

# Obstacles Shanghai may face in the Process of construction of the International Financial center

Zhang Ting

Business School, University of Shanghai for Science & Technology, Shanghai 200093, China

**Abstract:** Shanghai intends to basically be constructed an international financial center consistent with China's economic strength and its international status by 2020. However, compared with the mature international financial center, Shanghai still has a large gap in many aspects and faces many difficulties and challenges from other cities. In this paper, we will study the difficulties and challenges Shanghai faced in the construction of international financial center.

**Keywords:** Shanghai; International financial center; Difficulties

In March 25, 2009, the State Council of the People's Republic of China approved in principle 'On promoting Shanghai to speed up the development of modern service industry and advanced manufacturing industry, the construction of international financial center and an international shipping center'. Shanghai will be basically constructed to be an international financial center consistent with China's economic strength and its international status by 2020. In February 2012, the national development and reform commission formally proposed the development target of Shanghai to be the international financial center in the 'Twelfth Five-Year Plan' period. That is aiming at the world first-class international financial center, expanding financial services, promoting financial innovation, constantly enhancing the international content and global influence of the financial markets in Shanghai, striving to basically establish Shanghai to be the global trading, product innovation, pricing and settlement center to 2015. Hence we can see that it has become the urgent implementation of a national strategy to forge Shanghai to be an international financial center.

However, compared with the mature international financial center, such as New York, London, Hong Kong and Singapore, Shanghai still has a large gap in many aspects and faces many difficulties and challenges from other cities. There is a long way for the final completion of the international financial center of Shanghai. In this paper, we will study the difficulties and challenges Shanghai faced in the construction of international financial center.

## 1. Interest rate marketization problem

At present, the interbank interest rate, bond repurchase transactions and bond interest rate, discount and rediscount rate, the interest rate of the policy banks issuing the financial bond, treasury bonds interest rate

and large foreign currency deposit interest rate has already been marketed. However, the local currency deposit and loan interest rate has not let go. The non-market-oriented interest rate directly affects the market's leading role in the capital pricing, which leads to low efficiency of financial resource allocation. Besides, it is bound to affect the scale, structure, efficiency and the process of internationalization of Shanghai financial market, and eventually affect the pace of the construction of Shanghai international financial center.

Firstly, non-market interest rate restricted the scale expansion of Shanghai financial market. Because of insufficient of the breadth and depth of the development of financial market, the interest rate is hard to market. But it is undeniable that non market-oriented interest rate cause the undeveloped financial market. Although the National Inter-bank Funding Center and foreign exchange center has established in Shanghai, the number of listing corporation in Shanghai stock market is larger than Shenzhen stock market, and Shanghai has won more than 90% of the national treasury trading. While from the view of the construction standards of international financial center, Shanghai is far from it in the monetary market, capital market, foreign exchange market and the insurance market. One important reason for this situation is the restriction of the interest rate control, which makes the interest rate difficult to rationalize, the market integration and support insufficient, the capacity of the market hard to expand.

Secondly, the non-market interest rate causes the unreasonable of the structural of Shanghai economic and financial market. Rigid interest rate caused the commercial banks unable to set lending rates according to the risk measure, so that the current financial institutions and financial instruments cannot adapt the development of many kinds of ownership economy. Limited financial resources served for the traditional state-owned enterprises. Non state-owned enterprises,

small and medium-size enterprises and high-tech enterprises those playing an important role in the economy are hard to obtain effective financial services, thus affecting the entity economy growth that the international financial center relying on. In addition, the degree of interest rate liberalization in different market is inconsistent, for example, interbank lending and bond market interest rate liberalization is earlier, and the credit market interest rate in short term cannot be completely open, which leads to the non-equilibrium development in different markets. This is not in favor of the construction of the diversified and reasonable financial market system.

Once again, the non-market interest rate will greatly reduce the efficiency of market in Shanghai. The deposit and load interest rate are decided by the government, which means that a considerable part of income of the commercial bank has been guaranteed. It squeezes the competition between financial institutions through the capital price and weakens the incentives of the financial institutions seeking profits from other means. This is especially likely to cause moral risk of state-owned commercial banks and the restrained behaviors the soft budget brings. Eventually the non-performing assets ratio will high all the time, operating efficiency cannot improve quality. But the state-owned commercial banks take a large proportion in Shanghai financial sector. Interest rate regulation makes all financial institutions including state-owned banks cannot determine the operating cost, pricing, reasonable allocate financial resources according to the rules of the law of the market scientifically.

Therefore, in this sense, the non-market interest rates led the overall business management ability of Shanghai financial industry improved slowly. And the national control of the level of interest rate makes the financial market innovation inhibited. No autonomy in the decision of the interest rate will go ill with the launch of the new financial tools, products and services to facilitate the business development of the financial institutions. Interest rate is the cost basis of the funds. No matter the original financial assets like stocks and bonds, or derivative financial assets like futures and options, their pricing and operation are closely related to the equilibrium interest rate. If the non-market interest rate cannot reflect the supply and demand of funds in the market, it is not the basis for the pricing of the financial assets. Financial assets pricing is an important technical support of the financial market innovation, so the lack of the ability of pricing power of financial products becomes a chain in the financial market innovation.

Finally, the non-market interest rate will slow down the internationalization process of the financial industry in Shanghai. If Shanghai wants to become the international financial center in the future, first of all, it should be a global financial products pricing center. Unfortunately, the pricing function in current interest rate regulation is absent. Another sign of international financial center is the quality of the presence of foreign financial institutions. The elements attracting foreign financial institutions including political stability mechanism, market maturity, infrastructure facilities and loose interest rate environment. If the changes in interest rates are regulated, the competitive advantage of the

foreign financial institutions will be weakened, thereby affecting their enthusiasm of their presence in Shanghai.

## **2. Legal environment problem**

In the modern market economy, because of the huge financial market and complicated financial transactions, all the financial activities based on the market should depend on certain legal principles. Financial center also must have a robust and flexible legal system foundation, as well as an independent and effective judicial system, to support and enforce law system. Congenitally deficient legal environment has become a bottleneck in the establishment of Shanghai international financial center. Perfect, efficient and transparent legal environment can protect the legitimate rights and interests of market participants and ensure safety of the financial transactions.

In recent years Shanghai has made great process in the improvement of the legal environment. But in some aspects, such as legal system, legal environment, legal services, legal transparency and public awareness of law, Shanghai is still lagged behind Hongkong, Singapore and so on. For example, manufacture and transmission of false and insider information, market manipulation, and cheating investors often occur in the stock market. Financial reporting fraud of listing corporations never stopped. Now we should absorb from other countries and introduce the laws timely. It is the effective means of Shanghai in the acceleration of the construction of the legal environment of the international financial center.

## **3. Lack of financial talent problem**

There is a big gap from the construction of international financial center in the aggregation of financial talent in Shanghai. The density of financial talent in Shanghai is relative high in the country. But compared with the target of international financial center, the gap is obvious. According to the official information, New York as the international financial center has 770000 financial talents; Hongkong has 350000 financial talents. But Shanghai has only more than ten million. More than 10% of the population engaged in the financial industry in the world's international financial center. At present the ratio in Shanghai is only 1%. Therefore, strengthen training and the introduction of financial talents should become a pressing matter of the talent construction work in Shanghai.

Shanghai financial talent structural contradictions are still prominent. It still showed in short supply of the common talents and senior specialized talents. This contradiction is mainly due to the discordant in business and talent structure of the bank. Talent structure of the bank is determined by the structure of the business of the bank. In turn, talent structure of the bank will affect the business structure of the bank. Along with the space of deposit and load interest rate shrinking, many commercial banks began to carry out strategic adjustment of business structure. The focus of development gradually shifted to the intermediate business to provide a range of services for customers. However, credit

business was the main business of our commercial banks for a long time, which creating a large number of talents in credit business. Talents capable of investment banks, financial derivatives, financial transactions, corporation finance and personal finance are relative lack. The lack of human resources and the low quality become a bottleneck restricting the development of banks. Although the implementation of Shanghai financial talent has achieved remarkable results, but until now outstanding leaders of financial enterprises who both have solid theoretical foundations, familiar with financial services and strategic vision and strong capability are still scarce resources. The quantity of managerial and administrative personnel who master modern knowledge of finance, market development ability, familiar with international market rules and international practice are still unable to meet the needs of the construction of Shanghai as the international financial center. The construction of talent team still has a long way to go.

The comprehensive quality of Shanghai finance talent team needs to be further improved. From the cultural quality, the proportion of senior and high degree of high-level personnel of Shanghai financial talent team is still relatively small. Although the staffs obtained international certification has increased compared with the total staffs, it is only very rare. The international talents who can skilled use English is still rare too. Such talent condition reflects the large gap compared with foreign financial institutions. High-quality financial personnel need not only the high cultural quality, but also high physical and mental quality. The financial industry is a big temptation risk industry. Its industry characteristics require practitioners should face a faster pace of life and greater mental pressure. If financial personnel cannot timely release the pressure, it will cause them different degrees of psychological problems. Psychological problems not resolved in a timely manner will cause physical problems, which led to a lot of people in sub-health state. Therefore, in order to improve the comprehensive quality of employees, training of employees of the enterprises should not only from the

knowledge and culture, but also from the industry psychological quality.

#### **4. Facing strong competition from other cities in China**

In recent years, some domestic cities such as Beijing, Tianjin, Guangzhou, Shenzhen, have their plans to establish financial centers. Especially Beijing, in May 2008, formally put forward to build the capital of the international financial center. This would not only form competition patter with Shanghai in capital, market, customers and so on, but also make Shanghai more difficult to access policy priority and the franchise. In this before and after attack, the construction of Shanghai financial center should seek from the incremental financial services to the largest share, which neither impact Hongkong nor do harm to the existing interests of Beijing or other cities.

#### **Reference**

- [1] E.P.Davis. International Financial Centers: An Industrial Analysis .Bank Of England Discussion. 1990, 36-40.
- [2] Huang yuncheng, Wen Xiaobo, Yang zaibin. Analysis of basic conditions and main gap in the construction of Shanghai international financial center. Shanghai Economic Research. 2003, 17-19.
- [3] Lian ping, Zheng Zhong. The marketization of interest rates and the construction of Shanghai international center. Shanghai Finance. 2001, 75-77.
- [4] Saskia Sassen. Global Financial Centers. Foreign Affairs. 1999, 74-75.
- [5] Tu Guangshao. Cross-border RMB trade settlement and the construction of Shanghai international financial center. Chinese Finance. 2010, 18-19.
- [6] Wang Chuanhui. A comparative study on the international financial center and the enlightenment to China. The Research on World Economy. 2000, 24-28.