Can Shanghai become a global financial centre?

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Shanghai's current stock market turmoil has left the many observers wondering about short-term implications for the global economy. Looking beyond immediate worries, two issues are worth noting. First of all, the current crisis is an unmistakable sign that the Post-Western World is already a reality: two decades ago, a plummeting stock market in the global economy's periphery would have hardly caused global tensions. Today, by contrast, the saying "When China sneezes, the world catches a cold" seems remarkably fitting. After all, a staggering 38% of global growth in 2014 came from China, and 120 countries trade more with China than with any other country.

Secondly, the current crisis adds an interesting twist to one of the Chinese government's most ambitious and fascinating strategies, which symbolizes the extent to which China is willing to alter global structures: to turn Shanghai, a regional also-ran behind other geographically close cities like Hong Kong, into a global financial centre capable of challenging New York and London, the world's only truly global financial centres. According to China's State Council, this should be achieved by 2020.

Financial centres concentrate enormous economic power, and being home to one is seen as crucial to complement Chinese efforts in the realm of trade expansion and military modernization. Put differently, a global power cannot do without a global financial centre.

As Kawaii (an economics author?) explains,

A regional centre can grow to function as a global financial centre if it offers deep and liquid financial markets for global players – in addition to national and regional players; becomes a hub for global financial information; has a reservoir of highly educated and well-trained professionals (for investment banking, law, accounting, and information and communication technology (ICT); provides a conducive, responsive regulatory environment; and ensures economic freedom supported by unambiguous legal certainty.

China's challenge, thus, is a complex one that involves not only the set-up of a clear regulatory framework, but also attracting global talent from around the world, which requires turning Shanghai itself into an attractive city. Considering how low Chinese cities tend to rank in the global quality of life indexes (as virtually all urban centres do in developing countries), the Chinese government may have to undertake profound reforms to generate the momentum necessary to make young talents prefer Shanghai over New York, Zurich, Singapore, or other financial centres around the world. The government is considering lowering income tax for financial staff to become more attractive, particularly since income tax in Hong Kong is as low as 15%. Considerable investments in education, such as the Advanced Institute of Finance at Shanghai Jiao Tong University, are meant to help enhance the city's still insufficient intellectual infrastructure – after all, banks still prefer Singapore and Hong Kong due to their larger talent pool -- another area in which rich countries almost always beat poorer ones. If the Chinese government were ever to experiment with greater free speech, they may start in Shanghai, as censorship is unlikely to help bring international talent to the city. Anecdotal evidence suggests that most executives in finance from around the world would ask for substantial pay rises to accept a posting in mainland China, even though Shanghai offers a far more comfortable life style than Beijing or Chongqing.

China's objective to turn Shanghai into a global hub is intimately tied to internationalizing the yuan, creating the China International Payment System (CIPS) and the establishment, in 2013, of the Shanghai Pilot Free Trade Zone (FTZ), which is seen as the Chinese government's most innovative experiment. Initially the first free trade zone on the Chinese mainland, it has already led to three additional free trade zones, in Fujian, Guangdong and Tianjin. It is in these zones – and primarily Shanghai – that the Chinese government is set to conduct liberal experiments, not only regarding trade, yuan convertibility and interest rate systems, but also regulatory issues concerning joint ventures in the financial sector. Indeed, full convertibility of the yuan would be a requirement for Shanghai to begin to rival the existing financial centres. Before that, any such talk seems far-fetched.

In addition, the Shanghai Gold Exchange (SGE) launched, in 2014, a global trading platform in the city's pilot free trade zone, a move meant to challenge the dominance of New York and London in gold trade and pricing – considered to be of great strategic importance. China has recently turned into the world's leading importer of gold, and the SGE is the world's largest trading platform for physical gold. However, Shanghai does not yet