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The rise of international financial centers in mainland China

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ABSTRACT

This paper assesses the major cities in mainland China that are competing to become international financial centers (IFC). Shanghai, Beijing, and Shenzhen are compared in terms of their strengths and weaknesses as IFCs. We find that in China, the state plays a particularly important role in the growth of a financial center by providing favorable policies, creating localization economies, consolidating banks, and strengthening the city's power through state-owned enterprises. Our analyses generate a contour map of China's emerging IFCs in a global context and thus provide an important first step toward theorizing IFC development in a transitional economy.

Introduction

Recent financial geography literature highlights the importance of global financial institutions and stresses the role of money in the economic landscape of capitalism (Clark, 2005; Clark & Wojcik, 2007; Cohen, 1998; Lee, Clark, Pollard, & Leyshon, 2009; Leyshon & Thrift, 1998; Martin, 1999). With the financial industry's growing share of the global economy, finance is becoming an important source of power and innovation, as well as a way to govern circuits of value (Levine, 1997; Lee et al., 2009). In conjunction with these discussions, the ups and downs of financial centers have become a focus both of academic research and of public policy (Dicken, 2003; Gehrig, 2000; Grote, 2009). Since the 1980s, financial services have shifted and diversified on multiple geographic scales. International financial centers (IFCs), such as New York and London, continue to amass significant resources such that they remain the most powerful financial control centers in the world (Sassen, 2001, 2006). Positioned lower on the hierarchy, some established financial centers such as Tokyo and Frankfurt are currently declining in importance, whereas others, including a few regional financial centers, Hong Kong and Singapore among them, are rising as new competitive IFCs (Z/YEN, 2007–2014).

In this context, the growing competitiveness of financial centers in mainland China has become a subject of both scholarly and popular interest (McCauley & Chan, 2009; Mu & Seng, 2010; Xinhua, 2007, 2008). China had the world's second largest economy in 2011, the largest foreign exchange reserves accumulated by trade surplus, a banking industry that had remained relatively intact since the global financial crisis of 2008–2009, and a capital market predicted to become the world's third largest by 2016 (Xinhua, 2007). Given the size and dynamism of China's economy and the rapid globalization of its corporations and banks, the nation's financial institutions are expected to become key players in the global financial market. It is also expected that China's currency, Renminbi (RMB), will assume a more important international role when the influence of American dollars declines in the emerging world (Economist, 2012c; World Bank, 2011). As an important step for China in its path toward modernization and global leadership, it is possible that an IFC on its mainland might eventually compete with Hong Kong and other rising IFCs (McCauley & Chan, 2009; Mu & Seng, 2010; Shan & Qi, 2006; Wong, 2007).

Against this background, a discourse has emerged that centers on a potential "contest" between rival cities, particularly between Shanghai and Beijing, over gaining recognition as China's leading national financial center and achieving IFC status. Some studies, such as the *Global Financial Centre Index* (*GFCI*) reports have rated Shanghai higher than Beijing in terms of both financial resources and competitiveness (Z/YEN, 2012). However, basing their assessments on more extensive comparative studies of Chinese cities, some scholars consider Beijing to be the most powerful financial center, stressing its status as the nation's capital and noting its recent success in expanding major domestic banks and attracting corporate headquarters (Yin & Cai, 2010; Zhao, 2003; Zhao, Zhang, & Wang, 2004). In addition to these two major cities, Shenzhen is a new contestant with great potential to rise as an IFC due to its vibrant economy and growing financial sector (Zhao et al., 2004; Z/YEN, 2009–2014). In the recent Z/YEN (2014) ratings, Shenzhen ranked 18th, above Shanghai in 20th and Beijing in 49th place.

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There is a gap in the current literature on IFCs in China in regard to how they compare with IFCs worldwide. The approaches used in many IFC studies are based on market economies (Cassis, 2010; Cohen, 1998; Poon, 2003; Wong, 2006). Therefore, it may not be appropriate to apply these approaches directly to an emerging economic powerhouse like China, because its state capitalism has a strong influence on the growth of financial markets. On the other hand, IFC studies on China are usually bifurcated and create "piecemeal" knowledge that pertains solely to China. For example, some scholars stress the importance of market power and the influence of global forces, whereas others primarily stress the supremacy of state control (Yin & Cai, 2010; Zhao, 2003; Zhao et al., 2004).

The aim of the present paper is to investigate rising Chinese financial centers in the world arena and the theoretical implications for the current literature on IFCs. In particular, the paper is intended to explore the interplay of market, institutional, and other forces in the development of mainland Chinese cities toward IFC status. First, we will explore how the three cities compare with established IFCs in regard to financial performance and what this means for the potential of each to achieve IFC status, and then we will examine the development of three financial cities in China: Shanghai, Beijing, and Shenzhen. Our study of mainland China's leading cities focuses on the interplay of four central forces—institutional, market, geographical, and historical—in the nation's development in an era of globalization. We find that although China's leading cities appear to be driven by similar factors including agglomeration, a strong state under incomplete marketization is the single dominant player creating favorable conditions for these cities. Such a hypothesis is key to understanding and elaborating state capitalism vis-à-vis global forces: the state that functions as the leading economic actor versus global forces that serve as the paramount market power in developing countries. With the empirical evaluation of the state's role in promoting financial centers, our methodology and argument address and bridge the conceptual gap in the literature regarding the geography of institutional forces (Clark, 2005) and advance research on the development of IFCs in emerging economies.

A review of the literature on financial services and financial centers and a brief survey of empirical studies on China in this regard are outlined in the next two sections. The fourth section analyzes three leading Chinese cities, Shanghai, Beijing, and Shenzhen, in the context of financial centers worldwide. The fifth section compares the state's role in shaping the respective strengths and weaknesses of each city. The final section summarizes the study's findings.

Financial services and the development of international financial centers (IFCs)

Financial services are tertiary sectors that facilitate the transfer of monetary assets. In the current global economy, banks, stock brokerages, investment funds together with credit card, insurance, and consumer finance companies are the main providers of financial services (Wojcik, 2007, 2009). In recent history, finance has become a booming industry, fueled by an explosive combination of economic growth, globalization, technology, and innovation.

Financial services usually cluster in cities, or what are known as financial centers (Kindleberger, 1974; Nadler, Heller, & Shipman, 1955; Tschoegl, 2000). Measured by the geographic scope of the services offered, financial centers can be classified as national, regional, or international. National centers, such as Athens and Jakarta, act as the main center for financial services within a single country (Poon, 2003). Regional centers, such as Frankfurt and Toronto, conduct a large proportion of cross-border transactions among countries in a region (Garcia-Herrero & Wooldridge, 2007). National and regional financial centers are not only markets that channel funds between demand and supply, but play important roles in investment, capital accumulation, urban economic growth, and technological change (Levine, 1997; Martin, 1999).

International financial centers or IFCs, such as London and New York, participate in cross-border asset trade on a global level. Historically, an international financial center with a truly global reach develops in a large, stable economy where the national currency is an international reserve currency widely used in global invoicing and settlement (Krugman, 1984). In the 17th century, Dutch guilder was accepted worldwide and Amsterdam was the top IFC in the world. In the 19th century, however, the British pound sterling replaced Dutch guilder as an international currency when London became the world's most important financial center, and the British pound was gradually replaced by the US dollar as a world reserve currency when New York City emerged as the paramount international financial center in the early 20th century (Cassis, 2010; Cohen, 1998; Krugman, 1984). All these international financial centers grew and their currency strengthened when their national economy took a predominant role in the world. Therefore, it is argued that an international financial center's competitiveness lies in the size and power of the domestic market (Economist, 1992).

In the modern economy, IFCs often have a large share of foreign-exchange markets and are usually home to world-famous banks and/or a stock exchange (Economist, 1992; Gehrig, 2000; Poon, 2003; Sassen, 1999). For instance, New York City hosts the New York Stock Exchange as well as world-leading banks such as Goldman Sacks, JP Morgan, and Citigroup. Similarly, London hosts the London Stock Exchange as well as world-leading banks such as HSBC, Standard Chartered, and Barclays. The growing power of these IFCs may penetrate the national space of capital to reshape international political and economic relations (Cohen, 1998).

Localization of these financial institutions produces a strong agglomeration effect. Given that today's complicated global economic network relies on intensive division of labor, spatial agglomeration of financial services reduces firms' transaction costs when gathering and interpreting information (Agnes, 2000; Guillain & Huriot, 2001; Storper & Venables, 2004). Such a Marshallian-localization economy also generates a large pool of financial professionals, which deepens regional specialization and lowers the costs associated with recruitment (Agnes, 2000; Hanson & Pratt, 1992; Porter, 1998). Furthermore, an economy of this nature facilitates technology spillover and innovation in financial services (Fosfuri & Ronde, 2004; Fujita & Thisse, 2000; Romer, 1990).

Aside from a localization economy, an urbanization economy serves as an important factor in the formation of IFCs as well. First of all, large cities enable financial services to take advantage of economies of scale in terms of information and communication industries so that financial intermediation can be provided to large volumes of trade at a low cost (Porteous, 1995). World City and Global City theories also offer explanations for the formation of IFCs (Friedmann, 1986; Sassen, 2006). Both theories argue that by hosting multinational corporation (MNC) headquarters large cities have control and management power in the international economy and in international politics. In a complicated global market, MNC headquarters rely extensively on advanced producer services in a volatile world economy, including financial services (Mori, 2002; Noyelle & Stanback, 1984; Sassen, 2006; Thrift, 1994). Due to the complexity of these businesses, only a small number of large cities are capable of providing services that are sophisticated enough to allow an MNC's headquarter to operate globally. Such cities are most likely to grow into IFCs that provide cross-border transactions on a global level.

In conjunction with the effect of an agglomeration economy, path dependence offers an important explanation for the