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COMMENT

Opinion

Amid economic rubble, Shangkong will rise

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Two years ago, bankers and policymakers were arguing heatedly over whether New York or London was the world's premier financial centre. Amid the post-crisis rubble that covers both cities, those arguments now look terribly passé.

Financial services will still bring good jobs, revenues and vitality to cities that can attract them. Moreover, history shows that great financial centres confer significant global influence on the countries where they are located. Competition among these business hubs will thus remain intense.

Once the global recovery begins, however, New York and London might be vying less with one another than with a new competitor in the form of a partnership between Hong Kong and Shanghai – call it “Shangkong” – a highly consequential shift of financial gravity to the east.

Both New York and London will be nursing serious wounds for years. In both cases, budget deficits will be gigantic, resulting in higher taxes and cutbacks in public investment in the kind of services – transportation, education, even culture – that attract talent. In each city we can expect a big increase in financial regulation, not to mention ad hoc government interventions, adding to the cost and unpredictability of doing business. Controversies about financial remuneration will cause many professionals to seek other types of employment.

The status of New York will also be undercut by the emergence of another big financial centre on the east coast: Washington DC, now the world's largest sovereign wealth fund and soon to be the epicentre of world financial regulatory reform. The increased intermingling of politics and finance will create new risks in the US financial system. On the other hand, China will be the world's largest creditor for decades. When Great Britain and the US each held this position, they were the prime global financial centres.

China owns several of the world's largest banks, all well capitalised. It has a large reservoir of big companies and up-and-coming ones that will be going public on the Hong Kong and Shanghai exchanges. It has a rapidly growing middle class with enormous savings that will encourage the development of a bigger and more sophisticated financial services sector. Its growth rate is still above 6 per cent (compared with negative rates in the US and UK) and it will emerge from the financial crisis far stronger than either America or Britain.

China lacks the sophistication of Wall Street or the City, but given the mess that complex and opaque securities have caused, a simpler system has its virtues. China will need to free up its currency in global markets, but this has been happening as the renminbi has risen 16 per cent against the dollar in the past year and Beijing has recently allowed several countries to hold the renminbi in their reserves.

How could China make a big, dramatic leap? It could begin by strengthening the links between Hong Kong and Shanghai, and transferring financial know-how from the former colony. The two cities are 750 miles apart, not an insurmountable distance in this age of rapid transit and internet communications. The connections are already being made: Beijing has just declared that [Shanghai](#) will be a major global financial centre in the next decade and co-

operation between Hong Kong and Shanghai is growing, as shown by recent agreements to work together between key exchanges in both cities. Beijing could declare that Shanghai and Hong Kong will have a common set of regulations and recruit some of the world's best financiers to bolster its regulatory structures – perhaps luring them with an advantageous tax regime no longer possible in the west.

Besides that, if China continues to raise questions about the dominance of the US dollar and the need for an alternative monetary system, other countries may have no choice but to listen – and gradually act. An eclipse of the dollar would be mirrored by a rise in the use of the renminbi. That would guarantee Shangkong's prominence.

The US and the UK must understand that, as they rebuild banking systems, the vitality of their financial centres is important to growth and prosperity, and also to geopolitical influence. This entails looking at regulation, taxes and quality-of-life infrastructure with an eye towards keeping the most talented people. Unfortunately, powerful political forces are moving in the opposite direction. The US and the UK could be paying a steep price for many years into the future.

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