

## Hong Kong and Shanghai as China's Window to Global Capital

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## ABSTRACT

Since the reforms of Deng Xiaoping began the opening of mainland China, financiers have been positioning themselves strategically in order to gain competitive advantages in controlling and coordinating capital exchange between China and the global economy. One of the key strategic decisions these global financiers face is how they access the networks of capital, because these networks are the means through which they acquire access to mainland political officials and private and public firms in China. Thus, global financiers are faced with how they will integrate into the key pivots of the financial networks of China—Hong Kong and Shanghai. On the one hand, Hong Kong has been the pivotal meeting place of the Chinese and foreign networks of capital in Asia since the late nineteenth century. On the other hand, Shanghai has been the pivot to access capital markets in central and north China, also since the nineteenth century. And, the Beijing leadership and the municipal government of Shanghai have been vigorously promoting the city as an international financial center for its traditional hinterland. The competition between the governments of Hong Kong and Shanghai in promoting their cities as China's global financial centers introduces another element of uncertainty into the decision making of financiers regarding their access to China's capital markets. This paper argues that Hong Kong and Shanghai are hubs of intersecting networks of financiers who control the exchange of capital (financial, commodity) at three territorial scales—China, Asia, and global. The network relations between the Chinese (mainland and Overseas Chinese) and foreign (outside Asia) financiers position Hong Kong as the Asia-wide hub and China's link to global capital networks, whereas financiers from Asia and elsewhere access the China market mainly through Shanghai. Yet, Hong Kong also is a key base to access the Mainland's financial markets, because its financiers have deep ties to South China. Consequently, global financiers are developing a multi-level strategy, with their highest level of decision-makers for Asia in Hong Kong, and secondary financiers in Shanghai. However, those financiers which are focused only the China market in Asia are mostly choosing Shanghai. Mainland China, therefore, is developing global financial centers which occupy two tiers, and Hong Kong and Shanghai already rank among the leading financial centers in the world because of the massive and growing capital exchanges between China and the global economy.

## The China Factor

China's high rate of economic growth generates an enormous, increasing amount of domestic capital for investment, and this growth attracts swelling amounts of foreign capital for investment in China. Its economy (in real terms) more than doubled (203 percent) between 1990 and 2002, and the amount of annual foreign direct investment (current dollars) rose 131 percent between 1990 and 2001. The large-scale economic growth of China is shifting the relative balance of economic power in Asia. While Japan remains Asia's greatest economy, its slow growth of 14 percent from 1990 to 2002, if maintained over a long period, will lead to a rapid relative decline of Japan within Asia. China's economy was only 0.08 of the size of Japan's in 1990, but by 2002 China's was over one-fifth (0.22) the size of Japan's. If China's economy only doubles in size by 2010 and Japan's increases by about one-fifth, then China's economy will be almost four-tenths (0.36) the size of Japan's. By the middle of the twenty-first century, China's economy may very well be the largest in Asia. The gap between China's growth and other less-developed countries such as Thailand, which also are rapidly industrializing, may enlarge. In 1990, China's economy was almost four times (3.6) as large as Thailand's, and, by 2002, China's economy was almost seven times larger (6.6). This increasing gap is also showing up in foreign direct investment. In 1990, China received only 1.2 times the investment of Thailand, but, by 2001, China was receiving over ten times (10.2) the amount of annual foreign direct investment.<sup>1</sup>

These economic trends suggest that global financiers will be focused on China as the pivotal economy of East and Southeast Asia. Thus, financial firms which aim to be global leaders in Asia must position themselves as the key intermediaries of the exchange of capital both within China and between it and the global economy. On the one hand, it could be argued that financial centers outside China might be the operational bases for the global firms. After all, London is the world's leading global financial center, and it also dominates financial exchanges in Europe. National financial centers such as Paris (France) and Frankfurt/Berlin (Germany) are relatively unimportant, other than as national centers. And, even then, London financial firms, which include branches of firms headquartered in the national financial centers, provide the major links to global finance. In Japan's case, Tokyo houses huge Japanese banks which operate globally; thus, it might be argued that Tokyo could serve as the pivotal operational base for global financial firms which would control China's exchange of capital. Yet, that is unlikely, because Tokyo has never been the pivot of Asian finance. Hong Kong has served in that capacity since the late nineteenth century, and global financial firms either supervise their Japanese operations from Hong Kong, or the Tokyo office reports directly to the international headquarters in Europe or North America. Tokyo has never been a center of Chinese financiers; consequently, it does not serve as a hub of the social networks of capital which link Chinese and foreign intermediaries from outside Asia. Hong Kong has operated as that hub for Asia, including each of the subareas of East and Southeast Asia, and Singapore has been a hub for Southeast Asia. Japanese financiers in Tokyo have used that city as a base to operate in mainland China, but few foreign firms follow that lead; these foreign firms prefer to use Hong Kong.<sup>2</sup>

If external financial centers are unlikely to be the operational bases for global financial firms which aim to control China's exchange of capital, this still leaves open the question whether Hong Kong or Shanghai will be the chief headquarters for global firms. This debate has

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<sup>1</sup> World Development Indicators, World Bank.

<sup>2</sup> David R. Meyer, *Hong Kong as a Global Metropolis* (Cambridge, Eng.: Cambridge University Press, 2000).

been on-going since at least the time of the reversion of Hong Kong to China's sovereignty in 1997, and the debate continues to the present. Several themes dominate much of the discussion over the future of the two cities as China's global business center. Some observers argue that Beijing leaders favor Shanghai because it is an authentic mainland center, not tainted by long ties to a foreign power. Others argue that Shanghai was the greatest financial center of Asia during the early twentieth century, and its reascendance is only a matter of restoring what was its birthright. Still others claim that foreign multinationals are flocking to Shanghai and the Yangtze Delta to establish their manufacturing bases, and this will solidify that city's stature as China's business center. Finally, the point is made that the massive development of the Pudong Zone in Shanghai, with its ports, industrial districts, and financial district, is clear evidence that Shanghai is the most dynamic city of China. Hong Kong's days of glory are in the past.<sup>3</sup>

This debate over which financial center—Hong Kong or Shanghai—will be the headquarters of firms which operate as China's premier window to global capital, therefore, reduces to two broad issues. Observers tend to rely either on historical roots as justifying the future or on assertions that Shanghai is China's natural leading city because it is part of mainland China, whereas the termination of Hong Kong's colonial advantage undercuts its status as an international base for a resurgent China. The absence of a sound theoretical foundation for approaching this debate provides a weak analytical basis for adjudicating it. A sketch of such a theoretical approach offers a basis for re-examining this debate about China's future global financial center.

### Theorizing About International Financiers

International intermediaries are the decision-makers who control the exchange of capital across national boundaries; thus, their business always enmeshes them in political negotiation and conflict with nation-states. As they operate within that political-economic environment, their capacity to control this exchange rests on at least two features of their business and their actions as intermediaries: their specialization and amount of their capital; and their participation in social networks of capital.<sup>4</sup>

Intermediaries employ specialization of their business as a competitive weapon to control the exchange of capital. Opportunities to specialize emerge from the demand side when economic growth and development enlarges demand for a given intermediary service previously provided as part of a diversified portfolio of services offered by an intermediary or emerge from the supply side when an innovative intermediary service is developed that meets the needs of those requiring services. This new specialized service may be provided separately within an existing firm; thus, the firm dedifferentiates—that is, it adds the specialized service as a separate business while retaining other specialized services or less-specialized services. Alternatively, the new specialized service may be provided within a new firm that takes on the specialized service as its core business. Typically, intermediaries with greater access to information about the demand and supply of capital and with larger amounts of capital are better-positioned to add the

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<sup>3</sup> Tom McHale, "Hong Kong vs. Shanghai," *Electronic Buyers' News* (July 14, 1997); Mark Graham, "Industry Burgeons, Skyline Soars: Shanghai is Set to Rise Even Higher as a Global Center," *Industry Week*, vol. 249, no. 7 (April 3, 2000), pp. 36-37; Mark O'Neill, "Shanghai Plays Waiting Game; With Big Hurdles to Overcome, the City is a Long Way from Being the Wall Street of Asia," *South China Morning Post*, Business Post (March 2, 2004), p. 2.

<sup>4</sup> For a longer discussion of specialization, capitalization, and social networks of capital of international financial intermediaries see Meyer, *Hong Kong as a Global Metropolis*, pp. 5-27.

new specialized service. The high fixed costs of information acquisition (telecommunication infrastructure) and information processing (high-wage labor, computers, and software) and low variable costs for incremental provision of an intermediary service mean that economies of scale often are present in intermediary services. For example, the total cost to trade \$100 million of a currency will be far less than 100 times the cost to trade \$1 million; thus, per-unit costs plunge. Greater specialization in intermediary services and the larger scale of business that accompanies such specialization often means more-specialized intermediaries must operate over larger territories to have sufficient business to operate at higher levels of specialization. Financial intermediaries operate through a hierarchical linkage structure whereby more-specialized intermediaries exchange with each other and with less-specialized intermediaries, whereas the latter mostly exchange with the former.

Intermediaries participate in local (metropolitan) social networks of capital to access specialized business information and cooperate on the exchange of capital. Repeated social interactions are important for building trust, because participants can evaluate new information in the context of previously obtained information; and, the social network provides alternative checks on the trustworthiness of exchange partners. At the same time, the social network of participants offers a means to punish malfeasance, because members can build a consensus about punishing a malefactor. Exclusion from the social network of intermediaries is an extreme form of punishment, because no intermediary can operate in isolation. Intermediaries must expand their networks outside a small local network to enlarge their access to information and gain additional exchange partners. Over-reliance on a small network results in too much redundant information, and too much time spent in a small local network reduces the time to find alternative exchange partners. Therefore, intermediaries need to build bridges to other social networks of capital within a local network and to local networks in other metropolitan centers. These bridges enlarge the number of partners in exchange, and they enhance access to specialized business information. The most effective bridges are those built to pivotal members of other social networks locally and in other metropolitan centers.

### The Past Matters

Hong Kong is the global metropolis for Asia and China's main window to international capital. Its intermediaries of capital will continue to operate that way in the future; yet, such a contention seems to be contradicted by evidence. Tokyo's huge financial institutions and leading global corporations headquartered there make it one of the big-three global metropolises; and Singapore continues to attract large numbers of regional headquarters of firms with operations in Southeast Asia and some in East Asia. Shanghai attracts large numbers of global financial institutions and regional headquarters of firms active in China; and its Pudong zone of development for these international firms will make Shanghai the financial and corporate management center of China. On the basis of size measures of finance, Hong Kong ranks high, but Tokyo and Singapore sometimes rank higher; thus, Hong Kong does not seem to stand significantly above these centers as a global center. Beijing's determination to boost the financial stature of Shanghai seems to imply diminution of Hong Kong's stature as the international financial center for China. However, this evidence neglects the more important determination of the stature of metropolis—the extent that it is a social-network hub of intermediaries who are the most specialized and capitalized decision-makers in the control of capital exchange.<sup>5</sup>

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<sup>5</sup> Y. C. Jao, *Hong Kong as an International Financial Centre: Evolution, Prospects and Policies* (Hong Kong: City University of Hong Kong Press, 1997), pp. 23-56; Meyer, *Hong Kong as a*

The past does not always serve as a basis for predicting the future, but when the question is the control of capital exchange, the past matters. Social-network hubs in the control of capital exchange are not simply created or changed by individual decision-makers who can decide that an alternative metropolis is preferable as a base from which to operate. New decision-makers must assess which intermediary agglomeration possesses the greatest access to social networks of capital. Therefore, the most astute among them choose existing agglomerations of the most-specialized and highly capitalized intermediaries who are the pivotal hubs in capital exchange locally and who are the key bridges to social-network hubs in other metropolises. These choices continually reinforce the stature of the leading hubs as the top pivots in the exchange of capital. If a decision-maker chooses not to locate in the leading hub, then the firm hurts its competitive advantage to control the exchange of capital.

Hong Kong has been the pivotal intermediary hub of Asia since the social networks of capital were mostly structured around the 1840s to 1870s. Participants in the networks have appeared and disappeared, wars and economic contractions have reduced network activities, revolutions and the termination of colonialism have altered the political-economy, and the exchange of capital has expanded with economic growth and development. Nevertheless, the overall structure of the social networks of capital both within Asia and with the global economy outside Asia have retained remarkable resilience. The networks are founded on a core principle: Hong Kong is the premier Asian meeting place of the Chinese and foreign social networks of capital. Since the 1840s-1870s it has housed the most-sophisticated decision-makers in the control of capital exchange, and it houses less-sophisticated decision-makers.

Shanghai consistently has been the leading social network hub for central and north China, and the conduit of capital between these parts of China and the global economy. Because Shanghai housed the leading Chinese intermediaries with control over capital exchange for these parts of China, it was chosen by the foreign intermediaries as their base to operate in central and north China—often through the Chinese intermediaries—when these foreign business people arrived beginning in the mid-1840s. Shanghai's Chinese and foreign (British, United States, and others) financiers solidified its status as the financial center of central and north China by the 1870s, and this had been foreshadowed by the Hongkong and Shanghai Bank, which placed its leading Asian branch there by the mid-1860s. That branch reported to the Hong Kong headquarters.<sup>6</sup>

Even while China was mostly closed to Hong Kong intermediaries from the early-1950s until 1978, Hong Kong maintained its position as the premier hub of capital networks in Asia. After the opening of China with the reforms of Deng Xiaoping in 1978, the scale and specialization of intermediaries in Hong Kong soared and economic growth and development elsewhere in Asia also contributed to their growth and change. This enhancement of Hong Kong as the social network hub of Asian capital exchange continued right through the episodic political uncertainty leading up to the return of Hong Kong to Chinese sovereignty in 1997. Shanghai's re-emergence as the chief choice of foreign intermediary firms who want to access central and north China occurs both because the internal Chinese intermediary networks must have been maintained in some form through government firms during the early-1950s to 1978 period and because Beijing officials, with strong prodding from Shanghai officials, have

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*Global Metropolis*, pp. 228-35; Saskia Sassen, *The Global City: New York, London, Tokyo* (2nd ed.; Princeton, NJ: Princeton University Press, 2001).

<sup>6</sup> Meyer, *Hong Kong as a Global Metropolis*.

supported the re-birth of Shanghai as the hub of social networks of capital for central and north China. Therefore, the salience of the past social networks of capital in Asia continues.

### Shanghai as China's Financial Center

The Yangzi Delta and its hub of Shanghai are undergoing rapid economic development, driven, in part, by large-scale industrial growth. And, the two hundred million people in this region are among China's wealthiest, a status which they share with residents of southern China bordering Hong Kong, with those in the area south of Shanghai bordering Taiwan, and with those in the Beijing region. Foreign firms view Shanghai as the business center which gives them the best access to the large, wealthy market in the Yangzi Delta, and these firms also use Shanghai as their point of entre to central and north China. The Shanghai government established the Pudong development zone in order to concentrate its provision of high quality infrastructure for foreign firms in manufacturing, transportation, communication, trade, and finance. Thus, this zone is one of the prime targets for foreign direct investment in Shanghai. Some foreign business services firms, such as those in advertising or in air freight, have organized their operations using Shanghai as their headquarters for China, indicative of the view that the city is the premier business center of the nation.<sup>7</sup>

Shanghai officials promote the city as an international financial center, and their goal is to develop policies which enhance the financial infrastructure and services, such as domestic interbank loans, a national paper market, foreign exchange trading, and bond markets, which would be provided. The contribution of the financial industry to the city's economy has been increasing; from the mid-1990s to about 2000, the share of finance (including insurance) in the city's gross domestic product (GDP) rose from ten percent to fifteen percent. Many of the financial institutions are being encouraged to locate in the Pudong development zone, and, as of 2003, these organizations, which numbered one hundred forty-three, contributed about thirteen percent of the zone's GDP. Nonetheless, finance's contribution to Pudong's GDP fell behind the logistics sector, which accounted for seventeen percent of the zone's GDP.<sup>8</sup>

The degree of and timing of the opening up of China's financial markets to participation by foreign financial institutions impacts the status of Shanghai as an international financial center. This is so, because the importance of such a center is a function of the degree to which foreign firms locate in a national financial center. These foreign firms provide access to global networks of capital, and domestic financial firms gain from contact with foreign firms. The process of opening China's financial markets to allow the participation of foreign firms made slow progress during the 1990s. A small number of foreign banks were allowed to open branches, but their activities were largely restricted to the foreign-currency business—loaning money to foreign and domestic firms and providing various services in association with this

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<sup>7</sup> Huei-chen Flannery, "Shanghai Booms as Center of Advertising Influence," *Advertising Age*, vo. 68 (October 27, 1997: supplement), p. 24; Leonard Hill, "Freighters to Shanghai," *Air Transport World*, vol. 37, no. 3 (March 2000), pp. 95-96; Anthony G. O. Yeh, "Pudong: Remaking Shanghai as a World City," *Shanghai: Transformation and Modernization Under China's Open Policy*, edited by Y. M. Yeung and Sung Yun-wing (Hong Kong: Chinese University Press, 1996), pp. 273-98.

<sup>8</sup> "Shanghai Hailed Financial Prosperity in 2000," *Asiainfo Daily China News* (February 1, 2001); "Shanghai Set to be International Financial Center," *ChinaOnline* (March 22, 2001); "GDP of Shanghai Pudong Up 17.5% in 2003," *Global News Wire-Asia Africa Intelligence Wire, Business Daily Update* (February 13, 2004).

business. By the end of the 1990s, a small number of foreign financial institutions were allowed to conduct local-currency business in renminbi. Nonetheless, they were only able to do this in a few business centers, and they had to have branch assets of at least \$150 million and demonstrate at least two years of profit. This was difficult to do, because they made little money on their foreign currency business. With the accession of China into the World Trade Organization in 2001, China agreed to a timetable for liberalizing the country's financial markets. Consequently, through the 1990s Shanghai held little attraction to foreign financial firms, other than as a place to set up a small branch operation in anticipation of subsequent liberalization of China's financial markets.<sup>9</sup>

The policy of China to restrict the business of foreign financial firms in China, which severely impacted Shanghai through the 1990s, and continues to the present, rests on fears which have some validity. The country's financial institutions confront substantial threats, which are often dismissed by foreign firms. First, foreigners claim that Chinese banks benefit from *guanxi* (special relations) with local clients and government officials, but China's bankers say that this often draws them into making political loans, many of which are unprofitable or which are never paid back. Second, foreigners claim that the four big Chinese government banks have an overwhelming lock on the domestic market because they have thousands of branches all over China. For example, the Industrial and Commercial Bank of China, the nation's largest, has about forty thousand branches. However, many of these branches are in small towns and small cities in the country's vast areas of rural poverty, whereas the foreign banks are concentrated in the rich cities and they can tie their clients to their global financial networks. Finally, foreigners argue that China's banks have access to huge amounts of cheap renminbi deposits, for which they pay low interest on, yet China's bankers claim that those deposits will quickly move to foreign banks which have greater access to global financial markets and can pay higher interest rates on deposits. And, large government banks in China are quite weak, because a high percentage of their loans are categorized as nonperforming, that is, there is little likelihood the loans will be repaid. This limits the capacity of these banks to give out new, profitable loans to sound businesses. These problems imply that China may move slowly in its implementation of WTO liberalization, thus inhibiting Shanghai's rise as an international financial center.<sup>10</sup>

Nevertheless, foreign banks have been expanding their operations in Shanghai in anticipation of subsequent liberalization of China's financial markets. The typical approach of these foreign banks has been to begin with a small branch in Shanghai and gradually build their business. Then, some of them establish a China headquarters in Shanghai, which reports either to the international headquarters or to the Hong Kong office which oversees the Asia-Pacific region. Citicorp, whose incarnation from the early nineteenth century had a China office in 1902, began a small business in China in 1984 and opened a small retail branch in the historic Bund district of Shanghai in 1997. The bank established its China headquarters in the Pudong development zone three years later, and this office reports to Hong Kong, where the Asia-Pacific headquarters is located. However, these moves by Citicorp do not mean that its China business from the Shanghai base is booming. Limited renminbi currency business can be carried out, and its investment banking arm can participate in the renminbi-denominated domestic A-share

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<sup>9</sup> Phillip Moore, "Foreign Banks in China: Will WTO Open the Door?" *Euromoney*, no. 377 (September 2000), pp. 24-26.

<sup>10</sup> Pauline Loong, "What WTO Means for Chinese Banking," *Asiamoney*, vol. 11, no. 6 (July-August 2000), pp. 20-25.

market as of 2003. However, restrictions remain on the number of branches which Citicorp can open, and China cannot afford to open its financial markets too much to a global powerhouse such as Citicorp, regardless of the WTO timetable for liberalization, because China's four big banks remain too sickly to face full-fledged competition from a sophisticated global bank.<sup>11</sup>

The Hongkong and Shanghai Banking Corporation (HSBC) and Standard Chartered, both of which are now headquartered in London, are prominent global banks which have been active in Asia since the mid-nineteenth century, and they both use Hong Kong as their Asia-Pacific headquarters. HSBC moved its China headquarters from Hong Kong to the Pudong zone in Shanghai in 1999, and the office reports to Hong Kong. In 2001, the bank took an eight percent stake in the Bank of Shanghai, whose majority shareholder is the Shanghai government. By 2004, HSBC and the Bank of Shanghai had initiated a joint venture of offering China's first foreign-branded yuan credit card, and HSBC was contemplating raising its stake in the Bank of Shanghai. In early 2004, Standard Chartered was talking with the Bank of Communications, China's fifth largest government bank; the business networks of this Shanghai headquartered bank would provide Standard Chartered entre to Chinese consumers and firms. These moves by leading Asian banks boost the status of Shanghai as China's financial center, but, as of now, their expansion in Shanghai does not challenge the pivotal position of Hong Kong's financial institutions as the headquarters for the most sophisticated financiers in Asia.<sup>12</sup>

### Hong Kong as the Financial Center of Asia

For all of the commentary which stresses that Shanghai will challenge Hong Kong for the position as China's global financial center, Shanghai is vastly overshadowed by Hong Kong. As of 2003, the Pudong, which is the core of Shanghai's effort to house global firms which require financial services, had only 26 regional headquarters of international firms, whereas Hong Kong contained 966. In Shanghai as a whole, 143 financial firms operated and this included banks and insurance companies, and many of these banks were only representative offices with little depth or breadth in offering financial services. In contrast, a total of 73 of the world's largest banks operated in Hong Kong as of 2003. It had 136 licensed banks, which offer a full range of financial services, another 42 banks with had restricted licenses, an additional 40 banks which were deposit-taking companies, and still another 92 representative offices. Virtually all of these different types of banks were foreign banks.<sup>13</sup>

The Hongkong and Shanghai Bank (HSBC), arguably the leading bank in Asia since the mid-nineteenth century, maintains an organizational structure which positions Hong Kong as its

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<sup>11</sup> "Citicorp Opens Office in Shanghai Hotel," *American Banker*, vol. 162, issue 161 (August 21, 1997), p. 4; Neel Chowdhury, "Can Citibank Crack the China Market?" *Fortune*, vol. 142, no. 6 (September 18, 2000), pp. 222-28; "China—Citibank to Build in Shanghai," *ChinaOnline* (December 6, 2000); Julie Walton, "WTO: China Enters Year Three," *China Business Review* (January-February 2004), pp. 10-15, 37.

<sup>12</sup> "China—Citibank to Build in Shanghai," *ChinaOnline*; "HSBC in Talks to Buy Minority Stake in Bank of Shanghai," *ChinaOnline* (November 29, 2001); "Standard Chartered in Talks to Buy Stake in China's Bank of Communications," *AFX News Limited* (January 16, 2004); "HSBC Plans to Increase Stake in Bank of Shanghai," *Global News Wire-Asia Africa Intelligence Wire, Business Daily Update* (February 12, 2004).

<sup>13</sup> "GDP of Shanghai Pudong Up 17.5% in 2003," *Global News Wire-Asia Africa Intelligence Wire, Business Daily Update*; [www.info.gov.hk/info/hq.htm](http://www.info.gov.hk/info/hq.htm); [www.tdctrade.com/main/si/spbank.htm](http://www.tdctrade.com/main/si/spbank.htm).

Asian headquarters, and, since 1999, Shanghai has become the China headquarters which reports to Hong Kong. Thus, this management organization signifies that the bank houses its most specialized financiers, with the greatest decision making power over the exchange of capital, in Hong Kong. Similarly, highly specialized financial organizations such as Morgan Stanley Dean Witter Asia, the regional organization of the global investment banking and brokerage firm headquartered in New York City, structures its Asian operations with Hong Kong at the pivot. That regional headquarters has overall supervisory management over Morgan Stanley's operations which span from India to Korea and in a north-south span from Seoul to Sydney. Symptomatic of Morgan Stanley's view of its Asian operations, it hired Alasdair Morrison, formerly group managing director (effectively the head) of Jardine Matheson, in the year 2000. Morrison had worked with Jardine Matheson in Asia for almost thirty years, and, from his various positions with this firm, which has been highly networked throughout Asia as a provider of trade and financial services since the early 1800s, he brought to Morgan Stanley an Asia-wide grasp of finance. Financiers such as Morrison are hubs of Asian financial networks; therefore, other financiers who aim to access the most sophisticated networks, must engage in social networks which revolve around individuals such as Morrison. And, these individuals are based in Hong Kong.<sup>14</sup>

The financial firms in Hong Kong continue to pursue innovative strategies to remain competitive. HSBC has been the premier Asian bank since the 1870s, and it continually reacts to competition from international banks from outside Asia. Major European and United States investment banks have expanded significantly since 1990, and this has pressured HSBC's regional dominance. Thus HSBC recently restructured its investment banking operations to form an integrated Asian group with executive staff in nine countries. This restructuring builds on the bank's long term ties to these countries' financiers, a competitive advantage that firms from outside Asia cannot easily duplicate. The highly competitive financial firms in Hong Kong continue to innovate in order to maintain market positions. Brokerage firms, both locally owned and those owned by firms headquartered elsewhere, work together through the Stock Exchange of Hong Kong to provide sophisticated online brokerage operations, and they do this knowing that many of them may fail due to the heightened competition. Hong Kong's enormous telematic (telecommunications, media, and computer technologies) infrastructure serves its financial firms' Asian and global operations. It has the greatest fiber-optic linkages within Asia and to countries outside Asia, and its internal system is fully digital. The government works with the private sector to build the latest, most sophisticated telematics infrastructure in order that firms can remain competitive.<sup>15</sup>

China's support for Hong Kong as its premier global financial center has been unwavering, before and after the return of Hong Kong to Chinese sovereignty in 1997. In the

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<sup>14</sup> Quak Hiang Whai, "Ex-Jardine Taipan to Head Morgan Stanley Asia," *Business Times (Singapore)* (August 22, 2000), p. 19; "Opening a Bank Account," *Sunday Business* (September 24, 2000), p. 25.

<sup>15</sup> Simon Brady, "HSBC Beefs Up its Investment Bank," *Euromoney*, no. 382 (February 2001), pp. 12-16; David R. Meyer, "Hong Kong: Global Capital Exchange," *Global Networks, Linked Cities*, edited by Saskia Sassen (New York: Routledge, 2002), pp. 249-71; Kazuhiko Shimizu, "Hong Kong's Online Brawl," *Institutional Investor (International Edition)*, vol. 26, no. 2 (February 2001), pp. 36-40; Alan Siu, "Hong Kong: Asia's Global E-conomy," *The OECD Observer*, no. 224 (January 2001), pp. 82-4.

following year, the Bank of China relocated the headquarters of its international unit from London to Hong Kong and brought together its global investment banking under the Hong Kong office, as an explicit show of support. Beijing officials send their top financiers to work in Hong Kong where they become integrated into the city's most important financial networks, and then rotate them back into China. While their terms in Hong Kong are limited to less than seven years in order to prevent them from becoming permanent residents of Hong Kong, these employment trajectories of senior officials who are pivots of China's financial networks provide Hong Kong financiers with superb network connections through these government financiers with China's financial networks. For example, Liu Jinbao, who had been in Hong Kong for over six years and served as the chief executive of Bank of China (Hong Kong), was slated in 2003 to become the head of the Bank of Communications, China's fifth largest state commercial bank which is headquartered in Shanghai. And, these linkages are reciprocal. Laura Cha, who was born in Shanghai, educated in the United States, and served with the Hong Kong Securities and Futures Commission for ten years and as deputy chairman in the years leading up to 2001, was appointed that year as Vice-Chairman of the Chinese Securities Regulatory Commission (CSRC) which is headquartered in Beijing. She was the first vice-ministerial level official recruited from outside mainland China. Cha's pivotal position in Hong Kong's financial networks comes both from her position at the Hong Kong Securities and Futures Commission and from her family ties—her husband is a wealthy Hong Kong businessman whose family owns a real estate company. She serves as a bridge between Hong Kong financiers and the top of the mainland Chinese financial networks.<sup>16</sup>

### Hong Kong and Shanghai are Not Competitors

The rhetoric of competition between Hong Kong and Shanghai, which is occasionally promoted by their city governments and picked up by outside observers, does not reflect the reality of their positions as hubs in the social networks of capital in Asia. Beijing consistently supports Hong Kong as its window to international capital markets, and it enshrined that in the *Basic Law* that the Seventh National People's Congress adopted in 1990 as the framework for Hong Kong's status as part of China. Hong Kong continues as the global metropolis of Asia, a position it has held since the second half of the nineteenth century. It is the headquarters of Asia's most sophisticated and highly capitalized financial firms, and if these firms have placed a regional office in Shanghai, that office typically reports to the Hong Kong office. If a financial firm has few activities in Asia, but is aiming to move into the mainland China market, then the Shanghai office may report back to the international headquarters located elsewhere in Asia or outside Asia. Shanghai is viewed by many foreign financial firms as the entre to mainland China, especially to central and northern China. Thus, these firms are attempting to gain a position in Shanghai financial networks which reach throughout China. Nonetheless, the opening of the mainland China financial markets under WTO will be a slow process, because China's large

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<sup>16</sup> "Bank of China Launches Investment Banking Arm in Hong Kong," *Xinhua News Agency* (August 28, 1998); Kevin Hamlin, "China's Iron Lady," *Institutional Investor (Americas edition)*, vol. 36, no. 5 (May 2002), pp. 142-46; Pamela Pun, "Liu Jinbao Tipped for Bank of Communications," *Global News Wire-Asia Africa Intelligence Wire, The Standard* (March 17, 2003).

banks are in such a weakened condition. This will retard the growth of Shanghai as a financial center for central and north China.<sup>17</sup>

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<sup>17</sup> Meyer, *Hong Kong as a Global Metropolis*, pp. 244-7; *The Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China* (Hong Kong, 1992).