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The rise of international financial centres after the breakdown of Bretton Woods: The case of Bahrain, 1966-1986

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Résumé

Le développement des centres financiers internationaux depuis la fin du système Bretton Woods: le cas de Bahreïn, 1966-1986

Cet article analyse le développement de Bahreïn en tant que centre financier international dans les années 1970 et 1980. L'article analyse d'abord les raisons qui permettent d'expliquer le développement soudain et spectaculaire de Bahreïn en tant que centre financier international. Ensuite il étudie jusqu'à quel point Bahreïn est un centre de dimension réellement internationale, en particulier comparé à Beyrouth et Singapour. Finalement, l'article analyse les raisons qui peuvent expliquer pourquoi aucune crise bancaire ne s'est développée sur l'île, malgré un développement financier rapide qui aurait pu laisser penser à la formation de bulles spéculatives.

Mots-clés : Bahreïn - Beyrouth - Singapour - Centre financier international - Offshore Banking.

Abstract

This article focuses on the development of Bahrain as an international financial centre in 1970s and 1980s. The article first analyses the reasons that contribute to explain the sudden and spectacular rise of Bahrain as an international financial centre. Then it moves to scrutinise the extent to which Bahrain's rise was truly international in scope especially compared to Beirut and Singapore. Finally, the article reflects on the reasons why no banking crisis occurred on the island, in spite of a rapid financial development which could have signalled the growth of a banking bubble.

Keywords : Bahrain – Beirut – Singapore – International Financial Centre – Offshore Banking.

Introduction

Among the places in the world where commercial banks developed their activities from the 1960s and 1970s, the Middle East represents a revealing case study.² In terms of banking

¹ The author would like to thank the participants to the University of Stirling's banking history workshop and the University of Glasgow's Adam Smith Business School International Business and Enterprise cluster for their comments on earlier versions of this paper, as well as the three anonymous referees

² Henry Laurens, *Paix et guerre au Moyen-Orient : l'Orient arabe et le monde de 1945 à nos jours*, Colin, 2005, Roger Owen and Sevket Pamuk, *A History of Middle East Economies in the Twentieth Century*, Harvard

opportunities, the region had clear strengths: it was oil-rich, it was developing, and its geographical situation was an advantage, between the East and the West. But it also had clear weaknesses: the region was prone to armed conflicts, the economic development was only slowly taking off, and the local banking traditions were fairly recent.

Within the Middle Eastern region, the case of Bahrain stood out as a nearly flawless success story, for three main reasons. First, Bahrain suddenly took off from scratch as an international financial centre (IFC) in the second half of the 1970s. Bahrain was a British protectorate from the late nineteenth century until the island declared its independence in 1971. As one representative from the Société Générale in Bahrain put it in 1977, “it was surprising how quickly the world became aware of the existence of the new market in Bahrain and how ready it was to deal with Bahrain.”³ Second, during its rise, Bahrain did not go through any major banking crisis. One could have expected that the sudden rise of Bahrain hid a bubble that would sooner or later burst. Quite the contrary, the island established itself firmly as a respected IFC. Third, Bahrain’s rise placed it very quickly among the leading international financial centres. As early as in 1977, *The Banker* wrote that “if the present growth rate continues it should soon rank on a par with Singapore.”⁴ Mohamed Finaish, member of the IMF’s Executive Board, noted in 1982 that “Bahrain now ranks third among the world’s offshore banking centers, accounting for close to 15 per cent of the total business.”⁵

This article will try to explain this sudden rise, and situate Bahrain within the wider list of regional and international financial centres. Research for this article relies on a wide range of international archives from leading commercial banks, including Société Générale, HSBC/Midland, and Barclays, as well as the archives of the International Monetary Fund.⁶ First, the article looks into the factors that can explain the specific development of Bahrain instead of other financial centres in the Middle East region. Second, it gauges the place of Bahrain in comparison to other IFCs, by looking at its degree of internationalisation, and the size and nature of the banking activities carried out on the island. Finally, it focuses on the reasons explaining the absence of a banking crisis in Bahrain after such a sudden rise to the IFC status.

1. Financial globalisation and international financial centres

The literature on financial globalisation – understood as the development of global links through cross-border financial flows – largely focuses on the role played by international

University Press, 1999, Alan Richards and John Waterbury, *A Political Economy of the Middle East*, Westview Press, 2007.

³ Archives historiques de la Société Générale (hereafter AHSG), 81116, Société Générale, Bahrain Branch, February 1977.

⁴ “Bahrain’s banking boom,” *The Banker*, January 1977.

⁵ Archives of the International Monetary Fund (hereafter AIMF), 09331/8, IMF, Minutes of Executive Board Meeting 82/77, 6 July 1982

⁶ Part of the research for this article was funded by the UK Economic and Social Research Council [RES-062-23-2423].

institutions and national governments in the process. Jeffrey Chwieroth thus focused on the role of the International Monetary Fund (IMF), while Rawi Abdellal concentrated on the actions of French civil servants.⁷ As these studies concentrate on international institutions, they tend to overlook the role played by the evolution of local regulatory frameworks that could favour the establishment of banks in new offshore centres. Edoardo Altamura recently delved into the dramatic expansion of commercial banks in the 1970s and 1980s, but does not explore in detail the case of offshore centres in the Middle East⁸. Some pioneering studies on financial centres, such as Charles Kindleberger (1974) and Howard Reed (1981), have been published at a time when Bahrain was only emerging as a financial centre, and as a consequence could not take the rise of the island into account.⁹ Youssef Cassis delves into the world's most important financial centres of which Bahrain is not part.¹⁰ Catherine Schenk also looks at the rise of international financial centres during a period preceding the rise of Bahrain.¹¹ Only one article specifically looks into the rise of Bahrain as an IFC. The article highlights the importance that the new legislations on Offshore Banking Units played in the development of Bahrain's financial centre. The authors are two IMF economists who did not use archival material.¹²

Several definitions exist as to what exactly constitutes a 'financial centre.' Reed defines a financial centre as a "central [place] where financial transactions are cleared and coordinated,"¹³ while Choi, Tschoegl, and Yu talk of "a marketplace for financial services."¹⁴ Brealey and Kaplanis define "a centre as one in which foreign banks locate in order to access the centre's capital markets rather than to support bilateral trade."¹⁵ This article will use a broad definition of what constitutes a financial centre. The above-mentioned definitions point to the fact that a financial centre is a clearly delimited geographical entity where a range of financial services are performed.

⁷ Jeffrey Chwieroth, *Capital Ideas: The IMF and the Rise of Financial Liberalization* (Princeton: Princeton University Press, 2010), and Rawi Abdellal, *Capital Rules: The Construction of Global Finance* (Cambridge: Harvard University Press, 2007). See the discussion on Rawi Abdellal's book at the end of this special issue.

⁸ Carlo Edoardo Altamura, *European Banks and the Rise of International Finance : the Post-Bretton Woods Era* (Abingdon : Routledge, 2017).

⁹ Charles Kindleberger, *The Formation of Financial Centers: A Study in Comparative Economic History* (Princeton, N.J.: International Finance Section, Princeton University, 1974), Howard C. Reed, *The Preeminence of International Financial Centers*, Praeger (New York, 1981)

¹⁰ Youssef Cassis, *Capitals of Capital: the Rise and Fall of International Financial Centres*, Cambridge University Press, 2010. See also Youssef Cassis' contribution in this special issue.

¹¹ Catherine Schenk, "International Financial Centres, 1958-1971: Competitiveness and Complementarity," in Stefano Battilossi and Youssef Cassis (eds), *European Banks and the American Challenge: Competition and Coordination in International Banking under Bretton Woods* (Oxford: Oxford University Press, 2002), pp.74-102.

¹² A.S. Gerakis and O. Roncesvalles, "Bahrain's Offshore Banking Center," *Economic Development & Cultural Change*, 31:2, January 1983, pp.271-293.

¹³ Howard C. Reed, "The Ascent of Tokyo as an International Financial Centre," *Journal of International Business Studies*, 11:3, 1980, p.20.

¹⁴ Sang-Rim Choi, Adrian E. Tschoegl, and Chwo-Ming Yu, "Banks and the World's Major Financial Centers, 1970-1980," *Weltwirtschaftliches Archiv*, 122:1, March 1986, p.52.

¹⁵ R.A. Brealey and E. Kaplanis, *The Growth and Structure of International Banking* (London Business School, July 1994), p.36.

The literature provides different rankings of IFCs. Those rankings present stark differences as regards the place of Bahrain. For instance, Reed's analyses 76 cities in 40 countries over the period 1900-1980, and provides a detailed ranking of financial centres across the globe.¹⁶ Reed ranks Bahrain 48th. But Joël Métais, using a different methodology, places Bahrain at the 9th place.¹⁷ Choi, Tschoegl and Yu also analysed the world's major financial centres and the decision of foreign banks to establish themselves abroad.¹⁸ Interestingly – and highlighting the peculiarity of Bahrain in the range of IFCs – the authors acknowledge that “the model will not work well for centers such as Bahrain where attractiveness may be a function of time zone and proximity to other economies, even though the center's own economy may be quite small.”¹⁹ Another way of ranking IFCs is to draw a broad typology of financial centres. Geoffrey Jones thus provides an alternative model by identifying three types of financial centres: type A (sub-regional), type B (regional) and type C (global centres). In the period 1975 to present, Jones ranks Bahrain (along with Singapore, Hong Kong and Sydney) as a “type B” centre.²⁰

In sum, the situation of Bahrain is peculiar, and little studied, among the various IFCs. A central task of this article is therefore to clarify Bahrain's situation, and identify the circumstances explaining the island's rise to the IFC status.

2. Explaining the rise of Bahrain as an international financial centre

Before turning to the specific case of Bahrain, it is worth explaining why the wider Middle East region became an attractive setting for the development of banking activities from the 1970s. An envoy from the British bank Barclays who travelled to the Middle East in 1977 summarised very well the factors that made this region attractive:

“I remain convinced of the desirability of expansion into the Middle East, to take advantage of the phenomenal economic progress which is being made under the stimulus of oil money and in spite of wars. (...) The context is difficult sometimes to grasp. Huge cities have grown up out of nothing and unimaginable fortunes have been made in the process. Absurd conversations take place in millions, quite ordinary bazaar merchants, who in Africa would be lucky to end a lifetime of toil behind the counter with £100,000 salted away, here negligently let slip that they have £10 million to invest in Europe, or that rents are currently bringing in £120,000 a month.”²¹

Several other visits from Western European bankers similarly noted that the region faced both a shortage of banking expertise, and a need to provide financial services to invest the oil

¹⁶ Reed, “The Ascent of Tokyo”; Howard C. Reed, *The Preeminence of International Financial Centers*, Praeger (New York, 1981).

¹⁷ Reed, *The Preeminence*, p.40.

¹⁸ Choi, Tschoegl, and Yu, “Banks and the World's Major Financial Centers.”

¹⁹ *Ibid.*, 62.

²⁰ Geoffrey Jones, “International Financial Centres in Asia, the Middle East and Australia: A Historical Perspective,” in Youssef Cassis (ed), *Finance and Financiers in European History 1880-1960* (Cambridge: Cambridge University Press, 1991), p.412.

²¹ Barclays Group Archive (hereafter BGA), 1417/006, JPGW, Visit to the Middle East, Oct. 1977, 17 October 1977.

surpluses.²² Further to this, statistical advisor to the IMF Pani noted that “the sentiment that Arab surplus finance should be managed by institutions in the region with strong Arab interest, gave rise to the creation of banks with ownership by Arab public (Government) and private sectors.”²³ Having an Arab centre to deal with Arab surplus finances would therefore be an advantage. The need for financial services in the region developed against the background of Western banks looking for new opportunities in the 1970s.²⁴

Why, among various financial centres of the Middle East region, was Bahrain picked up as a priority destination for expansion? In his history of financial centres, Youssef Cassis provides a broad list of the major elements needed for a financial centre to succeed: “for a financial centre, what really matters is the liquidity and efficiency of the markets; the diversity and complementarity of financial activities; professional services (primarily legal and accounting); technological expertise; workforce skills; and, arguably above all, access to high quality information.”²⁵ Bahrain’s success is easily explained by the fact that it filled in all these criteria.

A favourable regulatory environment

First and foremost, the development of a favourable regulatory environment for financial services was paramount in the success of Bahrain to attract international banks. So-called ‘Offshore Banking Units’, or OBUs, lie at the heart of Bahrain’s successful expansion as an international financial centre. In September 1975, the Bahrain Monetary Agency announced the OBU scheme and invited international banks to apply to create such units. The British Midland Bank International defined an OBU as “essentially an operating branch, undertaking a full range of wholesale services, with the exception of the provision of facilities to local residents other than the government and its agencies.”²⁶

The objective of these OBUs was clear: to provide a clear, but lax regulatory framework in order to attract major international banks. Having simple and straightforward regulations was clearly one of the key selling points of the Bahraini authorities. *The Banker* thus reported in 1977 that the OBUs’ rules and regulations were “contained on a single sheet of notepaper.”²⁷ The Barclays representative thus noted in 1977 that “Bahrain could develop in due course as

²² “Oil surpluses” refer to the surplus funds generated by the rise in oil prices among Organisation of the Petroleum Exporting Countries (OPEC) after the 1973 oil shock. See for instance Elisabetta Bini, Giuliano Garavini, and Federico Romero (eds), *Oil Shock: the 1973 Crisis and its Economic Legacy*, IB Tauris, 2016.

²³ AIMEF, 02093/5, Pani to Leite, Bahrain – An International Financial Centre, 5 February 1987

²⁴ Alfred Slager, *The internationalization of banks: patterns, strategies and performance* (Houndmills: Palgrave Macmillan, 2006); Altamura, *European Banks*.

²⁵ Youssef Cassis, *Capitals of capital: a history of international financial centres, 1780-2005* (Cambridge: Cambridge University Press, 2006), 2; et son article dans le présent numéro.

²⁶ HSBC Archives (hereafter HSBCA), Midland Bank International Division papers, Head office, UK 0200/0760d, Report to the Chairman’s policy committee from G. W. Taylor, Middle East representation, a group representative office and an off-shore banking unit in Bahrain, 4 May 1976.

²⁷ “Bahrain’s banking boom,” *The Banker*, January 1977.

another link in the chain of tax havens.”²⁸ In noting that the Barclays branch was profitable, another Barclays representative explained about five years later, in 1982, that “particularly valuable [was] the fact that there is so much potential for off balance sheet earnings.”²⁹ As a consequence of this new and favourable regulatory environment, the number of OBUs rose from 26 in 1976 to 74 in 1984.³⁰

Bahraini authorities also aimed to keep the OBU system simple for themselves. Bahraini authorities carefully granted OBU status to the major international banks only, and insisted on OBUs having the status of a branch. Branch status meant that the parent bank was keeping full legal responsibility, and as a consequence that the BMA would not have to supervise them, nor to bail them out in case they run in trouble.³¹

In line with the idea that the Bahraini authorities did not want just ‘postboxes’ in its financial centre, they made clear that they wanted OBU businesses to start as soon as possible after their being granted the license. The British bank Midland thus reported that “the Bahraini authorities have stated that (...) those banks that have received licences should be prepared to begin business within, say, one year or they might have the permission withdrawn.”³² In turn, the quick establishment and success of branches of the world’s leading banks contributed to give much credibility, and stability, to the OBU scheme and Bahrain as a brand new IFC. The French bank Société Générale noted this in reporting that “Undoubtedly, the already good reputation of Société Générale throughout the world helped overcome any hesitation our counterparts may have had in dealing with a new and untried centre.”³³

A good geographical position

Second, Bahrain’s geographical position proved to be an important asset in its rise to the IFC status. Within a region that needed financial services, Bahrain indeed occupies a strategic location. Bahrain is situated in a convenient time-zone, completing a global circle of financial centres. A Barclays representative noted that “Bahrain has the best telephone and telex communications in the Gulf area and good international air links, which make it, at present, a natural centre for a dealing operation midway between the South East Asian and European time zones”³⁴ In foreign exchange, dealings start operating after Singapore closes but before European centres open. The same Barclays representative in Bahrain thus reported in 1979 that “our own Tokyo Branch soon began to avail itself of our services and our deposits with them were at \$47.1 million by the end of May [1976] and had risen to \$121.85 million as at

²⁸ BGA, 1417/006, JPGW, Note to Thomson, Visit to Bahrain July, 1977, 25 July 1977.

²⁹ BGA, 1417/006, JPG Wathen, Visit to Bahrain, March 1982, 10 March 1982.

³⁰ AIMF, 02093/5, Pani to Leite, Bahrain – An International Financial Centre, 5 February 1987

³¹ “Bahrain’s banking boom,” *The Banker*, January 1977.

³² HSBGA, Midland Bank International Division papers, Head office, UK 0200/0760d, Report to the Chairman’s policy committee from G. W. Taylor, Middle East representation, a group representative office and an off-shore banking unit in Bahrain, 4 May 1976.

³³ AHSG, 81116, Société Générale, Bahrain Branch, February 1977.

³⁴ BGA, 80/3431, Mr G.A.O. Thomson’s visit to Bahrain, Sharjah, Abu Dhabi, Dubai and Cairo, 8th-21st March 1976.

the 31.12.76.”³⁵ Bahrain’s location is also very convenient within the Middle East region: it is close to the shore of Saudi Arabia in the middle of the Gulf. The Midland representative in Bahrain explained that “It is thought practicable for our representative to cover the whole of the Gulf area from Bahrain, spending a few days each month visiting the four or five major centres.”³⁶

The weaknesses of regional competitors

Third, the rise of Bahrain is also partly explained by the lack of regional competitors. This lack of regional competitors comes from two main reasons: the decline of some well-established international financial centres (Beirut, Cairo), and the structural weaknesses of other financial centres (Abu Dhabi, Kuwait, Qatar). The decline of Beirut as an international financial centre and the rise of Bahrain were, however, coincidental. Bahraini authorities had been thinking for a few months already about developing the island’s potential as a banking centre, and Beirut’s decline occurred unexpectedly at the same time.

From 1975, the civil war that broke out in Lebanon led many international banks to reduce their financial activities, or move out of the country. As the Midland representative reports “This [establishment of a group representative office in Beirut in May 1975] proved highly successful for a very brief period but the political disturbances in the Lebanon caused us to have to close the office later in that year.”³⁷ But the same Midland representative further explains that “For several months before the Lebanese problem began, the authorities in Bahrain had been reviewing, with the help of British expertise, its potential as a financial centre. The enforced departure from Beirut, therefore, fortuitously helped to validate the thinking that Bahrain could be developed into an international money centre and the principle of off-shore banking units was announced towards the end of last year.”³⁸ Major international banks were in need of a new representative office, and Bahrain provided the most satisfactory alternative. Kuwait and Qatar did not allow the setting up of foreign banks. The United Arab Emirates did not represent a satisfactory option either. The Barclays representative noted that “We know that the UAE is heavily over-banked and we will face extremely slow growth prospects in the commercial banking sector.”³⁹ No other financial centre in the region in the 1970s therefore seemed able to compete with Bahrain.

A favourable economic and political local environment

³⁵ AHSG, 81116, Société Générale, Bahrain Branch, February 1977.

³⁶ HSBCA, Midland Bank International Division papers, Head office, UK 0200/0760d, Report to the Chairman’s policy committee from G. W. Taylor, Middle East representation, a group representative office and an off-shore banking unit in Bahrain, 4 May 1976.

³⁷ HSBCA, Midland Bank International Division papers, Head office, UK 0200/0760d, Report to the Chairman’s policy committee from G. W. Taylor, Middle East representation, a group representative office and an off-shore banking unit in Bahrain, 4 May 1976.

³⁸ HSBCA, Midland Bank International Division papers, Head office, UK 0200/0760d, Report to the Chairman’s policy committee from G. W. Taylor, Middle East representation, a group representative office and an off-shore banking unit in Bahrain, 4 May 1976.

³⁹ BGA, 80/172, D.L.J. to Probert, UAE – the options, 17 April 1979.

Finally, Bahrain offered nearly ideal local conditions for the development of banking services. First, regardless of the nature of the political regime in Bahrain, the political situation was considered to be stable, in particular thanks to close links between the Bahraini and Saudi royal families. The Barclays representative explained: “It would seem that the majority of Bahrainis feel little concern about the lack of a National Assembly, suspended by the Emir in 1975 as a reaction to the disruptive methods employed by a small number of radical members. (...) Furthermore, the friendly relationship between the Khalifa family and the Royal House of Saud is an important factor in sustaining the stability and prosperity of Bahrain.”⁴⁰

Second, the cost of office buildings was considered to be reasonable compared to London and the rest of Europe. The Midland representative reported that “Naturally, in an area as small as Bahrain, the rapid influx of banks has created a shortage of accommodation and property prices and related costs have escalated. However, suitable premises could be taken at an acceptable rental which would require capital expenditure on fixtures and fittings of about £60,000. Aggregate annual running costs of the office are estimated at £130,000, compared with an equivalent figure for Beirut of £110,000.”⁴¹

Third, unlike other countries in the region, Bahrain was not already rich and looking for more prestige. Bahraini authorities saw their future as a service centre for the Gulf region, and OBUs fitted well within this wider project. A Barclays report on the situation in Bahrain reflected this well in noting that “Compared with other countries in the Gulf region the process of economic diversification has already reached an advanced stage in Bahrain.”⁴² The Bahraini economy relied on oil refining (small and steadily declining), aluminium, ship repairing, and trade. The Bahraini authorities wished to diversify Bahrain’s economy. Financial services were therefore given a prominent role as oil revenues began declining to start preparing Bahrain for the post-oil era. The share of the oil sector in GDP fell from 40% to less than 20% during the 1970s.⁴³

A combination of all these four factors together – OBU legislation, geography, weak competitors, and business environment – allows to explain the successful rise of Bahrain as an international financial centre from the mid-1970s. If the OBU legislation obviously stands out in this list, it is nonetheless difficult to single out one factor among all four. For instance, the OBU legislation would not have worked without the presence of a stable political situation in Bahrain, or without the weaknesses of regional competitors.

3. Characterising and quantifying the rise of Bahrain as an international financial centre

⁴⁰ BGA, 80/6112, Basic data for Bahrain, 1979.

⁴¹ HSBCA, Midland Bank International Division papers, Head office, UK 0200/0760d, Report to the Chairman’s policy committee from G. W. Taylor, Middle East representation, a group representative office and an off-shore banking unit in Bahrain, 4 May 1976.

⁴² BGA, 80/6112, Basic data for Bahrain, 1979.

⁴³ AIMF, 09331/8, IMF, Minutes of Executive Board Meeting 82/77, 6 July 1982

If Bahrain developed suddenly and quickly as a financial centre, the scope of this expansion deserves a closer analysis. Several indicators can be used to characterise and quantify the rise of Bahrain as an international financial centre.

Banking presence in Bahrain

First, the statistics about banking presence presented in *The Bankers’ Almanac* provide a good indication about the rise in the number of financial institutions in Bahrain, as well as the chronological span.⁴⁴ Figure 1 shows the number of banks (branches and representative offices) established in Bahrain, from 1965 to 1995. The table highlights a clear acceleration in the establishment of banks from the late 1970s, until the trend reaches a plateau in the late 1980s and declines slowly. In the mid- to late 1960s, Bahrain counted only four banks, and it reached the 100 banks mark in 1984. The number of banks steadily increased between 1970 and 1976, with two to four new banks establishing their presence in Bahrain per year. From 1976, the rise became spectacular, with, on average, ten new banks per year until 1984.

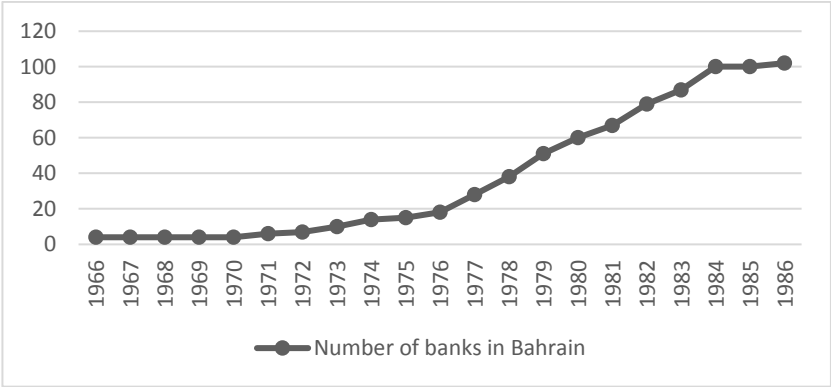


Figure 1 – Number of banks in Bahrain, 1966-1986
 (source: author’s calculation based on *The Bankers’ Almanac*)

The number of banks present in Bahrain is only an indicator of its rise as a financial centre. The extent to which Bahrain can be described as ‘international’ depends on the presence of non-Bahraini banks in Bahrain. Out of all banks present in Bahrain, Figure 2 shows that the vast majority of them (close to 95%) were international. The establishment of international banks in Bahrain thus clearly explains the internationalisation of Bahrain as a marketplace for financial services.

⁴⁴ *The Bankers’ Almanac* is a yearly publication compiling essential banking information on the worlds’ banks.

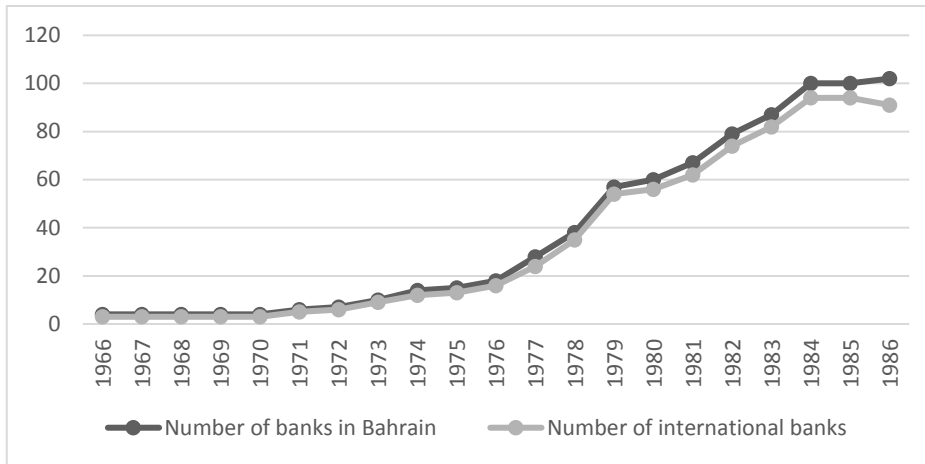


Figure 2 – Local vs. international banks in Bahrain, 1966-1986
(source: author's calculation based on *The Bankers' Almanac*)

Where did these banks come from? Figure 3 shows that Western European banks were particularly dynamic in developing their presence in Bahrain. In 1977, when the establishment of big international banks really started, five of them came from the US, two from France, five from the UK, and one from Germany. In 1984, when Bahrain reached the symbolic mark of 100 banks, 16 came from Japan, 16 from the US, 7 from France, 10 from the UK, 3 from Germany, and 2 from Italy. While US banks have developed their presence progressively in Bahrain from the early 1970s, Japanese banks really started their expansion on the island a decade later. For the 1978-1980 period, the Bank of Tokyo was the only Japanese bank established in Bahrain⁴⁵. In 1981, the Nippon Credit Bank opened a Representative Office. The number of Japanese banks in Bahrain more than tripled in 1982 (7 banks), and doubled again in 1983 (14 banks), to reach the same number as US financial establishments the following year (16 banks in 1984).

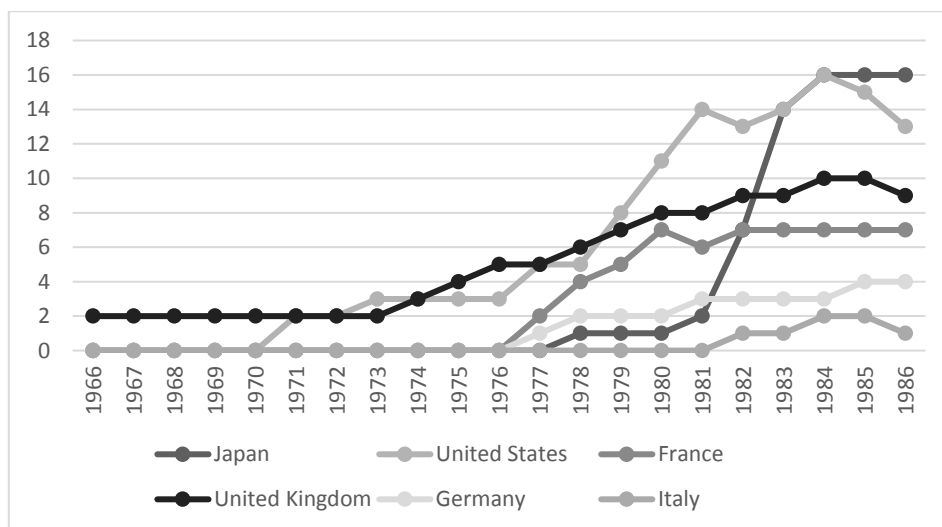


Figure 3 – Breakdown of international banks present in Bahrain by country of origin, 1966-1986

⁴⁵ On the Bank of Tokyo, see Kazuhiko Yago's article in this special issue.

(source: author's calculations based on the *Bankers' Almanac*)

The banking sector in Bahrain compared to the other financial centres

Where did Bahrain stand among other international financial centres? The *Bankers' Almanac's* statistics about banking presence in the world help compare and contrast the case of Bahrain with other major financial marketplaces. In particular, this data contribute to put in perspective Bahrain with the financial centre it would have replaced in the Middle East, namely Beirut, and with the financial centre it would have come close to, namely Singapore.

Figure 3 shows the evolution of local and international banking presence in Bahrain and Beirut. The data shows a very neat phenomenon of 'catch up' between Bahrain and Beirut, happening in 1982-1983, when the number of banks in Bahrain overcame the number of banks in Beirut. Contrary to what was perceived at the time, the table below does not reveal a real decline of Beirut as a financial centre due to the outbreak of the civil war. If the table shows a slight decline between 1976 and 1978 – the number of banks went from the 1976 peak of 89 to 80 in 1978 – the overall number of banks remained relatively stable throughout the period, although a steady but slow decline is noticeable (down to 74 banks in 1985). It is also noticeable that the proportion of international banks in the total number of banks present in Beirut remained very stable throughout the period. In sum, Beirut declined, but very slowly, and not in its international dimension.

Contrasting with Beirut's slow decline was Bahrain's rapid development. It took overall less than ten years for Bahrain to move from a non-financial centre to an international financial centre with a greater number of international banks than its Lebanese counterpart.

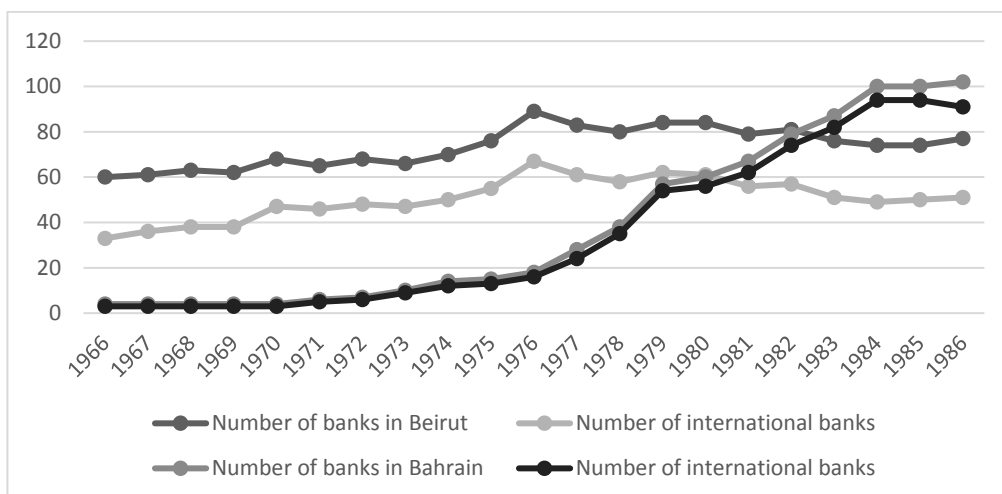


Figure 3 – Number of local banks vs. international banks in Bahrain and Beirut, 1966-1986
(source: author's calculation based on *The Bankers' Almanac*)

The development of Bahrain as an international financial centre was often said to be at a rate that would soon place the island on a par with Singapore.⁴⁶ In late 1978, the total assets of Bahrain’s financial establishments amounted to 23,4 billion dollars, while in Singapore, at the same moment, the total was of 27 billion dollars.⁴⁷ Figure 4 below shows the number of banks in Singapore and in Bahrain. The growth trends are strikingly parallel. Singapore has been faster in its early development in the 1970s, and did not start from nothing as Bahrain. Most importantly, the table shows that Bahrain came nowhere near to Singapore in terms of size, at least based on the indicator of the number of banks present in the financial centre. During the period studied, Singapore was nearly twice bigger the size of Bahrain.

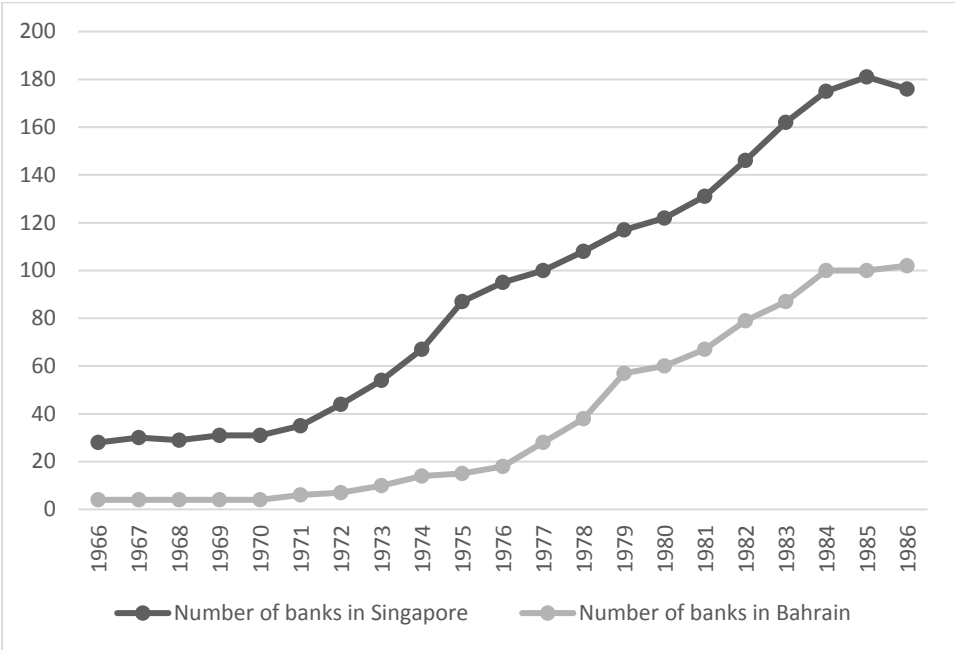


Figure 4 – Number of banks in Bahrain and Singapore, 1966-1986 (source: author’s calculation based on *The Bankers’ Almanac*)

As early as in 1977, however, a note to the IMF Managing Director Johannes Witteveen was already reporting that “some banking circles in Bahrain expect the size of the Bahrain market to equal or exceed the Singapore market by the end of 1977.”⁴⁸ The IMF however reported in 1978 that Bahrain had come to a par with Singapore in terms of assets: “The mission reviewed with the authorities ‘developments in the offshore banking system. Since the first licenses were granted in 1975, the OBU’s in Bahrain had grown at a fast pace. At end-December 1978, there were 42 OBU’s operating in Bahrain and their total assets amounted to BD 23.4 million—about the same order of magnitude as the assets of the Singapore offshore banking sector.”⁴⁹ If the number of banks present in the financial centres differed, the level of financial activity was therefore comparable.

⁴⁶ On Singapore, see Catherine Schenk’s article in this special issue.
⁴⁷ AHSG, 81116, Claude Sarrazin to Economics Minister, Les OBU’s de Bahrein en 1980, 26 January 1981.
⁴⁸ AIMF, 12164/4, El Seheldar to The Managing Director and The Deputy Managing Director, U.A.E., Qatar and Bahrain – Informal Visits, 29 November 1976.
⁴⁹ AIMF, 09387/7, IMF, Bahrain – 1979 Article IV Consultation, Minutes of Meetings, 7-11 April 1979

Where did Bahrain fit within the wider array of international financial centres at the global level? Table 1 shows the share of Bahrain in the business of offshore financial centres, first at the end of 1980, second at the end of 1985. Two elements stand out from analysing this table. First, Bahrain's share is, on average, between 8 and 9% of major offshore centres globally, which is not negligible. Second, Bahrain's share was relatively stable between the two dates. Bahrain's share did slightly decline (from 8.4 to 8.2% of assets, and from 8.5 to 7.9% of liabilities), but this decrease was marginal. This data helps confirm that Bahrain not only successfully and rapidly rose to the international financial centre status, but also did enter the list of major offshore banking centres.

		At the end of 1980			At the end of 1985		
		Major offshore centres	Bahrain	Share of Bahrain	Major offshore centres	Bahrain	Share of Bahrain
Assets	Interbank	247.3	23.7	9.6	424.2	36.3	8.6
	Others	135.8	8.6	6.3	216.5	16.0	7.4
	Total	381.1	32.3	8.4	640.7	42.3	8.2
Liabilities	Interbank	276.5	22.6	8.2	433.9	35.2	8.1
	Others	90.9	8.5	9.4	178.5	13.5	7.6
	Total	367.4	31.1	8.5	612.4	48.7	7.9

Table 1 – Share of Bahrain in the business of major offshore centres (in billions US dollar) (source: International Financial Statistics, IMF⁵⁰)

Finally, in order to fully appreciate the degree of internationalisation of Bahrain, it is necessary to look at the geographical composition of the island's banking assets and liabilities. Table 2 shows that Bahrain's financial activity was predominantly regional. The share of 'Arab countries' in the assets of the banks based in Bahrain rose from being around 40% at the end of 1976, to 46,7% at the end of 1984, and 47,1% in September 1986. Over this period, the share of Western Europe oscillated between nearly a fifth and a quarter of the total. Other offshore centres significantly dropped from representing almost a fifth of the total at the end of 1976, to constituting less than 10% in the mid-1980s. Bahrain therefore became more 'regional' over time, while keeping strong links with Western Europe, and a non-negligible share of other offshore centres connected to the island. This analysis tallies well with Geoffrey Jones' characterisation of Bahrain as a 'type B' financial centre.⁵¹

		At the end of 1976		At the end of 1984		September 1986	
		Amount	%	Amount	%	Amount	%
Assets	Arab countries	2.5	40.3	29.3	46.7	25.2	47.1

⁵⁰ A IMF, 02093/5, Pani to Leite, Bahrain – An International Financial Centre, 5 February 1987

⁵¹ Geoffrey Jones, "International Financial Centres in Asia, the Middle East and Australia: A Historical Perspective," in *Finance and Financiers in European History 1880-1960*, ed. Youssef Cassis (Cambridge: Cambridge University Press, 1991), 407, 412.

	Western Europe	1.1	17.7	16.5	26.3	12.0	22.4
	Offshore centres	1.2	19.4	5.6	8.9	4.8	9.0
	Others	1.4	22.6	11.3	18.0	11.5	21.5
<i>Total</i>		6.2	100.0	62.7	100.0	53.5	100.0
Liabilities	Arab countries	2.6	41.9	41.2	65.7	35.9	67.1
	Western Europe	2.3	37.1	13.5	21.5	10.4	19.4
	Offshore centres	0.9	14.5	4.2	6.7	3.4	6.4
	Others	0.4	6.5	3.8	6.1	3.8	7.1

Table 2 – Region wise distributions of assets and liabilities (in billions US dollar)
(source: International Financial Statistics, IMF⁵²)

4. The extent and limits of the rise of Bahrain as an international financial centre

Given the spectacular increase over just a few years in the number of banks present in Bahrain, the fact that no banking crisis occurred subsequently was noticeable. The striking development of banking presence on the island, especially compared to other financial centres, could have been a sign of the development of a bubble that would later on burst. In preparing a lecture on the development of offshore banking in Bahrain, an IMF Statistical Advisor noted that “Bahrain [was] one of the few centres where there was no bank failure or revocation of a bank license.”⁵³ The absence of a crisis can be explained as the result of two factors. First, the Bahraini authorities carefully regulated the number of OBU licences delivered every year to new banks. Second, banks progressively limited their activities in Bahrain due to the limits of the economic potential of the region.

Banks developing their presence in Bahrain have themselves been very cautious in their enterprise. As early as in 1979, Barclays stroke a note of caution on the development of banks and OBUs in Bahrain. After having alluded to the fact that the operating costs of OBUs were high, and the economic outlook not promising, the Barclays representative noted: “Perhaps we should not be too gloomy. The other three British clearing banks have all had OBUs here for nearly three years and as far as we are aware none of them are yet profitable either!”⁵⁴ Only a few years after their arrival in Bahrain, a number of OBU-licensed banks realised that the extent of the business they could perform locally and regionally was not indefinite. As a consequences of the development of Bahrain as an IFC, and in particular with the arrival of Japanese banks in the early 1980s (see Figure 3), local competition was ever greater, and the fear of an ‘over-banked’ sector developed. As a consequence, banks either decided to scale down their activities or occasionally withdraw from Bahrain.

⁵² AIMF, 02093/5, Pani to Leite, Bahrain – An International Financial Centre, 5 February 1987

⁵³ AIMF, 02093/5, Pani to Leite, Bahrain – An International Financial Centre, 5 February 1987

⁵⁴ BGA, 80/6112, West to Duncan, Bahrain O.B.U. – seven months ahead, 25 April 1979.

Bahraini authorities have been very careful not to transform the island into an overbanked area that could destabilise the entire country's economic balance. Throughout the initial phase of launching the OBUs, the Bahraini authorities set up very clear limits as to their numbers and functions. The Bahraini authorities sought advice from the IMF during the process of development of the island's international financial centre. According to IMF Executive Director Mr Lieftinck: "The authorities were well advised to pay attention to the danger of overbanking. Bahrain was developing as an international financial center, but the banks should be subject to appropriate supervision by the Monetary Agency and overbanking should be avoided."⁵⁵ In addition to this cautious attitude, the Bahrain authorities also seemed to be very conscious of the reasons why they wanted the island to become an IFC, and of what point they wanted to reach in this policy. Development and Industry Minister Youssef Ahmad al-Shirawi thus explained: "We just want to be a mini financial centre. That's the way we want to keep it because if you stretch it beyond its natural limits it will become artificial and the bubble will just burst."⁵⁶ The Bahraini authorities considered the development of the island as an international financial centre as part and parcel of a wider strategy for Bahrain's economic development, instead of this being an end in itself.

Conclusions

Having no specific financial tradition in contemporary history, the Bahraini authorities managed to successfully develop over a short period of time – between the late 1960s and the early 1980s – a respected financial centre with a regional and international reach. This article has shown that Bahrain's successful rise to the status of international financial centre rests on the combination of four factors: a favourable regulatory environment with the development of the OBU legislation, a good geographical position, the weaknesses of Bahrain's actual and potential regional competitors, and a favourable economic and political environment. This article has further shown that Bahrain's successful and spectacularly rapid rise to the international financial centre status allowed the island to overcome Beirut as leading international financial centre in the Middle East region, and to come close to Singapore – depending on the indicator used – at the global level.

⁵⁵ AIMF, 09331/3, IMF, Minutes of Executive Board Meeting 75/24, 28 February 1974

⁵⁶ Quoted in BGA, 80/6112, Bahrain's steady progress has solid foundations, Meed, 6 April 1979.