The Centennial Competition of Global Financial Centers: Key Determinants and the Rise of China's Financial Centers

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This study reviews and summarizes the historical experiences of development of global financial centres; based on their developmental conditions, pathways and determining factors. It attempts to identify and establish a theoretical framework that could give rise to a better account for the growth and development of international financial centres (IFCs). Based on the recent findings in the areas of the "Geography of finance", "Law-finance" theory and "Time-zone" theory, this paper synthesizes a new theory, which could best explain the up and down and rise and fall of IFCs. Amid the further deepening of the current global financial crisis and the mighty rise of Chinese economy in the world economy, this study foresees and portrays the prospect of robust growth of Chinese financial centres, including Hong Kong, Shanghai, and Beijing and their possible roles and positions in the global financial centres network in the post-crisis era.

Key Words: Global Financial Centers Network, the Emerging China, Global and Historical Experiences

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Introduction

In the aftermath of the current financial crisis, the current rise of China, both in global economy and politics has been phenomenal. To develop China’s own international financial center is an important integral part of the nation’s whole growth strategy and as a result financial center competition in China has intensified. Shanghai, Beijing, Shenzhen, Guangzhou, Zhuhai and even Dongguan’s Songshanhu are all striving to develop into financial centers. This study will review the development experiences of global financial centers during the past century and analyze their implications for China and Hong Kong. This study reviews and summarizes the historical experiences in the development of global financial centres; based on their developmental conditions, pathways and determining factors. It attempts to identify and establish a theoretical framework that could give rise to a better account for the growth and development of international financial centres (IFCs). Based on the recent findings in the areas of the “Geography of finance”, “Law-finance” theory and “Time-zone” theory, this paper synthesizes a new theory, which could best explain the ups and downs and rise and fall of IFCs. Amid the further deepening of the current global financial crisis and the mighty rise of Chinese economy in the world economy, this study foresees and portrays the prospect of robust growth of Chinese financial centres, including Hong Kong, Shanghai, and Beijing and their possible roles and positions in the global financial centres network in the post-crisis era. Finally, the paper concludes with some proposed policy recommendations.

A History Review of Global Financial Centers

A series of factors contribute to the formation of the hierarchical structure of financial centers across the globe. Scale of economies, economic development, international trade, history, transportations and communications all contribute to the development of international financial centers (Kindleberger, 1974; Poon, 2003; Reed, 1980). Sassen (1999) claimed that the two most important factors in transforming an ordinary city into a global financial center were national consolidation of financial activities (concentration of financial institutions and transactions in one location) and market and financial liberalization (financial services openness and free capital flows). As a matter of fact, the elements proposed by these scholars overlap and merely differ in rhetoric and varying degrees of generalization. Beaverstock, Taylor and Smith (1999) interpreted the modern international financial centers as world cities, global cities or producer services centers and built a three-level hierarchy for the major centers.

The hierarchy of financial centers appears stable, but in fact it is evolving all the time. Poon (2003) examined the evolution of the global financial center hierarchy and found that the hierarchical tendency has been strengthened from 1980 to 1998. Financial centers in the higher tier of the hierarchy were characterized by lower market and trading value concentration, larger average company size and lower risk rating. He also found that the position of Tokyo in the top tier of the hierarchy was replaced by London mainly due to London's excellent performance in international bonds and foreign exchanges and Tokyo's weakness in over-dependence on banks as the sources of funds and the funds' over-concentration on real estate that was ultimately exposed to frantic speculation in 1997 Asian financial crisis.

Despite the twentieth century's stability of the well-known New York and London's roles as global financial centers, their battle for the top position never ceases. New York has surrendered its crown to London since "9.11" in 2001 and the "Enron" scandal in 2002. The developmental history of global financial centers can be traced back to early Amsterdam, then London and Frankfurt, and back to London (Braudel, 1992; Faulconbridge et la., 2007). London regained its position as an international financial center in 1986 (Gordon, 2002). A little over two decades ago, Tokyo once showed its strength to challenge New York for the top spot, but according to the latest rankings of the Global Financial Center Index, Tokyo does not even make it to the top ten (City of London, 2009). More than ever, regional financial center hierarchy never stops changing. Sydney has taken the place of Melbourne, while Montreal was replaced by Toronto. What are the driving forces or determinants behind these evolvements?

We should first notice the changes in the ranking of global financial centers. London, New York, Hong Kong and Singapore have always been among the top ten till 2009 with minor variations, while the cities of Tokyo and Frankfurt have been declining. Besides, more and more small centers like Luxemburg and Iceland are emerging, as shown in Table 1. London and New York are on the uppermost layer of the hierarchy with Hong Kong and Singapore on the second layer. Moreover, there are several types of financial centers on the second layer, such as Frankfurt and Chicago (See Figure 1). In terms of market capitalization, New York accounted for 34% of the global stock markets (See Figure 2). But the size of market capitalization itself cannot determine the importance of a center. Basically, it merely reflects the size of the economy. The number of listed companies is also an important figure. The number of listed foreign companies is one key indicator of a financial center's position in the global network. Therefore, this ranking resembles the one mentioned earlier (See Table 2). Firms tend to choose established financial centers as their overseas listing locations (Pagano et al, 2001). London, New York, Hong Kong, Singapore and Frankfurt are the leaders in corporate overseas listings.

Table 1：Ranking of Financial Centers 2007-2010

	2007	**2008**	**2009**	**2010**
1	London	London	London	New York
2	New York	New York	New York	London
3	Hong Kong	Hong Kong	Singapore	Hong Kong
4	Singapore	Singapore	Hong Kong	Singapore
5	Switzerland	Switzerland	Switzerland	Tokyo
6	Frankfurt	Frankfurt	Geneva	Chicago
7	Sydney	Geneva	Chicago	Zurich
8	Chicago	Chicago	Frankfurt	Geneva

9	Tokyo	Tokyo	Boston	Sydney
10	Geneva	Sydney	Dublin	Shenzhen

Source：Global Financial Center Index，City of London, 2010

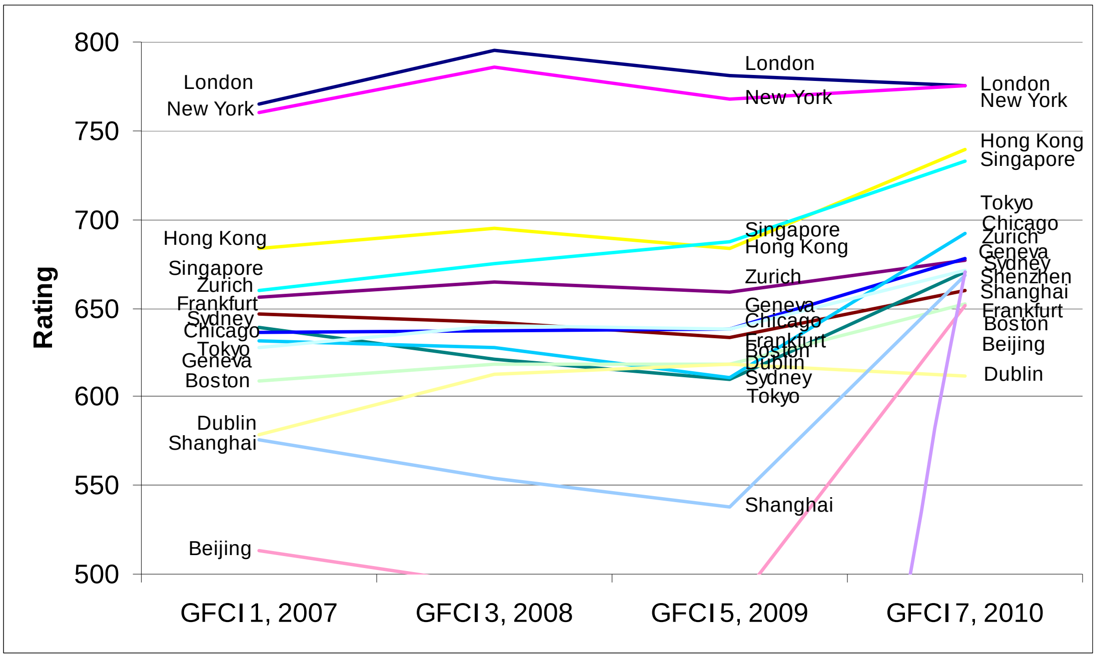
New York, the world’s largest economy by the unit of city, possesses the most concentrated information and has been a leader in global financial innovation (Gordon, 1999). While New York as a whole does not do as good in internationalization as London.

London has always been an international city. Great Britain incessantly expanded around 300 years ago. As the capital of an empire controlling as many as 150-160 colonies, London was a center for trading in raw materials with colonies and well managed merchandise export market. London’s financial industry originated from Lombard Street. In order to evade the warfare on Continental Europe, financiers from Italy, France and Germany moved here to start their business, which promoted London’s internalization and amassed large numbers of financial talents (Bagehot, 1920). As an example, the renowned Barclays Bank originated right here. Nevertheless, with the demise of Great Britain, London entered its recession period. In the wake of World War II, the Europe’s economic center had actually shifted to Frankfurt, and London’s position was in jeopardy. The globalization that emerged in the 1980s, however, revitalized London and facilitated its development into a global financial center and wealth management center (Beaverstock et al., 2005; Faulconbridge, 2004; Kynaston, 2002). The assets managed by London accounted for 34% of the whole Europe, or 25% of the globe.

Faulconbridge (2004) took London and Frankfurt for example to discuss Europe’s evolving financial center network, thus to emphasize his argument that more attention should be directed to the complementary functions and interdependence of different international financial centers instead of simply placing them in a hierarchical network according to their attributes such as financial turnover. The results suggested that London and Frankfurt along with other European financial centers formed a network rather than a hierarchy even after the launch of Euro and the European

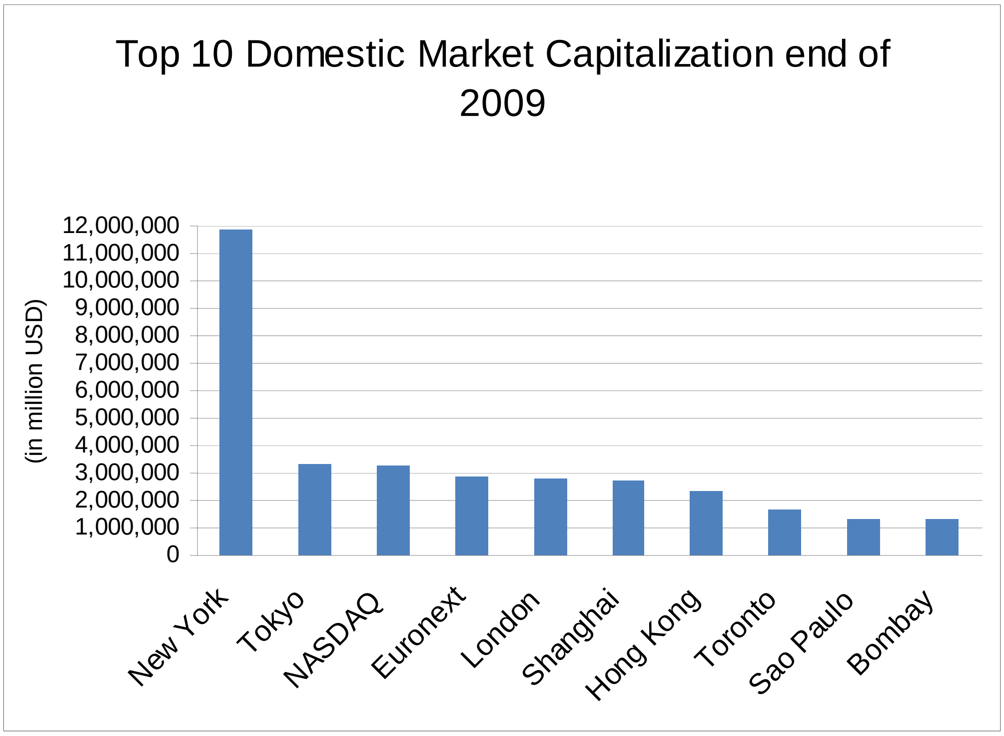
Central Bank. Global connectivity, unique denationalized and offshore platform, flexible regulation, knowledge production, presence of skilled workforce and the abilities to provide financial services that Frankfurt cannot ensures London’s continued dominance (Clark, 2002).

Figure 1: The top 10 Financial Centers 2007-2009



Source: Global Financial Center Index, City of London2007- 2010

Figure 2: Market Capitalization of World's 10 largest Stock Exchanges (As of June 2009)



Source: Local Market Capitalization Statistics, World Federation of Exchanges, February, 2010

Reed (1980) traced the rise of Tokyo as the top financial center in Asia in the 1970s and for the first time formally analyzed the hierarchical structure of 17 Asian financial centers. Japan's economic recovery from World War II and its increasing market dependence on Asian countries and regions nourished Tokyo as an international banking center and its further rise to the top of Asian financial center hierarchy, supplanting the roles of Hong Kong, Singapore and other traditional centers. The expanding capital needs of booming Asian markets (especially in the southeast Asian countries) and the retreat of western political, military and economic power from this region continually pressed Japan to assume more responsibility for Asia. In the 1980s, Tokyo's financial syndicate purchased the Rockefeller Center with a high profile and made a stir. The event signified the demise of Tokyo instead of the rise of a new kingdom, however. Tokyo, once viewed as a strong rival to New York and London, turns out to be the second largest stock market as well as third largest foreign exchange center in recent years. At present, Tokyo's position in Asia has been taken over by Hong Kong and Singapore.

What are the driving forces behind these vicissitudes of financial centers? Laulajainen(2003, p. 2) listed the three fundamental reasons why geography still matters in finance and financial centers. First, the daily rhythm of the globe forces the international financial activities to carry on endlessly like a 24-hour torch relay. Second, information constraints due to people's limited living radius and ability to digest information leave the neo-classical efficient market hypothesis futile. Third, when it comes to geography, the culture dimension cannot be ignored. In this study, we will use three strands of theories to explain these phenomena: the geography of finance; law and finance; and time zone theory. These theories have several overlaps with Laulajainen(2003, p. 2)'s interpretations in one way or the other.

Table 2: World's 10 largest Stock Exchanges（Number of Listed Foreign Companies）

		As of June 2009		Foreign Companies	
Exchanges	Number of Listed Companies	Local Companies	Foreign Companies	% of the globe	% of the local
London	2,926	2,289	637	19.2%	21.8%
NYSE-Euronext (USA)	3,155	2,662	493	14.9%	15.6%
Singapore	762	453	309	9.3%	40.6%
Nasdaq OMX	2,894	2,616	278	8.4%	9.6%
Mexico	382	125	257	7.7%	67.3%
Hong Kong*	1,273	1,017	256	7.7%	20.1%
Luxembourg	259	32	227	6.8%	87.6%
NYSE-Eronext (Europe)	1,169	997	172	5.2%	14.7%
Frankfurt	815	728	87	2.6%	10.7%
Sydney	1,985	1,903	82	2.5%	4.1%
World's Total	46,019	42,702	3,317	100%	100%

Source：Statistics of Number of Listed Companies，World Federation of Exchanges, June 2009

Note*：Statistics of Hong Kong's foreign companies includes China's red chips and H-share companies

Geography of Finance: Information Concentration as the Key Determinant

Geography of finance shares the same theoretical foundations with economic geography, but they have different applications. While both of them stress economic volume and development, economic geography focuses on three concepts: economic production, economic center and economic hinterland. Geography of finance introduces the concept of information with an emphasis on services industries as well as information and communication industries. It deals with the location of transactions instead of economic production (Gordon, 2002).

There are two important concepts regarding geography of finance: information hinterland and information center (Gordon and Wójcik, 2003; Porteous, 1995). Information hinterland and economic hinterland resembles each other in some aspects but different in others. First, information hinterland is referred to as a place or location that captures lasting attentions and becomes a center of information and investment. Surely, while the limelight of the global investment, trade and commerce was focused on Southeast Asia over the past 30 years by 1997, China is very likely to become the world's hotspot and investment center for the next coming 30 years. That is what we call the information hinterland is changing to Mainland China from Southeast Asia. Accordingly, information hinterland will most likely change as well, but Hong Kong is fortunately associated with this two information hinterlands. The difference between information and economic centers lies in their respective relationships with economic hinterlands. An Economic center dominates and leads the production activities in economic hinterlands, thus the relationship is quite straightforward. This relationship does not necessarily exist for information hinterland and center. Information center does not have to do with production management; instead, it is the center for services and transactions. For instance, the Pearl River Delta is a production base and information flows facilitate successful deals and contracts, thus creating value. But the location for these information exchanges does not have to be Guangzhou or Shenzhen; it can be in Hong Kong. The same applies to the Yangtse River Delta (Zhao and et la., 2003, 2004 and 2005). In retrospect, all financial centers must be attached to financial information centers, while information centers rely on information hinterlands (economic hinterlands). But information centers generally detach themselves from production bases and economic centers.

Propelled by economic globalization and information technology, London's economy has been dissociated from the the rest of Europe, while New York was severed from North America's manufacturing industries. Hong Kong did not escape the same fate and its economic structure has entered the phase of restructuring and upgrade. Due to the recent rapid economic development and the Olympic Games, Beijing has also showed the sign of detachment from its economic hinterland. Under the special economic conditions of Socialism with Chinese characteristics, Beijing features some aspects of an information center. The changes in global information hinterlands necessarily cause financial centers to evolve. A financial center declines as its associated information hinterlands are diverted elsewhere.

Moreover, information hinterland develops cyclically. Both New York and Tokyo have gone through several cycles. Take the financial center development in Australia for example. In the beginning, Melbourne enjoyed the advantage of its close connection with Europe. Yet, with the rise of Asia and the transition of economic power to America-centered network, Sydney gradually replaced Melbourne. Similarly, while Canada's economic development largely relied upon its connections with Europe, Montreal served as the initial economic center. But as its economic connections with America and Asia played a more and more important role, Toronto flourished. As an application of this theory, we can speculate that, Vancouver is likely to prosper because of its increasing linkage with Asia; and that Los Angeles will continue to show a promising prospect. In the aftermath of the financial tsunami, the western economies have to resort to nationalism. China's boom is itself a harbinger of the development of a financial center. Information hinterland and information center can be used to explain the relationship between economy and the development of a financial center. China is the new world-recognized information hinterland. Beijing and Hong Kong serve as the state-led and market-led centers for policies respectively. These two cities will grow into China and the whole world's important information centers. In the past 30 years, Hong Kong thrived on Asia's information hinterlands, and will continue to thrive on China's information hinterlands in the 30 years to come. Under "one country, two systems", Hong Kong may even parallel London and New York (Zhao, 2009b). This is an application of the first theory. The next section will elaborate on Shanghai's development.

Law and Finance: Flexible Common Laws are favorable to financial development

The second theory explains financial center development from a more sophisticated legal perspective. It is intended to explore the reasons why some financial centers prosper while others remain sluggish. The second theory attributes these to the legal fundamentals.

Basically, there are two legal systems in the world: the Anglo-American system and the Continental European system (See Figure 3; La Porta and et la., 1997, 1998). The continental European system originated from Roman laws. Code Napoleon of France is the foundations for the continental European law system. The code along with a corpus of civil laws in Germany becomes the two major pillars of the legal system in continental Europe. Japan’s civil law system was modeled after France and Germany. Since Japan was the earliest country to modernize and westernize in East Asia, other East Asian countries’ civil laws commonly referred to Japan’s experiences for guidance. Currently, most countries in Asia adopt the Continental European civil law system, which has fundamental impacts upon the development of financial centers.

The Anglo-American legal system, or common-law system, is centered on jurisdiction and based on social customs, conventions, ethics as well as general commonsensical rules. Complemented by precise procedures, the system prioritizes impartiality, publicity and justice. Legal cases are decided based on past ones, stare decisis, unless there are significant changes in the situations. If there are not precedents to follow, the judge refers to other common-law-ruled regions or historical documents. Moreover, the common law system features its independence of politics, immunity against governmental intervention and the jury system. Verdicts that come out this way are more impartial, reasonable and convincing. And actually, this involves the process of legislation. Laws that are based on the accumulating cases resemble ethics and justice in that they already exist in every individual’s conscience. This system is robust, human and flexible without violating social customs, habits and ethics. Meanwhile, it need not stipulate what can and cannot be done, which cultivates far-reaching liberalism.

The Continental European legal system is centered on legislative power and advocates rationalism. It focuses on framing abstract concepts and codification. Every detail within every category of laws must be codified before becoming a law. The chief task of judges is to interpret and apply these rules, which is a very rigid process.

When there are discrepancies between rules and facts or newly emerging situations, this system shows no flexibility or resilience. Since the Continental European law system does not acknowledge the Anglo-American system, the tribunal has to make new laws, which in turn are up to political leaders to legislate. Therefore, the differences between common law and civil law have profound impacts upon the distribution of global financial centers (La Porta and et la., 2008).

Figure 3：Distribution of World Legal Systems

Source：La Porta and et la., 2008.

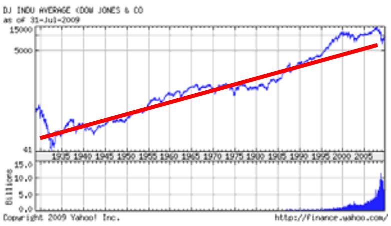
The distinctions among various law systems have led to different regulation philosophies. The Anglo-American system develops the industry-leader-centered regulations, while the regulations in Continental European system are largely up to political leaders. Industry-leader-centered regulations are supposed to protect small investors and the interests of industries. Political-leader-centered regulations aim at the protection of interests of institutions and nation-states. The associated consequences are starkly different. Take the privatization of PCCW in Hong Kong for instance. The minority shareholders won the lawsuit against its privatization. PCCW was Lee Ka Shing's second son's company. Two large shareholders of PCCW proposed the scheme of privatization and it was technically passed by the shareholders' meeting. The privatization proposal caused discontent among small shareholders and the SFC had to intervene. The first instance declared the success of PCCW. Small shareholders lodged an appeal. Ultimately, small shareholders and the SFC won the lawsuit, which resulted in the abortion of the plan. The judgment stated clearly its considerations for the interests of small shareholders.

In order to transform into an international financial center, the market should be able to play its role in effective financing and guarantee the interests of all participants. Thus, as the most important way to protect market operation, laws and tribunals would instead impede market development and competition if they lean towards syndicates. On the one hand, financial markets that are governed under an Anglo-American law system are overly flexible, may encourage reckless financial innovation and rely excessively on the ethical standards of bankers, particularly investment bankers. All these caused the biggest financial tsunami since the Great Depression. On the other, the rigid Continental European system develops dogmas for operation and regulation which hampers market development.

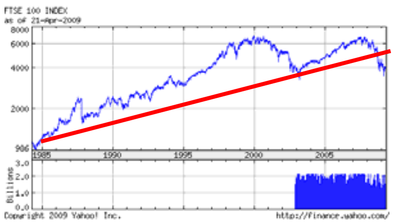
As a result, the two systems produce two distinct types of markets. Financial centers under Anglo-American system are dominated by securities markets, while those under Continental European system are mostly bank-centered (La Porta and et la., 2008). The Anglo-American system has been controlling global financial markets. Seven out of the ten largest financial centers operate under Anglo-American system. A comparison of the data from major securities markets in the past 30 years shows this trend of financial center development (See Figure 4). Firstly, as for Anglo-American system, asset appreciation can be seen in New York, London and Hong Kong; while no significant changes occurred to assets in Continental Europe. As for those Continental European markets in Asia, most assets incurred losses. Without fundamental improvements, these Asian markets could only be regarded as places for speculation. Lack of the support of long-term capital would lead to the underdevelopment of equities markets. As the largest financial center in Europe, London has long been the destination of global capital. Yet, in terms of cash and bond markets, Luxembourg, France and Germany are the biggest markets. Banks and bonds overwhelm these countries' financial markets.

Figure 4: A Comparison of the Three Systems of Stock Markets

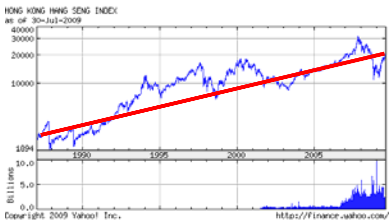
Anglo-American



New York: DJIA

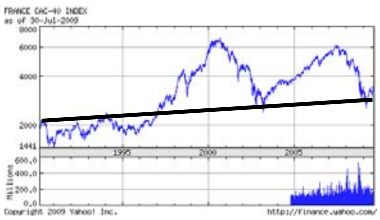


London: FTSE 100



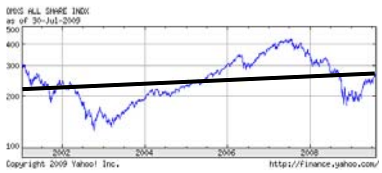
Hong Kong: HSI

Continental Europe



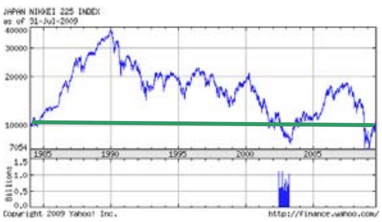
Paris: CAC40

Frankfurt: DAX

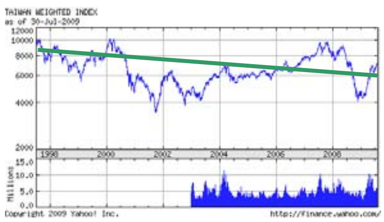


Stockholm: OMX

Asian Markets



Tokyo: Nikkei



Taipei: TWI

Shanghai: SSE Composite

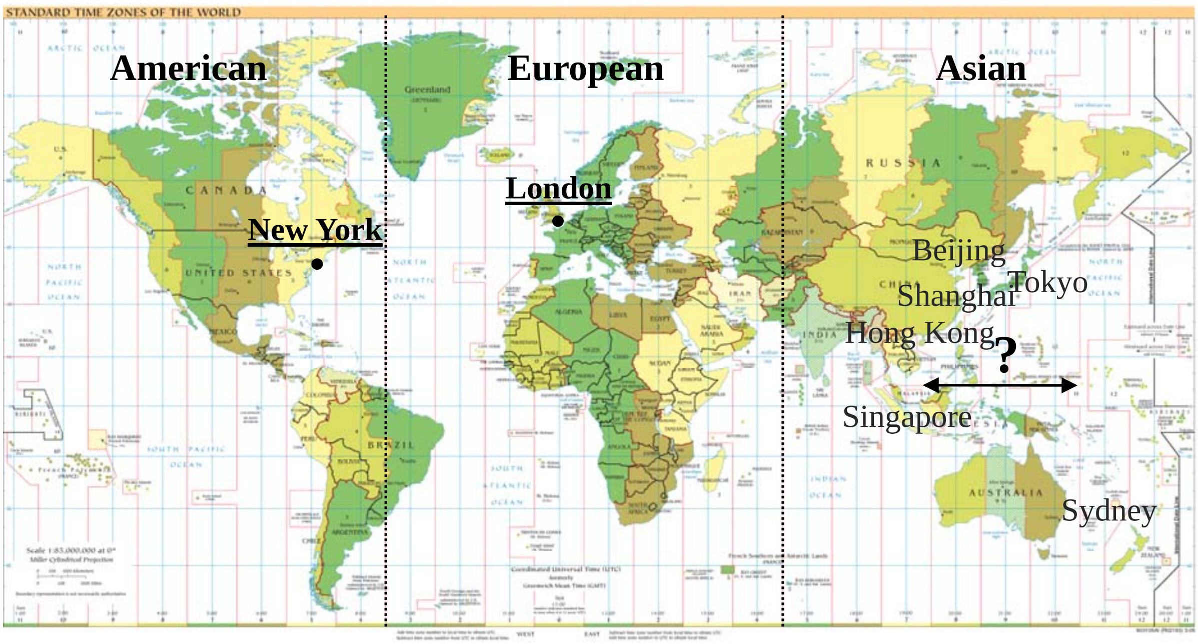
Source: Yahoo Finance, July, 2009

Time Zone Theory: the Irresistible Work-Rest Cycle

The third strand of theory is the time zone theory. What do American, European and Asian time zones imply for financial center development? Despite globalization and convergence of cultures, humans are still unable to defy work-rest cycles (Zhao, 2009a). A work-rest cycle is a natural rule developed during the long-term production and lives of human beings. People basically conform to this rule and cannot bear the burden of long-term overnight work and frequent cross-continent commuting. Physiological research shows that human bodies could suffer dysfunctions when dealing with more than 4 time zone differences. There is a positive relationship between the degree of sufferings and the number of time zone differences (Waterhouse et la, 2007). Therefore, the biological clock defines the segmentation of global markets and the three time zones. Global financial services specialize in respective time zones. If New York and London can be counted as the corresponding financial centers for American and European time zones, the global financial center in Asia is quite likely to emerge in the 8^{th} through the 10^{th} time zones. Following that are the specializations within time zones (Laulajainen, 2003; See Figure 5). It has been proved that in spite of the competition between New York and London, they cannot substitute each other's functions within respective time zones (Poon and et al, 2002, 2003; Wójcik, 2009). London competes with Hong Kong, Singapore and other Asian financial markets, yet they maintain their own advantages. Take the investment management industry in London for example, Asian capital accounted for merely 1% and the figure for USA was 27% (See Figure 6). It shows that only via Asian cities with free human capital, logistics, capital and information flows can global capital be invested in Asia. The concept "Nylonkong" brought up by TIME magazine was an application of the time zone theory.

The time zone specialization enables each financial market to process the transactions in stocks, commodities futures, gold and other financial products in a timely manner. International exchanges or markets are the most important thanks to their capacity for cross time zone transactions. Construction of exchanges or markets is conducive to the control of trading and pricing of products. Large investment banks hold the power of pricing, corporate valuation, IPO pricing and M&A bidding, and thereby have significant impacts upon the development of local firms. Therefore, exchanges or markets could help improve the competence of local investment banks and financial services. An international financial transaction platform with price setting power is an important indicator of international financial centers. As the global economic impetus gradually transfers to Asia and a comparable financial center emerges, the Asian markets will become the price setter of Asian and even American and European financial products. In the era of China's rise, the Renminbi will grow into a global currency, and the demand for Renminbi business and Chinese financial products will escalate. At present, every financial transaction platform establishes and develops markets for Renminbi and China-related products. Hong Kong is an open market and has the backing of the Chinese market, and hence has the greatest chance of becoming the international financial center for the Asian time zone and setting the prices of Chinese and global financial products. From the perspective of time zone theory and geography of finance, considering the size of economies, an international financial center that parallels New York and London is destined to emerge somewhere in Asia.

Figure 5: World's 3 Time Zones and Respective Financial Centers



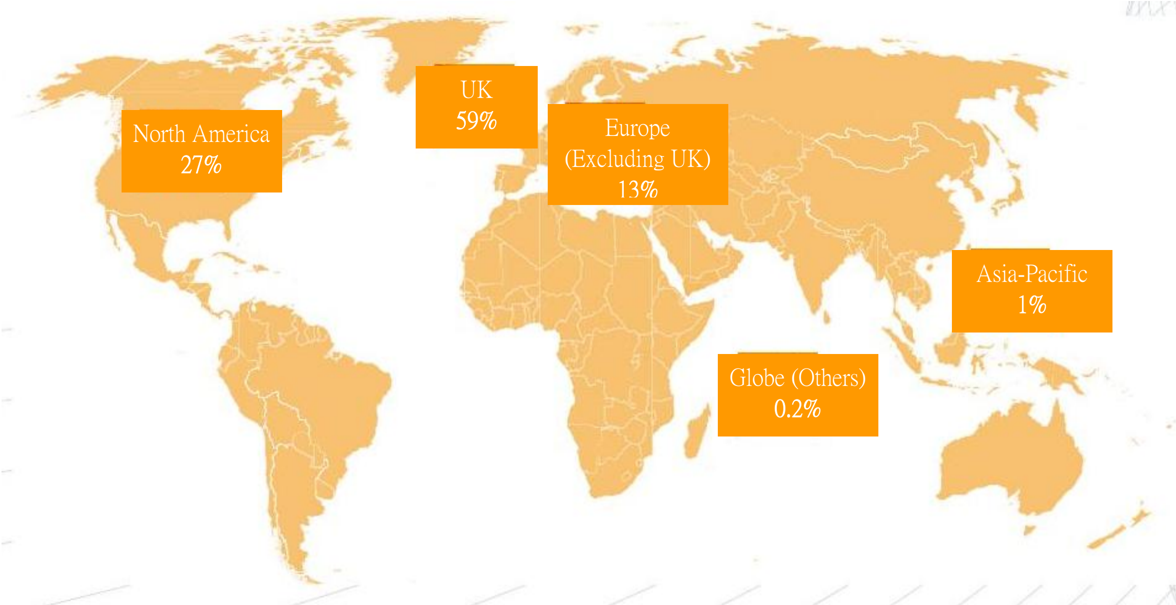
Source：Wikipedia，July 2009

The competition for China’s “international financial center” has intensified. Whether the competition will end up with one dominator left or several coexisting remains to be seen.

Pursuant to financial centers’ development path and experiences, there are two likely outcomes in China. The first possible ending is vicious competition without an apparent winner. Short of synchronized development and cooperation will result in a deadlock with three major players. Beijing, Shanghai, and Hong Kong, Shenzhen and Guangzhou enter a turf war with North China, East China and South China as their respective rear areas. No social welfare optimum can be reached. Similar to the case of Germany, because of historical, political and geographical reasons, eight separate financial markets coexisted but none of them is able to survive international competition. Even the current Frankfurt is not a match for London.

The second possible outcome is their specialization and complementary cooperation. The three major players will still remain, but when the Chinese economy is comparable to the USA, they are sure to integrate into the network of global financial centers. Karreman (2007) argued that Hong Kong and Shanghai were complementary as financial centers in terms of regional and sector specialization. The paper interpreted how market segmentation and comparative advantages gave rise to the collaborative roles of Hong Kong and Shanghai stock markets can play and are playing in terms of hinterland and sector specialization. The author systematically analyzed the interaction between the firms and the stock exchanges, which reside in the financial centers. High financial reporting standards may deter some new and small firms, which pursue a listing in stock markets, through imposing high information disclosure costs. These standards along with a well-developed legal environment, endow the investors with the ‘possibilities to gather, monitor and evaluate potential investment projects’. Firms could prefer a listing in a stock market with higher culturally homogeneity, higher liquidity and bigger size at lower communication costs, with abundant trading volume and better visibility and reputation respectively (also see Pagano, Panetta, Zingales, 1998).

Figure 6: Sources of Capital for Investment Management in London



Source: Investment Management Association, Asset Management in the UK 2007, 2008.

Firstly, with state-led economic development, Beijing has the capacity to develop into a banking center and financial policy center like Tokyo and Frankfurt. The first stock exchange was opened in Beijing in 1918 as a trading platform for government bonds of the day. The concentration of national financial institutions is helpful for the development of a bank-centered financial market in charge of the issuance of funds, bonds, treasury notes and even foreign exchange. Thus it could become a center for currency and capital flows. But the prerequisite is the Renminbi's free convertibility. The stock market capitalization in Shanghai has already ranked the 4th. The scale is likely to parallel New York. Its power will overtake that of Tokyo and become Asia's stock trading center. However, the underdevelopment of internal politics and legal system as well as the unopened capital account makes a Renminbi-dominated trading platform more plausible for Shanghai. With regard to Hong Kong, Guangzhou and Shenzhen, several favorable factors can contribute to the development of Hong Kong as Asia's international financial trading platform. These factors are geographical proximity, "one country, two systems", concentration of financial talents as well as the policy of "go and try beforehand" authorized by the central government. The Pearl River Delta will be likely to turn into China's and Asia's support base for financial services industries (Zhao, 2008). Hong Kong could develop into a Renminbi off-shore center, a regional bond market, a foreign exchange market and a service center for Chinese currency and financial derivatives. Like London in Europe, Hong Kong can become Asia's most advanced integrated financial center and China's asset management center. Finally, it could join London and New York and form "Nylonkong."

Therefore, China's financial center landscape can be prophesized as follows: Beijing, policy, control and banking regulation; Shanghai, trading operations; Hong Kong, asset management. It is hopeful these three places would first become China's own version of "Nylonkong." But in order to do so, it needs continuous reform and opening-up, mutual learning and cooperation and avoiding vicious competition (Zhao, Zhang and Christopher, 2009). Currently, there are several international financial centers, such as Chicago's futures market, Switzerland's off-shore banking, Geneva's private banking and Luxembourg's investment trust. They are all leaders in the respective industries. New York has the world's largest stock market, while the biggest fund house lies in London. Stock markets are more recognizable to the public, and that is why the two cities are always under the spotlight. The influence of a financial center depends on its strength instead of the visibility.

Policy Implication: Shanghai to develop into a global financial center

In order to develop an international financial center, Shanghai must be opened to international investors and adopt international standards. This is the only way to become an international center like New York and London. Shanghai absolutely has the strength to replace Tokyo as Asia's most competitive financial center. But its global reach largely depends on whether it caters to the interests of the entrenched or the nation's interests that strategically aims to integrate its national market with the whole world. In retrospect, China developed its stock market to reform state-owned enterprises and resolve financing constraints. But the development of an international financial center is not unilaterally decided by the state or government.

The recent article by Xiabin, a researcher with Development Research Center of the State Council, pointed out that, the central government simply followed the trend to choose Shanghai as China's financial center; and it was also out of historical and strategic considerations. If the Renminbi becomes convertible as expected, Shanghai will become a global "Renminbi financial center" in 2020 and its scale will surely surpass that of Hong Kong. Under "one country, two systems", Hong Kong has some advantages and its balance of payments are counted as overseas. Before China's capital market is fully open, Hong Kong should serve as a "bridge tower" during the transition period of financial strategies and a "buffer zone" for risk. Domestically, Shanghai should develop its financial markets, US dollar off-shore market and Renminbi off-shore market. Hong Kong should focus on the development of a Renminbi off-shore market and play its supporting role for the nation's financial strategies. It should explore how to upgrade its economic structure. After the transition period, the fate of Hong Kong dollar is going to change and Hong Kong's Renminbi market will leech on to Shanghai.

The views may represent the opinions of domestic officials and mainstream scholars and reflect the consistent logic of "government-led", "omnipotent" and "top-down" administration. We argue that these logics are applicable to the development of domestic financial centers. But, to develop an international financial center like New York and London, this ideology should be overturned.

In sum, our analysis basically justifies the central government's policies to develop Shanghai into an international financial center. Yet, a deeper understanding of financial center cooperation is conducive to the future development of China's financial center. Hence, this study has the following policy recommendations:

1. China's historical rise offers China (including Hong Kong) to develop a global financial center, as elaborated by geography of finance and time zone theory. But it should be made clear that a big economy can create a huge financial center but unnecessarily an international one let alone a global one. Tokyo and Frankfurt are good examples of these.
2. The old "government-led" ideology should be overturned. To protect a

minority of vested interests can hamper the development of an international financial center. Conversely, small investor protection is the foundation of an international financial center. The mode of hosting an Olympic Games may ensure the development of domestic financial centers but not the international financial centers. Policies should be centered on small investors instead of nation, syndicates and institutions.

3. Excessive policy support and governmental intervention can just prevent the development of international financial centers. A fair, impartial, open and transparent environment with the rule of law, regulations and contracts is essential to the attempt. Policies should only be intended to support the construction of infrastructures, laws, fair markets and regulation systems.
4. In consideration of the national security, China's peaceful rise and public welfare, China should make good use of Hong Kong's resources as an international financial center, enhance the cooperation among Hong Kong, Beijing and Shanghai, and build China's own version of Nylonkong.

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