

## **The Asian Significance of Financial “Tale of Two Cities”- Hong Kong and Shanghai**

Shanghai Forum 2013

### **1. Issues and Challenges**

At present, with China's notable rapid economic development, Asia has become an important force in shaping the global economy. However, compared to Europe and North America, the regional cooperation in Asia is still lagging behind in some aspects, restricting Asia's ability to promote its position in shaping the global structure, which is very incommensurate with Asia's own economic development level. The main challenges faced are:

- 1) Excessive dependence on the U.S. dollar.** Under the U.S. dollar standard, Asian countries cannot feasibly get rid of the “Trilemma”: in an open economy only two of the three goals— a fixed exchange rate system, full capital flows and the independence of monetary policies—can be achieved. Any attempt to realize these three goals simultaneously will lead to a monetary crisis.
- 2) East Asia becoming the world creditor.** The imbalance of international payments will continue. The foreign reserve that East Asian countries have accumulated will recycle by flowing out. To cope with the pressure of the money appreciating, some East Asian countries will carry out measures that open the capital out-flows. Also, because of the impacts by the U.S. subprime mortgage crisis and in addition to other financial turmoils, some large international financial and hedge funds institutions will be utilized in order to reduce the mixture of newly emerging markets and their respective security portfolios as a better way to address the carrying amount of loss. Lastly, on a local level, East Asian countries are less inclined towards investing.
- 3) Lack of regional financial monitor mechanisms.** Judging from the severe financial crisis, the transmission of the financial crisis has become one of the essential characteristics of financial globalization. On one hand, this phenomenon greatly undermines the effectiveness of individual countries to intervene. On the other hand, because the international financial institutions cannot provide timely and corrective assistance, it is very necessary to set up regional financial monitoring mechanisms. However in Asia, one of the longstanding policy debates suggests there is nothing in place to take on such a role.
- 4) The path of the Asian financial and monetary cooperation.** In the past ten years, Asia's financial integration has gradually increased but generally speaking, Asian countries are still very dependent on the U.S. market. The intensifying effects of financial globalization are forcing Asian countries to deal with new and serious challenges. An Asian regional financial cooperation should address many of the new challenges. More reasonable and effective solutions need to be explored in order to deepen the level of the cooperation, to ameliorate the risk of instabilities in East Asia and to fight against the excessive shocks from external

markets.

## **2.Promoting co-opetition of the financial industries in Shanghai and Hong Kong achieves a win-win scenario.**

When looking at capital demand and supply relations, Shanghai is the finance center, where foreign capital inflows to Shanghai and spreads around, while Hong Kong is the financial center's buffer where domestic capital is absorbed and flows out from. This complementary relationship suggests that Hong Kong mainly relies on the promotion of policies while Shanghai is more reliant on a strong domestic economic basis.

- 1) Shanghai and Hong Kong are in different development phases so it is necessary for them to complement each other.** The most important issue for Shanghai is to improve the structure of its own financial market; it is most important for Hong Kong to develop its own way because Hong Kong is restricted by its limited market. Hong Kong has a sound system, and via the mechanism of "A + H", adhering to the rule of law and other regulations in Hong Kong, it can help to improve the regulatory system in Shanghai and facilitate the reform of Shanghai's financial system. Because the framework of Shanghai's financial market is not adequate, it alone cannot afford all of the various large corporations that are listed. This problem can be compensated by Hong Kong and also be used to help to stabilize Hong Kong's position as a financial center.
- 2) Expand the scale of the financial sector to adapt to the needs of China's economic aggregate.** The rapid development of China's economy increased the demand for a financial industry and led to the rapid growth in financial assets. The expansion of scale of the financial sector was achieved through the formation and development of a financial center. As China's economic aggregate is expanding, it is necessary and beneficial to adapt to the needs of the open and evolving market. In order to promote further trade and investment is necessary to have several highly open central cities like Hong Kong. A financial cooperation between Shanghai and Hong Kong will lead to the expansion of the scale of China's financial sector and is an objective need for China's economic development.
- 3) Accelerate the maturity of the financial system by complementary functions.** From an international comparison aspect, characteristics of the financial centers are not the same. The two financial centers—Hong Kong and Shanghai, were developed under different conditions, and they each developed a set of unique but respective characteristics, which serve as a complementary foundation. The structure of the labor division between the two cities is to some extent decided by the extensive market factors. Therefore, concrete policies thus cannot be planned beforehand.
- 4) The two different currencies will give birth to the relative differences between the developments of the two financial centers.** Because of the special exchange rate program for Hong Kong dollars and the established characteristics of its financial market, it is reasonable to permit Hong Kong to remain a financial

center based on Hong Kong dollars. The first goal of Shanghai's financial center is to serve as a gateway for foreign capital to come into China and to be the distributive center for domestic financing and marketing, while being based on RMB. Therefore, the two cities will develop simultaneously. Before the implementation of a free exchange rate of the RMB, the impact of different currencies on the characteristics of the financial center will undoubtedly be more notable.

- 5) **The “A+H” shares listing mechanism provides an opportunity for the two cities to cooperate.** In order to become an international financial center, Shanghai has to carry out significant reforms and adjustments on the financial infrastructure. Through the “A+H” shares listing mechanism, Hong Kong’s effective supervision facilities can be utilized to monitor related mainland shares so that the gap of the supervision level between mainland and Hong Kong could be reduced.
- 6) **Hong Kong and Shanghai have different functions and can develop in simultaneously.** There is no international financial center in the world that is full-featured enough to tackle global business. Due to the different market institutions, the different opening levels of economic and monetary regulations, and the different historic backgrounds, Hong Kong and Shanghai inevitably have functional differences. These functional differences are the focus for these two financial centers to try and develop a cooperative relationship.

### **3. Policy Suggestions**

The construction of Asian free trade zones has promising outlooks and much room for expansion. However, if Asian countries do not take action and carry out tangible practices as soon as possible towards the construction of an Asian free zone, developed western countries, primarily the U.S. and the European Union, will further dominate the world trade system.

- 1) **If China wants to play an active role in the construction and development of an Asian free trade zone and benefit from it, we should pay extra attention to the experiences and lessons the EU has got when tangled with similar issues.**
- 2) **From the economic aspect alone, we should pay attention towards the development and construction of an Asian free trade zone, especially towards the negotiations among East Asian countries and areas (e.g. Japan and Korea).** As far as the free trade zones that are already constructed or will soon be constructed are concerned, when allocating relative resources, the Chinese government should make priority to focus on the differences of the categories of the imported and exported goods in the free trade zones (e.g. imports of goods in the agricultural, energy and mineral products category) so that relative resources can be made and used more effectively.
- 3) **When policy makers or researches of different Asian countries negotiate and study the cooperation level of regional economy, the dependence on foreign trade is only one of the factors to be considered.** Additionally, the size of the country in the region, current economic development levels and the impact

of various factors should also be taken in to consideration. Furthermore, with regards to the construction of Asian free trade zones, the Asian members should treat International trade protectionism policies and instruments carefully and according to their specific economic development characteristics and conditions.

**4) Concerning the Asian financial monetary cooperation, East Asian financial cooperation is an important trend.** However, by far, an East Asian financial cooperation is still in its primary stage. The urgent task that East Asia will soon be facing is the development of a feasible regional cooperation structure that has a long-term goal to promote the substantial development of the East Asian financial cooperation.