TALES OF SHANGHAI

Zhang Xiang, China's former Vice-Minister of Foreign Trade and Economic Cooperation, talks to Brunswick's Jinqing Cai about re-establishing Shanghai as Asia's premier financial hub

It is official policy: Shanghai is aiming to reclaim the status it enjoyed before the Second World War as Asia's center of finance. In 2009, the State Council, China's top decision-making body, formally directed the country's ministries and regulators to support the city's efforts to be ranked by the end of the decade on a par with the world's top international financial centers (IFCs) – New York, London, and Tokyo.

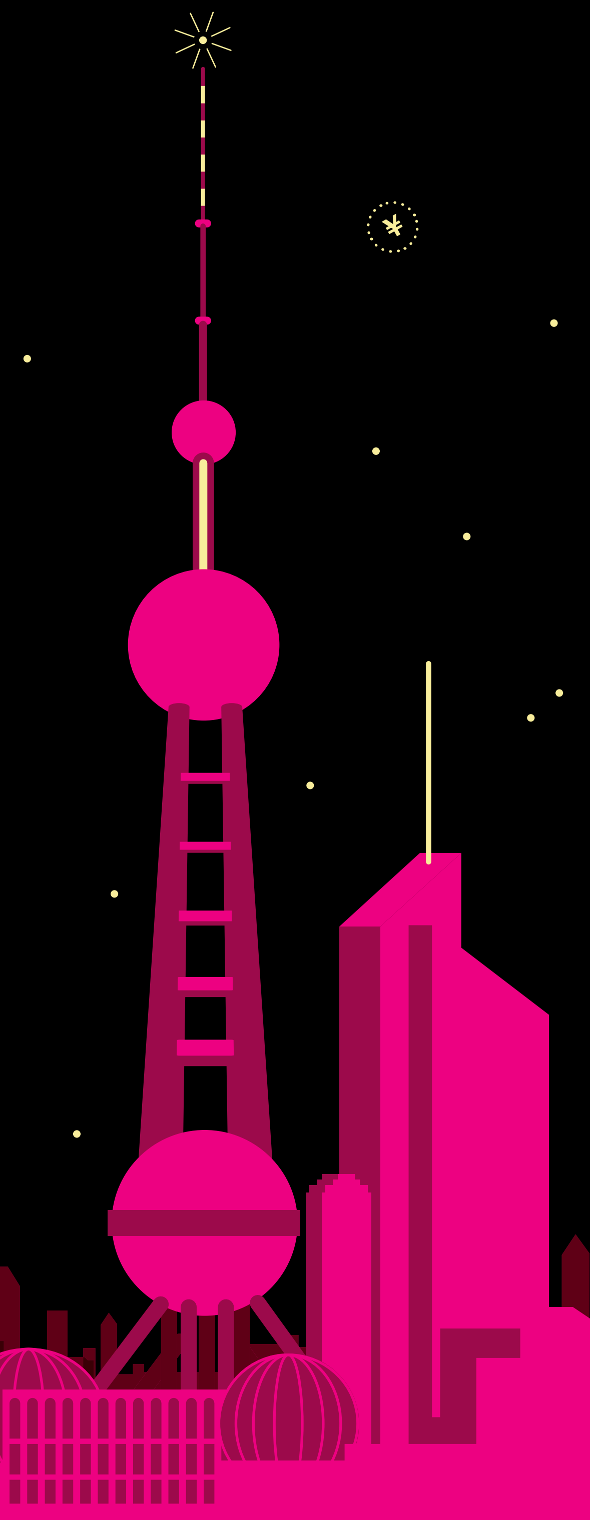
Physical infrastructure is important to reach this goal, but so too is the image the city projects within China and to the world, especially so that it can attract top-level financial talent.

Shanghai has already made great strides. Since it began to develop the Lujiazui Finance and Trade Zone on the eastern bank of the Huangpu river in the mid-1990s, the city has steadily climbed the ranks of international financial centers.

In 2010, when the Chicago Mercantile Exchange, Dow Jones, and Xinhua News Agency launched their International Financial Centers Development Index (IFCDI) – which is based on 66 indicators and more than 2,000 questionnaires – Shanghai debuted at number eight. A year later, Shanghai already had gained a further two places, surpassing Paris and Frankfurt, and closing in on Hong Kong and Singapore.

Shanghai's resurgence has been manifested architecturally in Lujiazui, announcing the city's ascendency to the world. Rising up opposite the old financial district – The Bund, on the western bank of the Huangpu – is a series of skyscrapers, each one outdoing the last. The Oriental Pearl Tower, with its distinctive spheres and broadcast tower, gave way to the Shanghai World Financial Center (the world's second-tallest building, by some measures), which will be surpassed by the nearby Shanghai Tower in 2014.

However, the IFCDI feedback indicated that Shanghai still lags in certain key areas when compared with top-tier financial centers. The country's financial infrastructure remains unfinished and the slow pace of regulatory reform is likely to hamper the city's ambitions.



Shanghai also lags in financial skills, both in quality and quantity. Better financial education and international experience are needed to build the city's human capital.

Zhang Xiang, former Vice-Minister of Foreign Trade and Economic Cooperation, who as a scholar and policy adviser has spearheaded research into building Shanghai into a top international financial center by 2020, here speaks candidly to Brunswick's Jinqing Cai about what it takes to translate the city's ambitions into reality – and how to communicate that vision to a global audience.

How close is Shanghai to becoming a top-tier international finance center and what are the most important areas that still need to be addressed?

At present, China's financial system still falls short. There is far too much direct administrative control by the government and regulators, the organizational costs are too high, and the taxation and legal environment also needs to be developed. Personal income tax rates particularly need to be reformed to attract high-caliber people. Also, there are too few products. For instance, there is a lack of derivatives for bond and foreign exchange products, making it impossible for market participants to manage risks adequately. This inhibits investors from investing long term.

To what extent will Shanghai compete with Hong Kong for status as China's main financial hub?

Shanghai and Hong Kong will be complementary to each other in some financial areas and compete in others.

For example, Shanghai's development will mean more mainland companies will want to "go global" and Hong Kong will remain as a key conduit for international investment in those companies. Also, Hong Kong will be essential for the renminbi offshore market, which is expected to develop in a way similar to the Eurodollar market in the 1960s, providing a less regulated environment for trading the currency. Furthermore, Hong Kong has unique advantages as an Asian wealth management center. Look at the US, where New York is the most important financial center while Chicago and Boston have big shares of derivative trading and wealth management, respectively.

Shanghai will develop at Hong Kong's expense in some areas too. For example, Hong Kong's role in listing state-owned enterprises overseas will be weakened.

Is there a risk that Hong Kong's development of an offshore renminbi market could curb Shanghai's financial development?

We should support Hong Kong in its efforts to become a renminbi offshore center. It will accelerate the implementation of the state's financial strategy. As Hong Kong is already an international financial center where foreign currencies can be converted and traded freely, it can make up for the inadequacy of the domestic financial system. It is impossible for Shanghai's market to become a major international finance center until the capital markets are opened up fully.

We should not be afraid of competition. Historically, Amsterdam, London, and New York all took shape amid fierce international competition.

Allowing foreign companies to be listed in China's domestic markets – known as the "international board" – is one of the hot topics for Shanghai. What is your view?

To build an international financial center, it is necessary to push cross-border investment, including "red chip" companies [mainland companies incorporated outside China with Hong Kong listings], "H-share" companies [mainland incorporated companies listed in Hong Kong], exchange-traded funds, and allowing large blue-chip companies of other countries – including Hong Kong, Macau and Taiwan – to issue renminbi stocks and bonds, and expanding the size of renminbi bonds issued by international institutions in China.

But there has been a clamor for international share listings for some time. What is holding them back?

There have been basically two arguments against it – both of which are about sending the wrong market signals. One is that if foreign enterprises issue stocks at high price/earnings ratios compared to domestic companies, it diverts domestic wealth from providing capital for domestic companies. On the flip side, if domestic companies issue stock at comparatively low P/E ratios then it will depress valuations for all domestic companies.

SHANGHAI: BY THE NUMBERS

- Shanghai (literally "on the sea") is the image of a 21st century city, with the Pudong business district's distinctive skyline of super-tall buildings on the east side of the Huangpu river, facing Puxi, the cultural and shopping district, which includes the old colonial quarter (The Bund), on the west side.
- Shanghai's population has doubled since the early 1980s to more than 23m. The foreign population in Shanghai has doubled since 2005 to more than 200,000, with Japanese, South Korean and US nationals making up about half that total.
- Since the beginning of 2010, highly qualified individuals – scientists, executives, investors – can apply for five-year residence permits, much longer than the usual one year.
- Shanghai is becoming a more expensive place to live, rising from 25th to 21st most expensive city in Mercer Consulting's 2011 cost of living survey, tied with Melbourne, Australia.
- Before the Second World War, Shanghai had the world's third largest stock exchange and ranked behind only New York and London as a securities trading hub. Its original listings included the forerunners of present-day HSBC and Standard Chartered Bank.
- The Shanghai Stock Exchange (SSE) Composite Index fell from its high above 6,000 in October 2007 to below 1,700 a year later. It has since recovered to about 2,400 but so far plans to list foreign companies have been unrealized.
- PetroChina is the largest company listed on the SSE, ranking as the second-largest company on the FT Global 500 in 2011, with a market capitalization of $326bn.

Sources: Shanghai Bureau of Statistics; the Financial Times; Mercer Consulting; China Daily; South China Morning Post.

Shanghai Stock Exchange-listed companies' values have gradually converged toward those of developed capital markets. It may now be the right time to encourage some of the top foreign enterprises to issue stocks in China, which the domestic market could absorb if done at a steady rate.

Some leading international companies have shown interest in a Shanghai share listing. Preparation for international listings have been under way for several years. Trading rules and procedures have been gradually established, a technical system and a regulatory framework have been put in place, and public market information systems are now installed.

The basic regulatory framework is ready for the international board. However, in light of the uneasy global economic situation and China's macro control, the specific timing for the launch of the international board will be determined by the central government balancing the priorities of economic and social goals as well as capital market initiatives.

Zhang Xiang, China's former Vice-Minister of Foreign Trade and Economic Cooperation, is currently Dean Emeritus of Shanghai Jiao Tong University School of Management and Executive Director of think tank China Center for International Economic Exchanges. Zhang has a Ph.D in applied physics from Columbia University and degrees in engineering from Tsinghua University.

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Brunswick's recently opened Shanghai office will be led by Po Ling Cheung, a Partner with more than 15 years' experience of communications in the region, including as co-head of Morgan Stanley's Asia Pacific corporate communications, looking after greater China and southeast Asia. For contact details, please see inside the back cover of the *Review* or visit *www.brunswickgroup.com*

"A MARATHON WITHOUT A FINISH"

How others view the development of the Shanghai International Financial Center

Laura Cha – Non-Executive Chairman of HSBC Investment Asia Holdings

It is only a matter of time for Shanghai to become a top-tier international finance center. Shanghai has some institutional disadvantages, such as law enforcement and taxation. But its advantages include a strong mainland economy, many highly recognized companies and abundant capital resources.

Ha Jiming – Vice-Chairman and Chief Investment Strategist, Investment Management Division, Goldman Sachs China

The key difficulty in making Shanghai an international finance center is the renminbi convertibility, which is beyond Shanghai's control. Another big obstacle lies in the availability of talent and how it is taxed. Shanghai may be able to lower the real tax rate by providing subsidies or rewards.

Dai Xianglong – Chairman of the National Council for Social Security Fund, former Governor of the People's Bank of China and former Mayor of Tianjin

A top-tier international finance center is an important marker to show that China is developing financially. The internationalization of the renminbi is also a core interest for China. These are goals that should not only be important for Shanghai, or a task just for the current administration of Shanghai, but a long-term task for the Chinese government.

Charles Li – Chief Executive of Hong Kong Exchanges & Clearing

The competition between Hong Kong and Shanghai is like a marathon without a finish. We hope that we run together and lead together. The prospect of a stronger China is pushing Hong Kong as well as Shanghai to a level of greater accomplishment. Any measure that pushes Shanghai ahead and makes China more open will always benefit Hong Kong. Hong Kong's success in the past fundamentally rested in its valuable contribution to China's reform and opening up. Whether Hong Kong will continue to be the new engine of China's economic development instead of being marginalized in the future depends on its contribution.

Source: Research report on Shanghai as an International Financial Center, July 2010, led by Zhang Xiang, China Center for International Economic Exchanges