

# The Role of Shanghai in Building an International Financial Center

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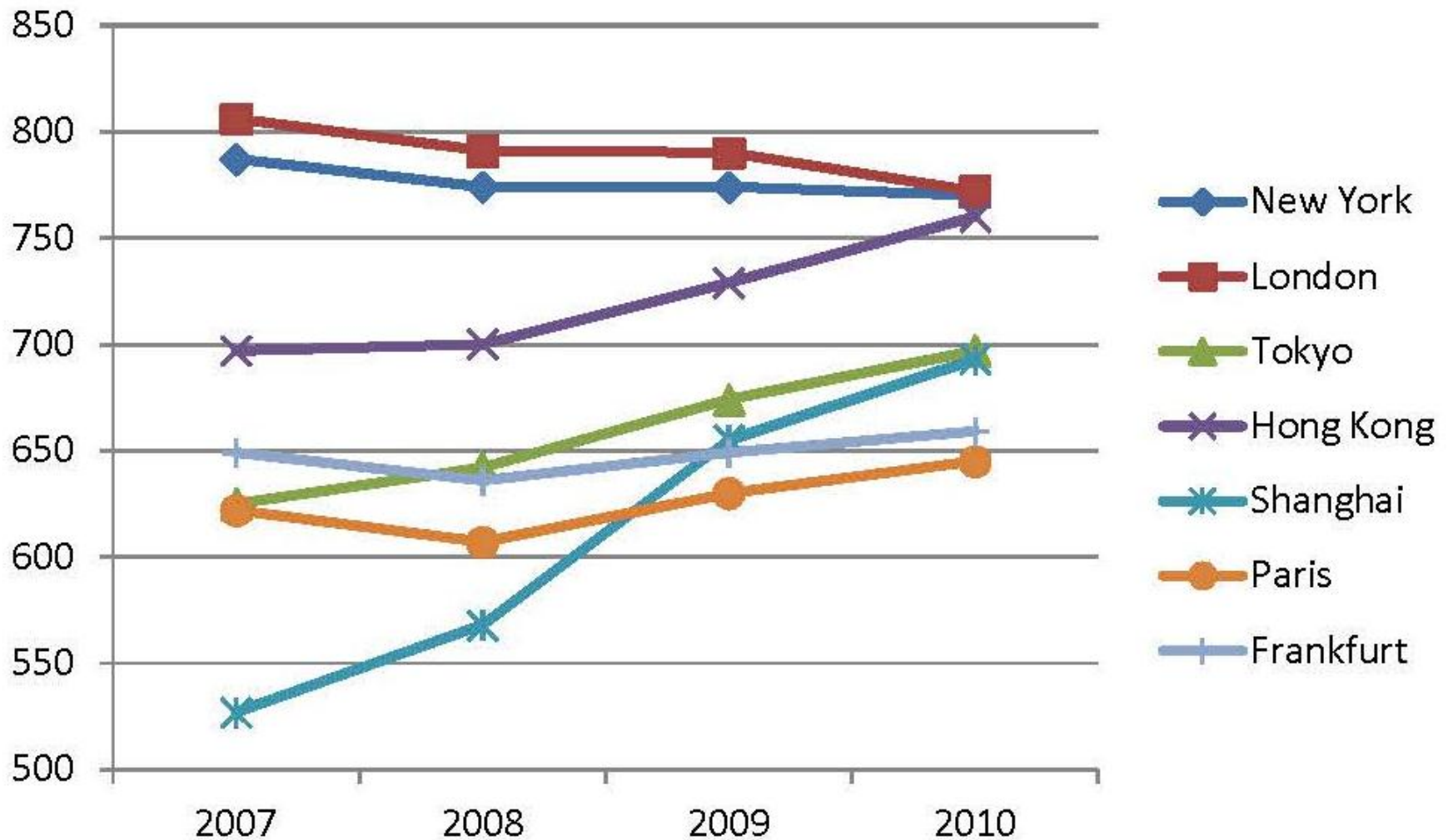
# Outline

- Necessity and opportunities for the development of Shanghai international financial center(SIFC)
- The Challenges of building SIFC
- Policy suggestions for the progress of SIFC

# 1. Necessities and Opportunities for the Development of SIFC

- The development of Shanghai international financial center is an important channel for the world to enjoy China's growth benefits.
  - If China financial system is unable to strengthen and expand, then much-touted increase in more consumption in China in order to balance the world economy will lose the market basis and be unsustainable.

# Shanghai's IFC Development



Source: Global Financial Centers Index(2010)

金融国际化程度	7	境外投资者规模	参与上海金融市场的境外投资者规模较小	参与上海金融市场的境外投资者规模显著扩大
	8	上海金融市场国际影响力	国际影响力总体较小	上海证券市场主要指数、大宗商品期货价格国际影响力显著提升
金融服务功能	9	金融市场直接融资额占社会融资规模比重	16.7%	22%左右
	10	管理资产规模	约 15 万亿元	30 万亿元左右
金融发展环境	11	金融从业人员	24.5 万人	32 万人左右
	12	金融发展环境的国际竞争力	国内领先	金融发展环境的国际竞争力明显增强，金融法律、税收、监管等与国际惯例接轨程度明显提高

## “十二五”时期上海国际金融中心建设主要预期指标

类别	序号	指标	2010 年	2015 年
金融市场规模	1	金融市场交易总额 <sup>1</sup>	386.2 万亿元	1000 万亿元左右
	2	债券托管余额	全球第 5 位	进入全球前 3 位
	3	黄金市场现货交易量	全球第 1 位	保持全球第 1 位
	4	金融衍生品交易量		进入全球前 5 位
	5	保险市场原保费收入 <sup>2</sup>	695 亿元	1400 亿元左右
	6	银行卡跨行交易额	10 万亿元	25 万亿元左右

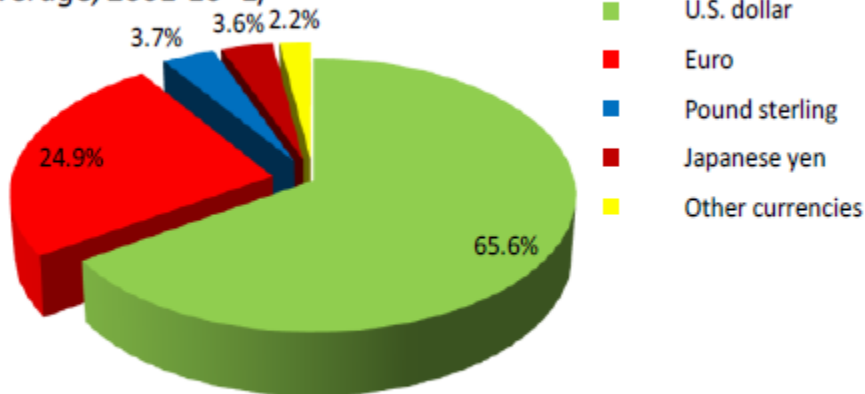
# 1. Necessities and Opportunities for the Development of SIFC

- The world expects Asia and China in particular to play a more active role in the reform of international monetary system.
  - The Chinese government has realized that it is much better to take the initiative to strengthen RMB by the means of building SIFC than to passively accept the pressure of RMB appreciation and capital account liberalization as it did in the past

# 国际货币体系的现状

## Composition of Foreign Exchange Reserves

Average, 2001-10 1/



1/ Shared of allocated foreign exchange reserves. Data as of 2010 Q4.  
Source: IMF COFER.

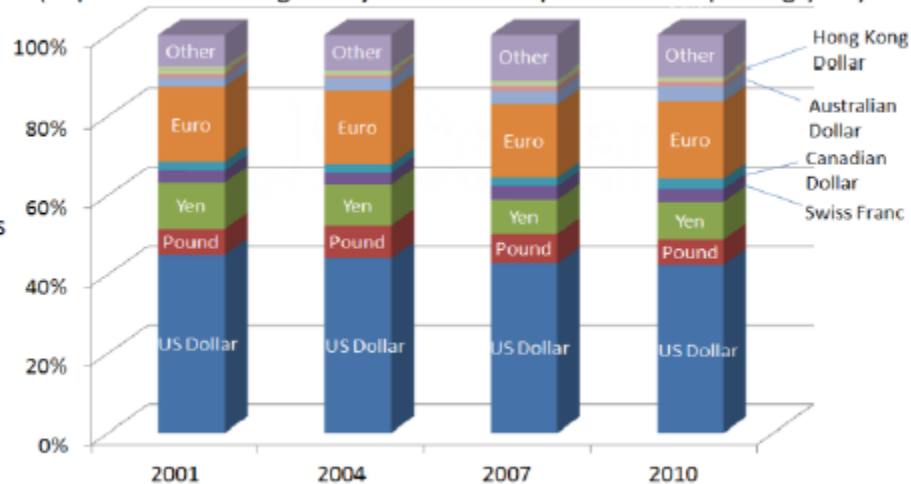
## Top five contributors to global financial depth

In percentage share of global financial depth weighted by GDP

	1989		2009
<b>Advanced countries</b>	92.8	<b>Advanced countries</b>	82.4
United States	32.5	United States	29.4
Japan	28.3	Japan	13.2
United Kingdom	5.7	United Kingdom	7.8
Germany	5.3	Germany	6.1
France	4.5	France	5.4
<b>Emerging markets</b>	7.2	<b>Emerging markets</b>	17.6
Brazil	1.9	China	7.2
China	0.9	Brazil	1.6
Hong Kong SAR	0.7	Hong Kong SAR	1.6
Korea	0.7	Korea	1.2
India	0.5	India	1.1

## Global Foreign Exchange Market Turnover

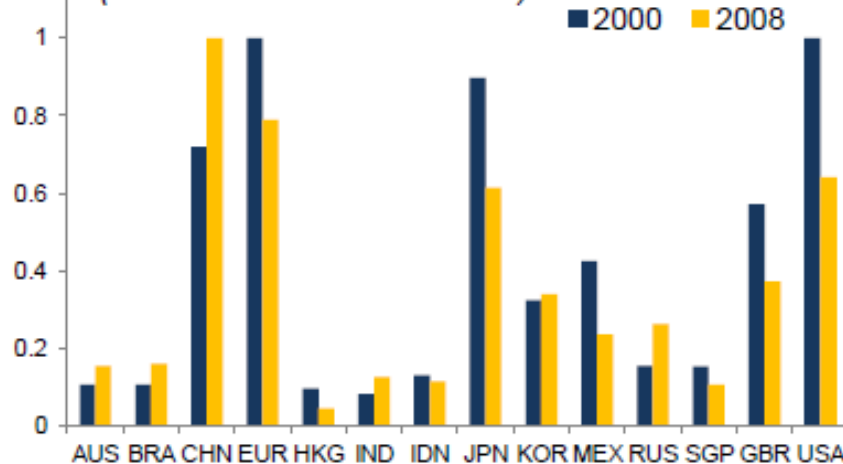
(In percent of average daily turnover in April of each reporting year)



Source: BIS Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity and IMF Staff calculations.

## Total Trade: Network Centrality 1/

(1=most central in the network)

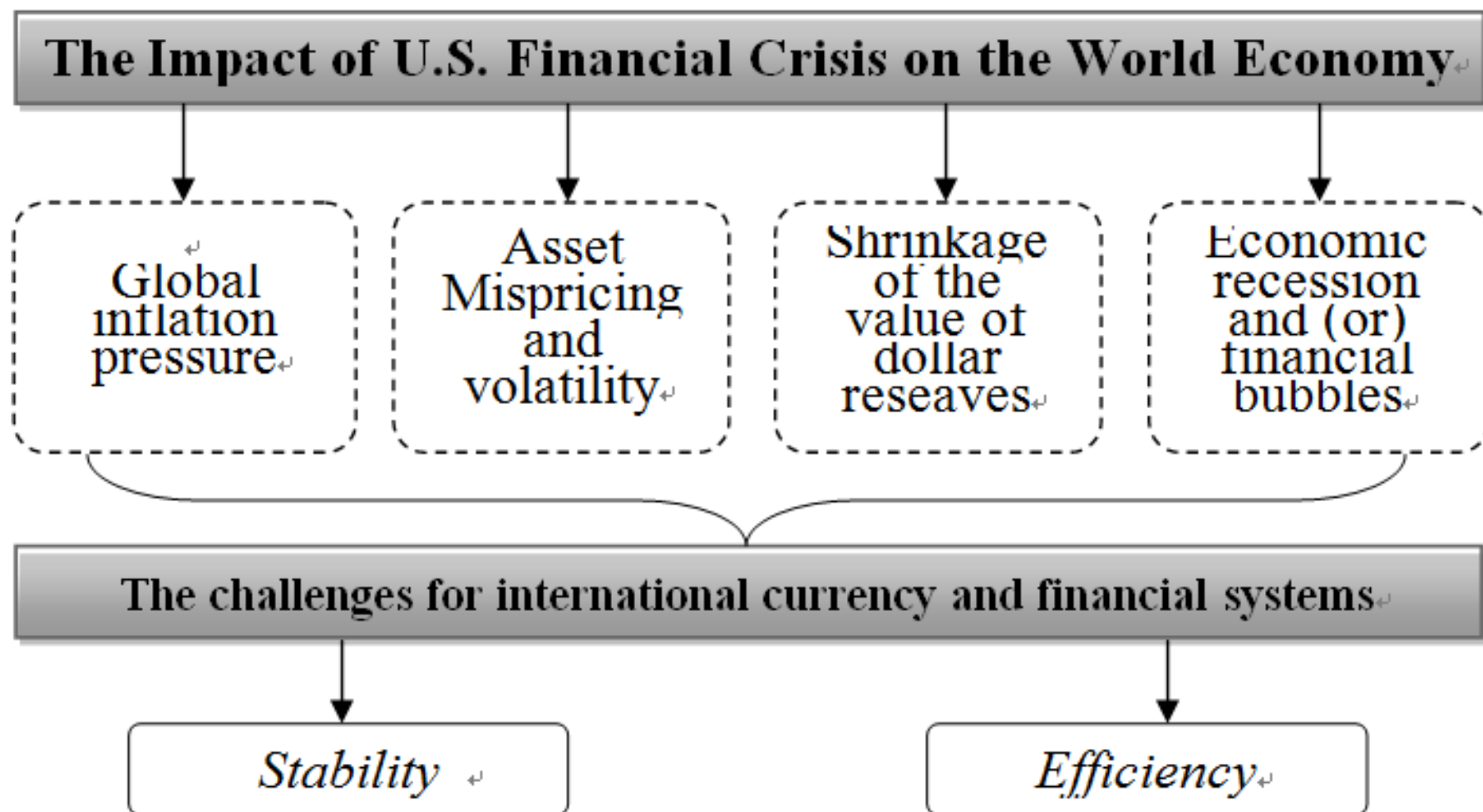


1/ Trade centrality is measured by Eigenvector centrality. See Select Issues Paper in China Spillover Report for more technical background.

Sources: DOTS, IFS, and IMF Staff estimations.



# 1. Dollar based international financial systems



# 1. Necessities and Opportunities for the Development of SIFC

- The concentration of multinational companies and financial institutions in Shanghai is a strong force to push forward the internationalization of the RMB and the construction of SIFC.

## 2. The Challenges of building SIFC

- Institutional impediments. As the financial system, such as interest rate and exchange rate system in China, is designed to enhance manufacturing and exports, it couldn't react so effectively to the shock from international financial market.
  - It is very dangerous and impractical to push the opening and integration of financial system before optimizing and adjusting the industrial structure.
  - Without mature legal, accounting, regulation and tax systems to guarantee the international business, it is difficult for China to play a leading role on the global financial stage in the short run.

## 2. The Challenges for the building of SIFC

- Lack of talent. China is in need of groups of talents to manage international financial operations.
  - What has caused the crisis in the U.S. may be the abuse of financial innovation, while what makes China lacking is the ability to use financial innovation for risk diversification. This has been proven by the poor performance of China sovereign wealth funds and overseas investments.
  - Of course, we should learn the lessons from the failures of American system which has serious moral hazard problem.

## 2. The Challenges of building SIFC

- Imperfect risk management. In China, management of risk on the asset side for the future is much more difficult than the liabilities side, caused by short-term capital inflow in emerging markets.
  - Today China, Japan and South Korea all have realized that financial development is not only conducive to industrial upgrading and structural transformation, but also helps their products and enterprises go aboard. Under these circumstances, if the financial cooperation model among these countries fails to meet the market demand on the asset side, but it is stuck in the approach of “liability risk management” after the framework of the Chiang Mai Initiative, its importance and effectiveness will be greatly reduced. In this sense, SIFC and other Asian bond markets will play an important role in the future.

# IFCs' derivatives trading volume, Number of contracts in million

Centers	2006	2007	2008	2009
Chicago	2885.895	4079.613	4475.769	3603.454
Seoul	2593.61	2777.42	2867.28	3102.89
New York	1293.73	1791.76	2179.34	2239.66
Mumbai	0.533	385.923	707.098	1304.101
Sao Paulo	561.823	746.261	714.303	883.775
London	909.977	1180.411	834.889	883.762
Shanghai	58.106	85.564	140.263	434.864

# 3. Policy Suggestion

- Following correct reform sequence.
  - Generally speaking, the main task in developing financial center is to straighten out the formation mechanism of domestic price marketization first.
  - then need to help financial capital seek high-return "venture" projects which are of good quality and worthy of financing supported by a complete incentive system and regulatory measures.
  - Next come accelerating the marketization of interest and exchange rates and improving innovation capability of financial institutions and individual based market service level. It is on this basis that we can then enhance financial market opening, both at home and abroad, and strengthen market fluidity, competitiveness and vitality.
  - Finally, when Shanghai's status as international financial center is acknowledged both at home and abroad, we can reasonably take the RMB business fully to the international stage.

# 3. Policy Suggestion

- Focus on financial services for the real economy
  - The main reason why the U.S. dollar-dominant monetary system is still powerful is that America's core competitiveness is not shaken. Moreover, America is still attractive to international capital as it has world-class brands and technology, standard-setting and R & D capacities.
  - China, which is still based on manufacturing and export, and good at standardized and scale production needs a structural adjustment on technology innovation and market services which will be supported by high lever financial services.



# 3. Policy Suggestion

- Strengthen Asian financial cooperation.
  - First, an integrated Asian bond market is imperative for discovery mechanism for reasonable levels of various financial assets in Asia.
  - Second, set up gradually an integrated network of payment and capital operation for Asian trading and investing.
  - Third, all the exchange, cooperation and co-cultivating programs in oversea students, financial talents and businesses between China, Japan and South Korea will enhance the management of financial risk

# SWOT Analysis (Young et al., 2009)

HONG KONG	SHANGHAI
Strengths	Strengths
<ul style="list-style-type: none"><li>• High level of transparency of the government and its policies</li><li>• Political and social stability</li><li>• Equitable treatment of foreigners</li> <li>• Foreign exchange stability and abundant liquidity</li><li>• Super financial infrastructure</li><li>• Minimal interference by financial supervisory/regulatory authority</li><li>• Predictable legal environment</li><li>• Workforce with good financial expertise and international experiences</li><li>• English-speaking population</li><li>• Regional headquarters for many global financial institutions, including investment banks</li></ul>	<ul style="list-style-type: none"><li>• Very large economic power and abundant human resources</li><li>• Large domestic capital market</li><li>• Very good potential for continuation of high growth</li><li>• Possess a large amount of domestic savings</li></ul>

# SWOT Analysis (Young et al., 2009)

Weaknesses	Weaknesses
<ul style="list-style-type: none"> <li>• Limited local market size</li> <li>• Serious air pollution</li> </ul>	<ul style="list-style-type: none"> <li>• Regulations hindering efficient functioning of the market mechanism</li> <li>• Limited openness to foreign investment</li> <li>• Slow internationalization of the capital markets</li> <li>• Soft financial infrastructure development lagging behind hard infrastructure development</li> <li>• Limited command of the English language among the local population</li> </ul>
Opportunities	Opportunities
<ul style="list-style-type: none"> <li>• Physical proximity with China</li> <li>• The role of a bridge connecting foreign companies to investors in China</li> </ul>	<ul style="list-style-type: none"> <li>• Opening of the market to foreign firms and investors</li> </ul>
Threats	Threats
<ul style="list-style-type: none"> <li>• Competition with Shanghai as a financial centre</li> </ul>	<ul style="list-style-type: none"> <li>• Competition with Hong Kong to become the main financial centre in China</li> </ul>

# 3. Policy Suggestion

- Strengthen Asian financial cooperation.
  - Fourth, establish a real, effective, appropriate and timely information disclosure system between China, Japan and South Korea to lead reasonable expectations on the basis of economic fundamentals so that the Asian financial institutions can conduct high-efficiency investment and financing.
  - Fifth, set up a Finance Association of China, Japan and South Korea and also a standardized supervision department of the three countries to intensify the Asian investing and financing corporate governance.

# Conclusion

- **The development of Shanghai international financial center is an important way for the world to share China's growth benefits.**
- **For Shanghai itself, it is imperative that it makes every effort to perform the six core financial function required by an international financial center, i.e. price discovery, liquidity insurance, risk management, information disclosure, governance, value creation.**
- **The RMB internationalization as well as the strategy of building Shanghai into an international financial center should be subsumed under an Asian financial cooperation system for positive interplay and better governance of international monetary system.**