was sketched in the published banking history of the HSBC, professor Frank H. H. King did little to explore the relation between trade finance business and the development of the London Office in depth.

[3]The main source in this chapter is Letter Books of David McLean in David McLean Papers, MS 38041, the Library, School of Oriental and African Studies, University of London [hereafter referred to as MP].

1 Exchange Business

The London Office was a key branch of HSBC in foreign exchange business between Asia and the West. Moreover, it also functioned as a regional head office in supervising business at branches in San Francisco, New York, Lyon and Hamburg that opened between 1875 and 1889. The routine business of London Office included collecting payment for bills purchased by head office and branches in Asia, making payment for telegraph transfers (T.T.) and short-term bank drafts on London sold by Asian offices, buying documentary bills on exports from Britain to Asian countries, remitting funds to Asian branches by sending silver, Council Bills, or sight drafts in rupees on India sold by Indian Office in London.

1.1 Export Trade Finance

Firstly, let us examine the exchange business of financing British exports. Table 1 shows that the total exports from Britain to Asian countries grew 14% between 1875 and 1886, while over this period the amount of documentary bills purchased by HSBC increased more than twice. This business expanded rapidly in the 6 years between 1875 and 1881 while the pace of growth was slowed down between 1881 and 1886. The feasible explanation for the cause of this rapid growth in the late 1870s was the fall of the Oriental Bank, the void left by the Oriental Bank was quickly filled in by the HSBC. In spite of the great progress it had made, HSBC only financed 10.4% of

Table 1 Export bills purchased by London Office of the HSBC and exports from Britain to Asia, 1875–1886 (in £1,000)

Britain's exporting countries	1875	1881	1884	1886
China	4,928	5,965	4,153	5,249
Hongkong	3,600	3,615	3,219	2,315
Japan	2,460	2,825	2,255	2,170
Straits Settlement	1,962	2,564	2,633	2,107
India[a]	25,323	30,051	31,322	31,965
Total exports (A)	38,273	45,020	43,582	43,806
Amount of bills purchased (B)[b]	1,721	4,381	4,569	4,561[a]
Share = B/A (%)	4.50	9.70	10.50	10.40

Source Data for Britain's exports, derived from Page (1919, pp. 109, 113)
Data for amount of bills purchased: McLean to the Board of Directors of the HSBC, 17 February, 1882, McLean to Jackson (Hong Kong), 14 January 1885, McLean to Cameron(Shanghai), 20 January, 1887, MP
[a]Including Ceylon
[b]Bills on Straits Settlement is not included

UK's exports to Asia in 1886. China and Japan were more important than India for HSBC though the latter country occupied a large part of the British exports to Asia.

1.1.1 Silver Currency Bills

With the decline of silver and the global developments in transportation and telegraph communications, the method of financing British exports to Asia underwent great changes in the 1870s. By the early 1870s, most of the British goods were sold on consignment in Asia. British exporters would draw bills on London when they shipped the goods off. After 1876, instead of drawing sterling bills, British exporters would draw 60 days' sight bills on Asia in local silver currencies, such as taels for Shanghai and Mexican dollars for Hong Kong and Yokohama, which an international bank in London would buy at a rate of exchange they fix themselves.[4] The bills purchased were then sent to the banks' Asian branches for collection. As a result, this kind of bills transferred the exchange risk from export merchants to the banks. In addition to silver currency bills, a new type of sterling bill called interest bills was also devised and became widely used as well. The bank's interest bills business will be examined in detail in Sect. 1.1.2.

Silver currency bills were mainly drawn for financing exports to China and Japan because of the difficulties in doing forward exchange business there. Tea and silk, the principal exports of both China and Japan, were practically exported between June and September and subsequently the sale of export bills were concentrated during this time of the year. Moreover, the uneven quality of tea made it difficult to be sold "forward." Contrastingly, most of the export of India could be sold "forward" because of two reasons. Firstly, business was done throughout of the year. Secondly, Council Bills sold by India Council in London amounted to about 14 million pounds annually, a large figure when compared with the value of trade between Britain and India. These features enabled forward exchange business to be developed in India. Thus, in India's case, an British exporter would simultaneously draw on London and telegraph to his correspondent in India to buy forward exchange in sterling in amount equivalent to the proceeds of the goods, thus ensuring himself a certain return for the goods when the proceeds sent back to Britain.[5]

As shown in Table 2, the export bills purchased by the London Office of HSBC were mainly drawn on China and Japan in 1884 and 1886. Bills on Shanghai, Hong Kong and Yokohama accounted for 30–50% of total exports of Britain to China, Hong Kong and Japan, respectively, in both 1884 and 1886. As most of the exports from the USA and Europe to Asia were financed by London, the share of exports financed by HSBC may be over exaggerated. However, even taking this fact into

[4]Royal Commission appointed to inquire into recent changes in the relative values of the Precious Metals with Minutes of Evidence, First Report, British Parliamentary Papers, 1887, Volume XXII, p. 157.

[5]Royal Commission appointed to inquire into recent changes in the relative values of the Precious Metals with Minutes of Evidence, First Report, British Parliamentary Papers, 1887, Volume XXII, pp. 160–1, 258–607.

Table 2 Export bills purchased by the HSBC by place of collection, 1884–1886 (Unit: £1,000)

Place of collection	1884			1886		
	Bills purchased (A) (%)	Exports of Britain (B)	A/B (%)	Bills purchased (A) (%)	Exports of UK (B)	A/B (%)
Shanghai (China)	1,567(34.3%)	4,153	37.70	1,785(39.1%)	5,249	34.00
Hongkong	1,028(22.5%)	3,219	31.90	1,107(24.3%)	2,315	47.80
Yokohama (Japan)	1,018(22.3%)	2,255	45.10	1,177(25.8%)	2,170	54.20
Bombay and Calcutta (India[a])	723(15.8%)	31,322	2.30	514(11.3%)	31,965	1.60
Singapore (Straits Settlements)	233(5%)	2,633	8.80	NA		
Total	4,569(100%)	43,582	10.50	4,562(100%)	41,699	10.90

Source Same as Table 1
[a]Including Ceylon

consideration, the data still clearly shows that HSBC was in a dominant position in the exchange business of China and Japan.

One of the reasons leading to the success of the HSBC in trade finance was its willingness to adapt to the local environment. From the latter half of the 1870s, European importers began to import goods based on order from Japanese merchants, rather than based on prediction as in the former times. This business practice becomes more common in the 1880s. As the transactions were basically on cash basis and most of the Japanese merchants could not settle the payment for all the goods they ordered at one time, they would collect the goods and pay for that several times (Ishi 1984, pp. 205–6, 389). In the case of China, most of the goods imported based on sales prediction and Chinese merchants usually made payment in a 10 days' sight draft of native banks. Thus, the European importers in both China and Japan had to store the stock in a warehouse until it was collected or sold. Therefore, there was a time lag in receiving the proceeds of goods and making payment to the bank.

If the importers could dispose the imported goods before they settle the bills, it would certainly improve the cash flow of their business to a large extent. HSBC was very probably the first bank that was willing to take their own risk and allowed importers to do that while other banks including the Chartered Bank of India, Australia and China were reluctant to do that.[6] However, it seems that this business

[6]MP. In a letter from McLean to Jackson dated 17 December 1880, McLean wrote that, "I understand a good number of our customers get the goods into their own godowns." In the same letter, McLean mentioned about the measure taken by the Chartered Bank. "The Chartered has had some difficulty with J Batt & Co [exporter in Britain] & Melcher & Co [importer in Asia]. The latter want the goods in their own godown & say that the Hongkong Bank give them up. Gwyther [manager of Chartered Bank] won't do it unless John Batt & Co. authorize them & this they decline to do."

practice was eventually adopted by most of the international banks in the 1880s[7] and still existed by the end of 1890s.[8]

As international banks had to bear the exchange risk at the use of silver currency bills, they tried to hedge against exchange risk, by buying equivalent amounts of bills on London in Asia as cover when they bought silver bills in London. How did they secure their profit? In his letter to Jackson, McLean mentioned how the London Office set the exchange rate of the 60 days' sight bills.[9]

> "As a rule, we buy 60d/st at 2d. under your rate for 4 months private.
>
> £100@3s.6d. = $571.43 @ 3s.8d. 4m/st £104 15s. 3d.
>
> Allow
>
> 37 days out [delivery time for sending bills from London to Hong Kong]
>
> 37 days home [delivery time for sending bills from Hong Kong to London]
>
> 63 days for 60 days' bills to mature
>
> 123 days for 4 months' sight bills to mature
>
> 7 days extra
>
> Altogether 267 days @ 3 1/2% (rate for overdrafts last 6 months) = £ 2 11s. 3d.
>
> Stamp 1s.
>
> Profit £ 2 3s.
>
> 2.3 per cent net profit on the transaction.
>
> This estimate also applies to Singapore and Yokohama."

In other words, the exchange rate of the 60 days' sight silver currency bill quoted for every Mexican dollar was as a rule £.0.0083(=2d.) less than that of 4 months' documentary bill. When London Office purchased a 2 months' sight silver currency bill at $1 = £0.175(=3s.6d.) for £100, they would get $571.43. Simultaneously, Hong Kong Office would use this amount of money to purchase a 4 months' sight bill at $1 = £0.183(=3s.8d.), then they would get £104.76 (£104.15s. 3d). After

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[7] "Shanghai Manager letter with reference to allowing Merchants to store goods in their own godowns, and Resolved: that the Manager may at his discretion allow this to be done. It being understood that this facility is to be given to firms of undoubted character and good means only, and the working of the business to be carefully watched by the Manager" (4 April 1888, Minutes of Mercantile Bank, Board Minute Books, Mercantile Bank History, MB HIST2308.1-2308.5, HSBC Group Archives).

[8] As mentioned in the inspector's report on Yokohama branch of HSBC in 1896, "Bills Receivable: …you are aware that the goods against which the Bills are drawn given into the custody of the acceptor of the Bill on arrival in nearly every case. We have tried all we could to start neutral godowns but the scheme did not answer and the company in which the Bank was the largest shareholder has now been wound up. … We must insist on regular inspection of godowns and making Constituents pay into an Instalment Account the proceeds of any goods dispose of before the maturity of their acceptance. I think this rule is at present fairly adhered to and that with good supervision we do not run any great risk in thus parting with our property."(*Inspector's report on Yokohama Branch*, 9 January, 1896, HSBC Group Archives)

[9] MP. Letter from McLean to Jackson, 14 January 1885.

deducting the interest for 267 days (74 days for delivery of both bills, 186 days for both bills to mature and 7 extra days) at rate for overdrafts in the last six months and stamp duty, the net profit would be £2.15 (=£2.3s), i.e., the rate of net profit would be 2.15%. Although there were times that the London Office could not secure a £.0.0083 difference in quoting their exchange rate, the exchange rate of the 2 months' sight silver currency bill quoted was principally based on this rule during most of the 1880s. In addition to the 4 months' sight documentary bill, T.T. on London was also an option as cover of the 2 months' sight silver currency bill.

The depreciation of silver price affected Shanghai, where silver taels were used, more than places using Mexican dollars such as Hong Kong, Singapore and Yokohama in the latter half of 1886, a time marked by the vigorous fluctuation in the pricing of silver. For example, the difference of 60 days' sight bills on Shanghai and T.T. on London averaged £0.0053 for every Shanghai tael in the first six months of 1886, then it jumped to £0.0107 in the second half of the year, much larger than that of Hong Kong of the same period.[10]

All international banks did not align their policy in quoting the exchange rate of the 60 days' sight silver currency bill by 1886. While HSBC tried to use the same standard throughout the year, the other banks usually quoted an exchange rate more favorable to British exporters during the export season of Asian produce, a time when there was an export transaction corresponding to every import transaction. However, they may have not been willing to quote a rate, especially for bills on China, during off season of exports.[11] Thus, buying silver currency bills at exchange rate on the same standard throughout the year was very probably one of the key factors that led to the growth of HSBC's exchange business.

However, this business came to a turning point in the middle of 1880s.[12] With the sharp decline of silver price, whether the bank should continue to purchase silver currency bills in forward exchange or not had already been the subject of heated discussion among the management of HSBC from the end of 1884.[13] After a

[10]The average calculated was based on the data in Appendix IXof Royal Commission, 1887, Vol. XXII.

[11]McLean wrote to Jackson in a letter dated 17 December 1880, MP, "What I have told and impressed upon our customers is this. That we are always prepared to take their drafts at a fair difference, say 2d per $ or 2.5 d on Shanghai for 60 days sight under 4 months sight of the Bank's quotations and I consider it unfair to pass us when rates are low, to another bank who appears as purchaser when rates are tempting as they have been lately and which won't look at bills when rates are high in China and Japan." McLean mentioned the same thing in another letter to Jackson dated 2 April 1880, MP.

[12]For the loss of HSBC caused by the fall of silver in 1886, see Kitabayashi (1992), King (1987, pp. 319–321).

[13]In a letter to Jackson dated 14 January 1885, MP, McLean tried to persuade Jackson to continue forward purchase at London. He wrote that "with reference to our forward purchases of 60 days sight Bills on China and Japan. I would point out that we never give higher rates forward than those current for immediate delivery, and if the Branches interested will only buy a little each mail in excess of their immediate requirements, the profits on our purchase are at once secured…. The merchants find they cannot work their business unless they can settle the exchange forward so if we stop buying forward altogether the business will go to our neighbours."

while, both London Offices of HSBC and the Chartered Bank temporarily stopped to purchase forward silver currency bills in November and December of 1885, respectively.[14] In 1886, all British international banks operating in Asia changed their policy in exchange business from competition to cooperation among themselves. They gave up the hitherto way of quoting their own exchange rates on silver currency bills and fixed the rates weekly together. The agreement between the British international banks will be examined in detail in Sect. 4. This agreement could be considered to be one of the preconditions for making interest bills the sole form of export bills in the 1890s.

1.1.2 Interest Bills

At the time when silver currency bills were introduced, sterling bills also began to be used in financing exports trade to Asia in London. McLean wrote to Thomas Jackson in Hong Kong about interest bills in 1876 as follows. "Our outward business is falling off very much & with the other Banks too. Those that sold through the Banks have lost owing to the high rate this summer and many of the houses who drew are now financing on this side. Some are getting advances from our neighbors at 7% interest. Will it suit you and Cameron [manager of Shanghai branch] to make advances on this side at 7% interest payable at your sight drawing rate".[15] This was the first time that interest bills (also called advance bills) was mentioned in McLean's letter. Although both the terms "interest bills" or "advance bills" were not used there, they consisted of the characteristics of the so-called interest bills. That is (1) denominated in sterling, (2) an advance was provided to exporters in London, (3) was settled with bank draft on London at the exchange rate of the Asian ports.[16] Therefore, by the judgment of this author, the phrases like "the advances at 7%," "advancing business" used under the heading of "outward business" in McLean's correspondence will be interpreted as interest bills. International banks did not purchase interest bills in the same way as ordinary documentary bills. When an exporter drew an interest bill on an Asian importer, the London Office would usually advance money to the drawer of the bill. The bill, as the security of the advance, would be sent to the bank's Asian office for collection. When the bill is paid and the money has been received in London, the bank will settle with the bill drawer. In fact, the term "interest bill" had not been used even by the end of the 1880s. In the report of Royal Commission on Gold and Silver published in 1887, A.D. Provand, a merchant traded with China, explained export trade finance with interest bills as follows, "the banks make advances against

[14]On 6 November 1885, MP, McLean wrote to Jackson that "As a rule, we can always buy forward at the current rates. At the moment we are refusing all business on Hongkong for forward delivery which I think is a mistake." In regard to the forward business of the Chartered Bank, McLean wrote to Jackson that, "The Chartered is in a funk about Silver and won't buy forward as all the business has come our way" (Letter from McLean to Jackson, 24 December 1885, MP).

[15]Letter from McLean to Jackson, 27 October 1876, MP. The earliest interest bills used by Shanghai branch of Jardine Matheson & Co. was in April 1877 (Ishi 1998, p. 158).

[16]For the explanation of interest bills, see Nishimura et al. (2012, p. 65).

Table 3 Export bills in sterling purchased by the London Office of HSBC, 1884–1886 (Unit: £1,000)

Place of collection	1884				1886			
	Sterling (A)	Silver currencies	Total (B)	A/B (%)	Sterling (A)	Silver currencies	Total (B)	A/B (%)
Hongkong	538.0	490.0	1,028.0	52.3	371.2	735.7	1,106.9	33.5
Shanghai	1,222.0	345.0	1,567.0	78.0	550.0	1,206.0	1,756.0	31.3
Yokohama	483.0	535.0	1,018.0	47.4	267.7	908.8	1,176.5	22.8
Bombay	102.0	154.0	256.0	39.8	87.4	129.5	216.9	40.3
Calcutta	48.0	418.6	466.6	10.3	33.9	262.9	296.8	11.4
Total	2,393.0	1,942.6	4,335.6	55.2	1,310.2	3,242.9	4,552.2	28.8

Source Same as Table 1

shipments at 6 and 7% per annum, but in such cases the merchant runs the risk of the exchange which is taken at the rate current at the port of arrival in the East when the advance is paid off." In addition, he pointed out that "strictly speaking, the banks do not lend the money to the merchant?—Strictly speaking, they do not. It is an exchange, and not a loan transaction that takes place between them" (Royal Commission on gold and silver 1887, p. 167).

HSBC started to purchase interest bills not later than 1878. From then on, there was keen competition between international banks in buying interest bills. In order to finance exports of big firms such as Jardine Matheson Co., Turner & Co. and Melchers & Co., HSBC gave them better terms than exporters with less mean.[17] As a practical matter, to what extent was interest bills used? Table 3 shows that the ratio of interest bills to total exports finance of the London Office dropped from 55.2% in 1884 to 28.8% in 1886. Although silver currency bills went out of use and was superseded by interest bills in the 1890s (Kitabayashi 1987), the use of interest bills did not increase with time in the transitional period.

1.1.3 Profit of Export Trade Finance Business

How much profit did London Office gain from financing export trade? As shown in Table 4, the estimated net profit of exports trade finance of London Office contributed to nearly 20% of the net profit of HSBC. This estimate was based on McLean's method for calculation of the rate of profits.[18] The estimated net profit must be a realistic

[17]In his letter Jackson, 17 December 1880. McLean wrote that,"The Chartered Bank is bidding for China and Japan business at rates quite out of proportion to the current rates in China and Japan." In regard to the big firms, McLean wrote to Jackson that, "Melchers: I have arranged to do all the outward business @ 6%. The bills will bear interest @7% so you will please return the difference to Melchers or rather charge them 6%." (13 August 1880, MP). Moreover, arrangement with Jardine Matheson & Co. was mentioned in another letter (McLean to Jackson, 17 December 1880, MP).

[18]McLean to Jackson, 9 January 1885, MP.

Table 4 Profits of export finance business of the London Office, HSBC, 1884–1886 (in £1,000)

		1884	1886
Export bills in sterling	Annual purchased amount	2,393	1,310
	Profit (A)	34.9	19.1
Export bills in silver currencies	Annual purchased amount	2,175[a]	3,243
	Profit (B)	46.76	69.73
Total profit of export bills	(A) + (B) = (C)	81.66	88.83
Total expenditure of London Office	(D)	9.47	9.47
Net profit of London Office	(C) − (D) = (E)	72.19	79.36
Net profit of the HSBC	F	271.91	209.92
Share	E/F	26.55%	37.80%

Source Data for annual purchased amount of export bills in sterling as well as in silver currencies, same as Table 3. For method of profit calculation, McLean to Jackson, 9 January 1885, MP. According to McLean's method of calculation, in the case of export bills in sterling, the profit would be 3.5% per annum while in the case of export bills in silver currencies, the profit would be 2.15% of the amount purchased. Net profit of HSBC derived from King (1987, p. 313)
[a]The amount derived from subtracting the export bills in sterling from total bills purchased
[b]The amount of export bills purchased does not include bills on countries of South East Asia

figure as McLean wrote to Cameron in 1881 that, "next to the China loan business, the next best part of our profits come from the outward business, but this is now being cut into very much and before long the margins will have to be cut down. However, we shall do our best to keep them about present level".[19]

1.2 Import Trade Finance

Exports from Asia to Britain were financed with documentary bills. The bills purchased by branches and head office in Asia would immediately be sent to London Office for collection. The fund used for purchasing documentary bills in Japan and China included capital allotted to branches, deposits received locally, income obtained from the sale of T.T., and drafts drawn on London and other branches. Table 5 shows that, the total amount of bill receivables purchased by branches and head office in Asia increased to £20,472,000 in 1881, about three times of that of 1875, grew from 13% in 1875 to 41.9% in 1881 of the total imports from Asia to Britain. The number of bill receivables corresponds to this increase and shows the same trend of expansion. Considering the fact that a large part of the Asian trade with Europe and the USA was financed by London money market, it is difficult to estimate the accurate share of import trade financed by HSBC. Nevertheless, there is no doubt that by 1881 HSBC had grown to become a bank of great importance in Eastern exchange business.

[19]McLean to Jackson, 22 December 1881, MP.

Table 5 Import trade finance of the London Office, HSBC, 1875–1881 (in £1,000)

	Imports of Britain from Asia					Exchange business of London Office		
	China[a]	Japan	India[b]	Straits Settlement	Total (A)	Amount of Bills Receivables (B)	Number of Bill Receivables	B/A (%)
1875	14,810	378	34,518	3,149	52,855	6,861	5,897	13.00
1881	11,718	676	32,629	3,784	48,807	20,472	20,862	41.90

Source Data for Imports of UK from countries of Asia, Page (1919, pp. 108, 112). Data for exchange business of London Office, D. McLean to the board of directors, HSBC, 17 February 1882, MP
[a]including Hongkong
[b]including Ceylon

How did international banks quote exchange rate of 4 months' sight documentary bills? How profitable was this business? According to McLean, the exchange rate of documentary bills was principally based on that of T.T. on London. The latter rate linked directly with both the price of silver in London and the delivery cost of sending silver from London to Asia. For every £100 the gross profit could be obtained by deducting interest for 167 days of £100 to be paid and the stamp tax from the difference between purchasing 4 months' sight and selling T.T. on London with £100.[20] As indicated in Table 6, the difference between the exchange rate of T.T. on London and 4 months' sight documentary bills in Hong Kong dropped drastically in 1885, then maintained at a low level by 1888 and had a sudden rise in 1889. The margin between purchasing 4 months' sight and selling T.T. on London was very slim because of keen competition for obtaining exports bills between banks in the 1880s. Basing on the calculation method devised by McLean, for the ten years from 1880 to 1889, there were six years that HSBC might have incurred losses in the 1880s in exports bills business in Hong Kong. An increase in Bank Rate of the Bank of England would directly affect the amount of profit or loss in the operation.

The amount of the documentary bills purchased by Asian branches accounted for a large proportion of liquid assets of London Office. London Office had the options of discounting these bills at London discount market, holding these bills until they fall due, or using these bills as security to obtain advances from financial institutions in London. In any case, London Office had to establish a correspondent link to make use of the London money market.

2 Relationship with the Correspondent Bank

In February 1865, a few months before the commencement of business of the London Office, HSBC reached agreement with the London and Westminster Bank on the

[20]McLean to Jackson, 14 January 1885, MP.

Table 6 Estimated profit on exchange operation in financing export from Hong Kong to Britain

Year	T.T. on London in Hongkong (a) ($1 = x Pence)	4 months' sight bill in Hongkong (b) ($1 = x Pence)	Difference in selling (a) and buying (b) for £100[a] (c) (in £)	Bank rate of Britain[b] (%)	Interest and stamp duty for £100 (d) (£)	Estimated rate of profit (e) = (c) − (d)
1880	44.890	45.657	1.709	2.763	1.284	0.425
1881	44.372	45.048	1.523	3.503	1.614	−0.091
1882	44.461	45.274	1.829	4.138	1.898	−0.069
1883	43.540	44.267	1.67	3.563	1.641	−0.029
1884	43.784	44.524	1.69	2.448	1.143	0.547
1885	42.012	42.418	0.966	2.917	1.353	−0.387
1886	38.683	39.168	1.254	3.065	1.369	−0.115
1887	37.859	38.332	1.249	3.342	1.542	−0.293
1888	36.409	36.907	1.368	3.319	1.532	−0.164
1889	36.478	37.177	1.916	3.561	1.64	0.276

Source Data for T.T. on London and 4 months' sight bills in Hong Kong exchange market, Schneider et al. (1992, pp. 100, 107)
Data for Bank Rate, Nishimura (1980, pp. 440–441)
[a]The calculation based on the formula (c) = £100 × (1 − a/b)
[b]Yearly average

details of establishing corresponding banking relationship. The terms of the agreement were (1) the London and Westminster Bank (LWB) would accept bills drawn by HSBC up to a maximum of £500,000 covered by approved bank or mercantile paper at or under six months' sight, and an uncovered position of a further £100,000 for exceptional purposes or circumstances, (2) HSBC would keep on deposit a minimum balance of £10,000 without interest. Upon the termination of the agreement with the LWB, HSBC entered correspondent banking agreement with the London and County Bank (LCB) in December 1865. The terms of this agreement were more favorable to HSBC than the one with LWB as LCB would enlarge facilities granted and would accept bills drawn by HSBC up to £1,500,000 and £100,000 uncovered accommodation. However, HSBC was required to keep on deposit a minimum balance of £20,000 without interest (King 1987, pp. 99–101).

The enormous loss of the London Office led to the decision of setting up a London Consultative Committee in 1875. Newly appointed as manager of London Office, McLean exerted himself to set up the Committee. The Committee consisted of A. H. Phillpotts, a director of the LCB, E. F. Duncanson with T. A. Gibb and Co., and Albert Deacon, partner in E. A. Deacon and Co. (King 1987, pp. 100–1).

With the expansion of exchange business, HSBC and LCB changed their correspondent arrangements in April 1879. The limit of credit would then be increased to £2.5 million while the amount of uncovered accommodation would stay the same as before, i.e., £100,000, but could be increased by a further £100,000 for exceptional purpose (King 1987, pp. 100–1). Despite obtaining better credit facilities, HSBC

Table 7 Bills payable of the HSBC, 1876–1889

Year end	£ Equivalent in millions of HK$	£ Equivalent in millions of pounds	Exchange rate, $1 = £ y
1876	24.4	(5.08)	£0.2083
1877	24.7	(4.84)	£0.1958
1878	22.3	(4.09)	£0.1833
1879	20.3	(3.89)	£0.1958
1880	14.6	(2.68)	£0.1833
1881	15.4	(2.86)	£0.1854
1882	17.0	(3.05)	£0.1792
1883	16.0	(2.93)	£0.1833
1884	15.6	(2.76)	£0.1771
1885	20.8	(3.47)	£0.1667
1886	17.2	(2.83)	£0.1646
1887	16.8	(2.63)	£0.1563
1888	19.6	(2.98)	£0.1563
1889	17.3	(2.70)	£0.1563

Source Published accounts of the HSBC derived from King (1987, pp. 274, 290, 317, 432)

was not totally satisfied with the arrangements because the credit facilities were not enough to meet an increasing demand for fund. They made request to LCB repeatedly in order to get additional credit facilities.[21]

The financial devices used in settling international transactions underwent great changes with the development in telegraphic communications in the 1870s. T.T. came to take the place of drafts on banks. As shown in Table 7, the amount of drafts and bills at sight drawn by Asian branches on LCB and London Office decreased continually while the amount of T. T. drawn on London Office and the export bills purchases at London Office increased considerably from 1876 to 1889.[22] As a result, the London Office was constantly in an urgent need of funds.

One of the solutions for coping with the fund shortage problem was to obtain advances from LCB. The advances from LCB were of a short-term nature, mainly in the form of call loans. In January 1881, LCB agreed to advance HSBC to the extent of £250,000 against documentary bills to the limit of 95% of its face value at the Bank Rate.[23] With the increase in profit of HSBC, the credit line of advances was enlarged

[21]McLean to Morriss, 15 August 1879, MP.

[22]The total amount of payment on bank drafts and T.T. drawn by Asian branches and outward bills purchases increased from around £100,000 in September 1878 to £539,000 in December 1883 (McLean to Jackson, 7 December 1883, MP). McLean commented that, "London and County acceptances are down to £1,300,000. I think the day is not far distant when this mode of [business] will almost be done away with T.T. and short dated bills on London Office" (McLean to Jackson, 21 December 1880).

[23]McLean to Jackson, 21 December 1880, MP.

to £500,000 at the end of December 1882.[24] In July 1883, the two banks revised the agreement again, and the credit line was further increased to £750,000 (King 1987, p. 300). In addition to LCB, McLean also negotiated with other London banks such as London and Westminster Bank, Scottish Linen Bank for granting advances against documentary bills at Bank Rate in the early 1880s, but HSBC eventually preferred to do all the business with LCB alone.[25]

In 1880, following the suggestion of the LCB, HSBC established a reserve fund and deposited its securities at the former bank. About five years later, HSBC decided to set up another reserve fund, a special reserve fund that would be entirely separated from the one that set up at LCB and part of its securities were to be deposited with the Bank of England. This was likely to be an endeavor to weaken its dependence on the LCB.

3 Deposit-Taking Activities

"If they [deposits accepted in Britain] are sent out to the East and employed there in local advances, any sudden fall in silver might affect your profits considerably, but if the deposits are kept moving in outward and homeward remittances, there would be little or no danger on this score. All your silver deposits in the east could be employed in local advances and our sterling deposits available for sterling purposes".[26] D. McLean's policy of fund management of the bank meant that by keeping the balance of gold and silver assets and liabilities, at no time would the bank be seriously affected by the fluctuations and decline of silver. However, the success of this policy ultimately depended on the ability of the bank to obtain enough silver deposits in Asia as well as gold deposits in Europe.

Though the silver deposits were collected in Asia, most of the depositors were not local Asians, but both European and American trading firms and expatriates of the Treaty Ports. In other words, the better banking services it rendered was an important factor that led to its success. On the other hand, the London Office was the most important branch for obtaining gold deposits.

London office accepted both current deposits and fixed deposits. We will examine the current deposit first. As shown in Table 8, the amount of current deposits increased from £24,900 in 1875 to £93,200 in 1881 with the number of current deposit account increased from 150 to 400 respectively. Despite the considerable growth of current deposits, the amount of that dropped to 4.9% of the total deposits of the London Office.

In the same period, the London Office saw remarkable growth in its fixed deposit (see Table 9). The increase in amount was particularly significant between 1879 and

[24] McLean to Jackson, 29 December 1882, MP.

[25] Letters from McLean to Jackson dated 19 November 1880, 3 December 1880 and 20 November 1885, MP.

[26] McLean to Jackson, 30 June 1882, MP.

Table 8 Current deposits and overdrafts of the London Office, HSBC, 1875–1881 (in £1,000)

Year end	Current deposits	Overdrafts	No. of current accounts
1875	24.9	30.3	150
1881	93.2	111.2	400

Source D.McLean to the board of Directors, HSBC, 17 February 1882, MP

Table 9 Fixed deposits of London Office

Date	Fixed deposits of London Office		Total Deposits + Banknote		Share
	£ (a)	(HK$ Equivalent) (b)	HK$ (c)	(£ Equivalent)	b/c (%)
31 December 1875	266,000	(1,337,000)	13,410,000	2,668,000	9.9
30 April 1878	486,000	(2,535,000)	21,050,000	4,035,000	12.0
30 October 1878	510,000	(2,780,000)	24,490,000	4,493,000	11.4
24 December 1879	512,000	(2,668,000)	24,950,000	4,788,000	10.7
30 June 1881	1,372,000	(7,395,000)	31,920,000	5,922,000	23.2
31 December 1881	1,821,000	(9,815,000)	35,170,000	6,525,000	27.9
30 June 1882	2,143,000	(11,422,000)	37,740,000	7,080,000	30.2
2 December 1883	3,067,000	(16,715,000)	49,230,000	9,033,000	34.0
2 May 1884	2,687,000	(14,483,000)	49,620,000	9,206,000	29.2
17 May 1888	4,015,000	(27,800,000)	74,363,000	10,740,000	36.0

Source McLean to Jackson, 30 June 1882, MP, D. McLean to the Hongkong and Shanghai Banking Corporation Board of Directors, 17 February 1882, MP
(a) are the original figures shown in the correspondence. (b) are conversed with exchange rate shown in the published accounts of the HSBC

1883. The average amount of fixed deposit account grew from £1,080 to £1,380 while the number of these accounts grew from 247 to 1,547. As fixed deposit of the London Office grew at a faster rate than the total deposits of HSBC, its share of the total deposits was 10% in 1875 and reached 36% in June 1888.

The London Office relied heavily on the fixed deposits as working capital. The usual practice that depositors had to give a 12 months' notice in the case of cancelling the contract of fixed deposits suggested that the bank did not expose to the risk of sudden withdrawals. Fixed deposits were accepted at both London and Edinburgh. During the early 1880s, London Office offered 5% for 12 months' fixed deposits, and the interest rate was 0.5% higher than agency in Edinburgh. With the increase of fixed deposits accepted at London Office, the role of Edinburgh agency in receiving deposits became smaller and the Edinburgh operation eventually closed in the early 1880s.[27]

[27]McLean to Jackson, 3 November 1882, 27 November 1885. Also, King (1987, pp.154–155).

4 Cooperative Relations Between British International Banks

How far can we date back for cooperation between international banks operating in Asia for doing exchange business? The most well-known case for cooperation in exchange market is the reduction of the customary usance of sterling bills for exports from China and Japan from six to four months' sight after the crisis of 1866. As the newly established HSBC refused to join the agreement, the other banks were forced to return to the old system (Collis, 1965, p. 33). In 1878, HSBC eventually agreed to conform to the London banks' decision to shorten the usance of their sterling bills from six to four months' sight for China, Japan and the Straits Settlements and three months' sight for India (King, p. 291). However, agreement between international banks did not appear in David Mclean's correspondence until the early 1880s. He wrote in January 1881 that the meeting of the banks held at the Oriental Bank would discuss on the abolition of the habit of paying brokerage on all export bills.[28] In the letter from McLean to Cameron written in July that same year, McLean claimed that, "You may sneer at the Combination among the Eastern banks…".[29] We can infer that the cartel agreement between the banks was formed between late 1870s and early 1880s.

As we have seen in Sect. 1, the volatile changes in price of silver in the middle of the 1880s deteriorated the business environment in trade finance. Both HSBC and the Chartered was conscious about the exchange risk that their banks were exposed to with silver currency bills. Nevertheless, it is unknown when the silver currency bills cease to exist and when the interest bills became the sole export bills in financing exports from gold using countries. The transition is thought to have been taken place from the late 1880s to the early 1890s (Kitabayashi 1986). At any rate, the cooperation between international banks must have prompted this to happen.

The first thorough study on cartel agreement between London Offices of the international banks operating in Asia was made by Masao Yokouchi (Yokouchi 1996, pp. 151–185). He confirmed the existence of the formal organization of these banks by using a newly discovered written document drawn up at 1909 by Eastern exchange banks on agreement of rules regarding exchange business. He pointed out that the London bankers worked in accord in setting the interest rate for both fixed deposit of the London Offices and interest bills purchased by the banks.

Another document deposited at HSBC Group Archives showed that these Eastern Banks arranged a similar agreement in 1887. Table 10 shows the details of this agreement. There were 15 resolutions to be applied for branches or head offices in London and 3 rules to be recommended to the consideration of the branches of contracting banks in Asia. On the other hand, there were 26 clauses in the agreement of January 1909. If we compare the two agreements, we will find that agreement of 1909 included all the resolutions subject to business in London and rules recommended to the Asian

[28]McLean to Jackson, 7 January 1881 and 21 Jan 1881, MP.

[29]McLean to Cameron, 27 July 1882, MP.

Table 10 Agreement between Eastern banks in London (October, 1887)

	Resolutions agreed to at various times
1	The maximum brokerage to be paid on the sale of all Bills of Exchange, Interest Drafts Coupons. & Co.
2	The maximum brokerage to be paid on the sale of Indian Government Stocks
3	On the purchase of Indian Government Stocks, Bills of Exchange & Co., no brokerage shall be paid
4	The rate of discount to be allowed to the Drawees or Acceptors on all Documentary Bills retired before maturity
5	The buying rates for Bills on India, Burmah, and Ceylon are to be based on the minimum rate at which Council Bills are alloted each week
6	The minimum amount of reduction from the minimum rate of allotment in fixing the buying rate for 30 d/st bills on India, Burmah, and Ceylon
7	On each Wednesday, after the Tender for Council Bills, the Banks shall fix the maximum buying rates for Bills on other places by common agreement
8	Interest Drafts and Bills are fixed at the differences between the buying rates for Bills on the East at 30 d/st and at other terms
9	The buying rates for forward outward bills on all places in the East shall be not higher than the fixed current rates at time of purchase
10	The rates fixed for the purchase of bills on India, Burmah, and Ceylon, shall be binding for one week. The rates on other places may be changed by common agreement at any time
11	The foregoing rules regarding the buying rates for bills shall not be applicable either to Bank Bills or Indian Bills
12	Minimum commission to be charged for the simple collection of Bills and remittance of proceeds
13	Returns of all bills, or for documents without Bills, on India, Burmah, and Ceylon, on which advances are granted in London, must be in the Drafts of the Bank which made the advance
14	The rate of Interest to be allowed on Marginal Receipts
15	Bills of Lading hypothecated against Documentary Bills have to be accompanied by receipted Freight Notes
	Rules recommended to the consideration of the Eastern Agencies of the Contracting Banks
1	The time that Bills delivered to the Banks in the East to be paid for
2	That mixed bills shall not be bought at a uniform rate
3	That under all forward Contracts the time during which the Sellers shall have the power to deliver, shall be limited to a period of one month

Source Summary of Resolutions agreed to at various times by the Manager of Eastern Exchange Banks in London, and in force on October, 1887 (drafted by Chartered Bank), HSBC Group Archives

branches in agreement of 1887. Therefore, we can say that the agreement of 1887 formed the basis for the agreement of 1909. It implies that the mechanism of exchange business of these international banks did not undergo any significant changes in these two decades. Yet the contracting banks limited to British international banks in 1887, Comptoir d'Escompte de Paris, the only non-British international bank operating in

Asia did not participate.[30] On the other hand, the agreement of 1909 was contracted by both British international banks as well as non-British international banks. One of the plausible explanations is that the influence of non-British international banks was much stronger after 1900s and the agreement would not be effective without their participation.

The agreement between these international banks comes to a turning point in 1887. Firstly, they made a formal agreement. Secondly, they formed a cartel to prevent competition among them in setting price for bills of exchange, the core business of international banks. McLean mentioned in his letter dated 25 November 1887 that "all the Banks here arranged the rates for Council Bills & Outward Bills every Wednesday". The minutes of the Mercantile Bank Board of Directors meeting on 30 August 1887 also confirmed that the international banks were working in accord in determining the interest rate of advance bills.[31]

The cartel between banks was mainly subjected to business engaged in London. For the business transacted at trade ports in Asia, it was negotiated by respective managers working there. HSBC and Chartered Bank agreed to work in accord in London, the Straits and Hong Kong in the 1890s.[32] Although we know little about the details about the cartel agreement, undoubtedly the cooperation between these two banks had been extended to a larger area as time passed. This was likely to give rise to an oligopoly in the exchange market between Asia and the West.

5 Conclusion

One of the salient features of British international banking in Asia before 1914 is the strong financial linkage between Asia and London. With the development of global telegraph communications and the continued fall of silver, how to control exchange risk and maintain a smooth flow of funds were challenging issues for international banks in the 1870s and 1880s. The development of the London Office of HSBC showed the path of how HSBC coped with these problems.

Firstly, it saw a remarkable growth between 1875 and 1881 in both foreign exchange and deposit-taking business. The expansion of exchange business proved the conventional view that HSBC took away much of the exchange business from other international banks operating in Asia when their business had deteriorated and indicated that HSBC was in a more advantageous position in dealing with the fall of

[30] McLean to Jackson, 25 November 1887, MP.

[31] "The Hongkong and Shanghai Bank and National Bank of India having given notice that they are prepared to advance on goods outwards at 6%, returns being made in their Bank's Bills, it was Resolved: that this Bank should follow their action in this matter" (Minutes of Mercantile Bank, 30 August 1887, HSBC Group Archives).

[32] H. M. Bevis, manager of Shanghai branch, wrote to David Jackson, manager of Yokohama branch of the HSBC, in a letter dated 27 January 1896, that, "…that the Chartered Bank and ourselves are working in accord in the Straits, we also do so in London and Hongkong, so I think it will be to our mutual advantage if we can arrange to do so in Japan" (Shg 72, HSBC, Group Archives).

silver. Secondly, export bills purchased in Asia increased at a faster rate than those purchased in London as the annual bill receivables increased three times while the annual bills purchased increased only two times between 1875 to 1881. A possible explanation for this is that HSBC faced more competition in London than in Asia, probably because of the higher profitability in the former market. The competition among banks in London may explain why both silver currency bills and interest bills were used in parallel in export trade finance. Despite of the bank's consistent efforts in hedging exchange risks, it was difficult to avoid that completely, particularly, at times when silver price fluctuated violently. This eventually led to the formation of a cartel by international banks and that as a matter of course paved the way for prompting interest bills to be the sole export bills used. This enabled the banks to shift the exchange risk from the banks to importers in Asia and maintained the stability of their business. Finally, it is noteworthy that the access to City of London enabled London Office to respond to the increase demand for funds brought by the changing environment of exchange business.

By the end of the 1880s, HSBC has established an unwavering position in international capital movement between East Asia and Britain with the pivotal role being played by the London Office. It financed about 40% of imports of Britain from Asia in 1881. On the other hand, in regard of exports from Britain to Asia, it financed more than 30% of those to China and more than 40% of those to Japan. Consider the fact that London Office also supervise the operations of other branches in Europe and the USA, it could be said that the financial services provided by the London Office was indispensable for the development of trade between Asia and the West.

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