The 2008-09 Global Financial Fallout: Shanghai and Dubai as Emerging Financial Powerhouses?[1]

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Abstract

The global financial crisis of 2008 to 2009 tested the United States financial leadership as well as sent a beam of hope to many emerging countries in finding ways to shoulder the global financial leadership. The major idea behind this paper is to demonstrate and critically assess the possibility of emerging economies re-shaping the future financial system. Shanghai and Dubai will be used to understand the meaning of a government-supported international financial center project. This paper will first assess the challenge of the current financial turmoil in relation to financial globalization. Second, Shanghai and Dubai will be used to illustrate their effort—both before and after the financial crisis—in the establishment of an international financial centre with a view of the challenge toward the current financial system. Finally, I will endeavor to draw some parallels/differences of the responses or measures taken by the countries that were affected by the financial crisis in Asia in 1997 to examine the possibility and shortcomings of government-backed financial policy in connection with the global financial architecture.

Key words: Dubai International Financial Center, Financial intermediaries, Global Financial Centers Index, Regulation, Shanghai International Financial Center

Introduction

Global market confidence shattered as a result of a chain of huge financial collapses. Two of the U.S. housing mortgage giants, Fannie Mae and Freddie Mac (sharing 50 percent of the U.S. housing mortgage market share) had been nationalized by the U.S. government in early September 2008. Then, Lehman Brothers, the fourth largest investment bank in the U.S., was forced to go bankrupt in the middle of September 2008. Immediately after that, the largest insurance company, American International Group (AIG) was bailed out by the Federal Reserve with U.S.$85 billion. According to the Editorial comment from the *Wall Street Journal*, after Morgan Stanley and

Goldman Sachs returned to commercial banking, it spelt the end of the Wall Street: "And so, in a single week, the era of the independent investment bank has ended. Wall Street as we've known it has ceased to exist." (*The Wall Street Journal* 2008: 15). According to the estimation of the National Institute of Economic and Social Research (NIESR), the total cost of the sub-prime housing crisis will be in the range of U.S.$400 to U.S.$600 billion (NIER 2008: 9). The global growth was expected to reduced from 5.0 percent in 2006 to 4.2 percent in 2008 (ibid.: 10). In the final quarter of 2008, the global trade in goods and services actually declined by 6.7 percent! The NIESR yet expected that by the end of 2010, global growth should return to 2.1 percent. (NIER 2009: 10-11)

In respond to the global financial crisis, it appeared that all the leading economies tried to come up with some solution to rescue the global market. All the Group of Seven (G7) financial ministers agreed on October 10, 2008 in Washington that the confidence of the financial market in the world should be restored immediately and one of the broadly agreed measures was to take the ownership of banks by injecting money directly from the government. According to Willem Buiter, Professor of European Political Economy, London School of Economics, guarantee, especially government guarantee of banking liabilities is essentially (Buiter 2008) Such a dramatic agreement resulted from the tumbling of almost all financial centers of the world did not seem to be able to boost market confidence because the original U.S.$700 billion bail-out plan was not especially effective. Dow Jones dropped by 20 percent within a week from October 6-10, 2008 and the Tokyo Nikkei Index dropped 24 percent concomitantly.

Another major global cooperation was made through the London Summit on April 2, 2009 (or G20 Summit).[2] The Summit agreed to throw another U.S.$1,100 billion to boost the global economy, to help ailing economies through further help from the International Monetary Fund (IMF), to provide more supervision of multinational institutions and strengthen regulations, to increase trade, to eradicate tax haven and to reform the IMF. (Grice and Morris 2009: 2-3) During the Summit, Barack Obama, the President of the United States, declared, "After weeks of preparation, we have agreed on a series of unprecedented steps to restore growth and prevent a crisis like this from happen again." (*Financial Times*, April 3, 2009, p. 4). The Summit set a standard of agreement and also generated some solidarity among leading economies. They also agreed to rejoin in Pittsburgh in September 24-25, 2009 for another G20 Summit. Nevertheless, some economic sectors of individual countries were still suffered as a result of the crisis. One other noticeable examples was that the largest carmaker in the U.S., General Motors, filed for Chapter 11 protection and was officially bankrupt on June 1, 2009, resulting in a total losses of U.S.$81 billion. (Clark 2009)

The current financial crisis has demonstrated the problem of the existing international financial architecture. According to Roger C. Altman, "The financial and economic crash of 2008, the worst in over 75 years, is a major geopolitical setback for the United States and Europe." (2009: 2) Yet, it also signals to a number of emerging economies that there is window of opportunity for them to help create a new order of global financial architecture. Among the others, the "international financial outreach" of Shanghai and Dubai presents some opportunities and challenges. For one thing, they are determined to greatly enhance their international financial power. As a result of this, at the moment of global bail out, the world may need to take into consideration how to engage, if not accommodate, two emerging economies which have long been reliant on the development of state driven financial centers. This paper will first illustrate the interaction between financial liberalization and globalization, and followed by using the *Global Financial Centres Index 3* (GFCI3) report in 2008 to assess the international financial standard between Shanghai and Dubai against other financial centers. In addition, I shall discuss the current development of Shanghai and Dubai with a view to looking at the respective government's policies of creating their own model of international financial centre before and after the financial crisis. We will evaluate the responses of the leading economies under the current financial crisis with a view to compare the responses that were carried out a decade ago among other Asian economies.

Financial Globalization and the Emerging Financial Centers

Globalization emerged in the period between the latter half of the 19th century and the initial years of the 20th century (1850—1914) (O'Rourke and Williamson 1999: 5). The notion of globalization is not new but the outcomes of globalization, such as standardization, marketization and norms adherence, nevertheless, penetrate and precipitate into every country, requiring mutual inter-dependence and assimilation to take place. Karl Polanyi's (1944) ground-breaking book *The Great Transformation* set forth a classical literature in studying the power of transformation, the pattern of change and the facilitation of market economy in the 19th century. The "self-regulating" nature of market behavior actually energized the world toward an astonished new page (ibid.: 3). In addition, as argued by Edward J. Nell:

> Not that market outcomes are *optimal*, [italic in original] but rather that they have a certain objectivity and reflect robust good sense. If you pay attention to the market signals, you ought to do all right; if you don't you will run a serious risk of going under. (1996: 51)

The momentum of market and the dynamic force of liberalism energize the world to grow in an unprecedented manner. Empirical studies and research recently attribute the transformation of the global economy to the market impetus and the force behind it (Chandler 1990).

As far as international finance is concerned, the U.S. was first confronted with a setback in the 1970s when Nixon announced the collapse of the Bretton Woods System in 1971 (Gilpin 1987: 134). However, the inability to maintain the Bretton Woods System in the early 1970s (U.S. dollars pegged with gold) gave rise to the foundation of our current volatile financial infrastructure. (Komiya *et al.* 1988: 318). Although the U.S. financial leadership has been challenged after the 2007-09 financial crisis, the relative decline of the U.S., especially in global finance, is more complicated. As Beeson and Broome put it clearly, "As a result, the negative externalities that are potentially generated by U.S. hegemonic influence are likely to come more sharply into focus, especially if scholars examine the complex nature of American power in the contemporary era without pigeon-holing such debates into ideological clichés or limited discussions about relative U.S. hegemonic decline." (2009: 5)

Different from military might, in the reign of international finance, no state can single-handedly create a financial hegemony. Benjamin Cohen wrote a decade ago warning that: "Currency spaces now are shaped not by political sovereignty but by the invisible hand of competition–governments interacting together with societal actors in the social spaces created by money's transactional networks" (Cohen 1998: 5). After almost a decade, in *Territory, Authority, Rights: From Medieval to Global Assemblages*, Saskia Sassen further contended the tension between globalization and nation-state by reminding us that "For today's globalizing dynamics to have the transformative capacities they evince entails far deeper imbrications with the national – whether governments, firms, legal systems, or citizens – than prevailing analyses allow us to recognize" (2007: 1). Financial globalization was made more salient through the latest technology and the facilitation of various intermediaries, mutual funds and hedge funds, apart from the subsidiary of various banking sectors. According to John Eatwell, "Liberalization has been accompanied by extraordinarily rapid technical progress – in data processing and financial modelling – that has transformed financial markets" (2008: 83). In time, such dynamism of the globalization of finance eventually brought about two divergent views on the governance of global finance.

Academicians such as Robert Shiller (2000) used *Irrational Exuberance* to describe the rocketing of stock prices in the late 1990s and the early 2000s. He attributed the causes to the financial chaos from the confluence of a cluster of reasons such as the availability of internet, irresponsible financial analysts, the increase of pension fund and the mutual fund, coupled with the baby boom in the United States. Yet, George Soros, the founder of the Quantum Fund, disagreed with the academics by challenging the foundation of the economic theory.[3] He argued that:

> In my view there is no such thing as equilibrium in financial markets because market participants are trying to discount a future which is itself shaped by market expectations. … they are shooting at a moving target rather than counting a future equilibrium.
>
> (Soros 1997: 2)

His assumptions are that economic agents are not perfect and knowledge is costly. Therefore changes are inevitable. He further contended:

> I cannot change them [rules that govern financial market] unilaterally. If I impose the rules on myself but not on others, it would effect my own performance in the market but it would have no effect on what happens in the markets because no single participant is supposed to be able to influence the outcome.
>
> (Soros 1998: xxv)

He simply called the financial market a 'reflexive' event. His latest comment on the current financial crisis is that:

> "The international financial system also needs repairing but there are grounds for optimism. Europe has realized that it needs to complement the euro with a government safety net for interbank credit. And the International Monetary Fund is finding a new mission in protecting countries at the periphery from the storm at the centre." (Soros 2008)

If we go back to his motto, changing is everything and no one can dominate in the financial market. We are now actually watching a game of redistribution of financial power between the state and the market witnessing the current financial market. Of course, Soros has been criticized by many that his so-called theory was not new but some sort of personal reflections and most of them are within the scope of neo-liberalist doctrine. We will turn to the analysis of two emerging financial centers: Shanghai and Dubai.

Importance of Shanghai and Dubai as International Financial Centers

In March 2008, Y/Zen Group, commissioned by the City of London, came up with the Global Financial Centres Index 3 (GFCI3) report.[4] The report used five key areas for the construction of the index. They are: people, business environment, market access, infrastructure and general competitiveness. As a result, London ranked number 1 (rating of 795) and New York ranked number 2 (rating of 786). Both therefore are considered as not just international financial centers but global financial centers (GFCI3 2008: 16). The rest of the financial centers were categorized to fulfill various roles for international, niche, national and regional purposes. Hong Kong, ranked number 3, had a rating of only 695, far away from even New York. In other words, in the reign of financial and global monetary competition, no one can rival these two financial hegemonies. Yet, if we move down from the ladder, the competition among the rest of financial centers is as severe as that between London and New York.

Most important of all, according to the report, three financial centers will become "significantly more important over the next two to three years". They are Dubai (ranked 24 and rating of 585), Shanghai (ranked 31 and rating of 554) and Singapore (ranking of 4 and rating of 675) (ibid.: 6). If we do not take Singapore into consideration (which should link with Hong Kong more closely), it is intriguing to study Dubai and Shanghai because their rating had increased by 10 and 27 points respectively from the last GFCI2 in 2007. As far as the report is concerned, "A movement of between 10 and 30 points signifies that the competitiveness of a financial centre needs to be watched" (ibid.: 13). Dubai's financial status, according to the report, is less sensitive to change. The GFCI3 indicated that it has been evolving toward a mature and stable market in the coming two to three years. On the contrary, Shanghai, although changed rapidly in terms of rating (increasing by 27 points), it might be more volatile and susceptible to global changes. Yet, the report agreed that these two financial centers are very dynamic in terms of stability.

Development of Shanghai as International Financial Center

Shanghai's Financial Status before the 2008-09 Financial Crisis

Before the establishment of the People's Republic of China (PRC) in 1949, Shanghai had already been a banking and financial center. Under the semi-colonial status, Shanghai in the 1930s was considered as very liberal and a land of opportunity in China. Yet, after 1949, the PRC banned any activities that were considered as capitalist. Among the other cities, Shanghai was hit hard because of its capitalist and financial status. After China re-opened its doors in 1978, the idea of locating Shanghai as financial center was first initiated by the paramount leader Deng Xiaoping when he visited Shanghai on January 28, 1991. The following year, he also paid visit to Shenzhen (the Southern tour) to re-confirm China's initiative in opening its market and sustaining economic reform. He mentioned that

> Finance is very important. It is the centre of modern economy. If finance can be handled well, it will activate the whole economy. In the past [in the 1930s] Shanghai was a financial centre, a place for free exchange of currency, and it has to be the same in the future. If China has to achieve international financial status, we need Shanghai. Although it is something in the future, we should begin now.
>
> (Deng 1993: 366)

The 14th National Congress of the Chinese Communist Party formally named Shanghai an 'international economic, financial and trade centre' in 1992. Pudong was designated to be a new economic zone and Lu Jia Zui the Central Business District (CBD). Yet, even before 1992, shares were traded in Shanghai in 1984, and the People's Bank of China established an 'over-the-counter' market in Shanghai and the Shanghai Stock Exchange (SSE) was officially opened on December 19, 1990 (Gamble: 2003: 167–168)

Ever since the mid-1990s, both the central and municipal governments have been working together to attract domestic and foreign companies to invest in Shanghai. In order to make it a success, Shanghai's financial center, considering as a strategic initiative, was directly placed under the central government's control. The Financial Work Party Committee (FWPC) was established in March 2000 under Shanghai Municipal Party Committee and the Financial Services Offices (FSO) was under Shanghai Municipal Government. Both bodies are directly under the State Council in charge by Chinese Vice Premier (Heilmann 2005: 651). Even Hong Kong, which has always been an international financial center, was hugely mocked by Zhu Rongji's, Chinese Premier, comment that (Freudian slip or subconscious feeling!) Shanghai was like New York and Hong Kong was like Toronto. In other words, Shanghai was bestowed such extraordinary power both from the central government as well as from the party. Recently, Wen Jiabao, China Premier, pointed out that financial development is the key to Chinese economic competitiveness (Nie *et al.* 2008: 115).

In 2005, Shanghai Academy of Social Sciences completed a report "Assessment of the Financial Ecological Environment on Chinese Cities" which assessed 50 big cities in China by using different financial variables. Shanghai ranked as the top financial city.[5] Local companies began to set up new headquarters in Shanghai as a result of the government's incentive. According to Sebastian Heilmann, in time, "Shanghai's emergence as the main center of financial business in China was seen as a threat to the growth of local financial industries in other parts of China" (Heilmann 2005: 649). Shanghai's GDP recorded U.S.$128.8 billion in 2006, and per capita GDP was U.S.$7,000 in the same year. (*China Daily*, February 10, 2007) In 2007 the value of the stock market in Shanghai was U.S.$326,272 million (GFCI3 2008: 43). Until December 2006, there were 94 foreign banks having branches in Shanghai, with approximately U.S.$60 billion capital values (*Hugang jinji* 2008: 33). Domestically, until February 2007, 25 out of the 55 Chinese mutual funds established offices in Shanghai, and four out of nine insurance companies operated offices in Shanghai (ibid.: 35). On March 14, 2006, during the Fourth Plenary Session of China's Tenth National People's Congress, 'Shanghai International Financial Centre 2010 Blueprint (2010 *guihua*)' was formally included in the Eleventh Five-Year Plan (2006–2010) (Fan 2006: 708).

As far as Shanghai's future development is concerned, according to Liu Gang of Guangdong Business School, there are three stages of development. Immediately, Shanghai should keep its financial status in China by increasing the percentage of financial contribution in the GDP. Such measures can be worked out initially with the local financial intermediaries. In the medium term, regulation and financial infrastructure should meet international standards. Government should provide more professional training and to gradually open up the *renminbi* or yuan (Chinese currency) market. In the long run, Shanghai should be considered as a regional financial center, competing with Hong Kong, Singapore and Tokyo. By that time, the financial market should be completely opened and government's (especially local government) intervention should be kept to minimum (Liu 2007: 153). Yet, internationalization, limited financial products, regulations and limited financial professionals are the major elements that Shanghai has to improve to narrow the gap from other international financial centers (Duan 2005: 18). With the construction of the Shanghai World Financial Center (new tenants began to move in from June 2008), Shanghai's international financial center's status is going to climb to new heights, especially in the provision of state-of-the-art infrastructure and financial hardware.

Challenge of Shanghai as International Financial Centre after the 2008-09 Financial Crisis

To many surprise, the first move of China after the financial meltdown in Wall Street in late 2008 was not to respond to the international financial environment but to stabilize internal financial stability. One of the major measures was to announce a 14-point of support to Hong Kong's economy, including the crucial point of letting companies to conduct cross border trading of Chinese currency (yuan). (*South China Morning Post*, December 20, 2008, Business B1). According to Donald Tsang, Hong Kong's Chief Executive, 'The motherland, China, will always be the strongest support.' (Chan: 1). Of course, the launching of 14-point of support to Hong Kong was also a compensation to Hong Kong as a result of the losing of visitors/travelers from Taiwan because of the re-linkage between China and Taiwan.

Secondly, China quickly slipped into the chaos and tried to first discredit the U.S. dollars in the London Summit. China pledged potential help to the international financial market by offering U.S.$95 billion yuan to the International Monetary Fund. Yet, China also wanted to use Special Drawing Rights (SDRs) to partly supersede the receding of the power of the U.S. dollars in the international finance. (Evans-Pritchard 2009) Yet, finally, more importantly, the biggest financial initiative after the financial crisis was Shanghai's financial status. On April 14, 2009, Chinese State Department released Document 19 which was to officially developed Shanghai as an international financial center and international transshipment center. In general, according to the architecture of the State Department, Shanghai should be developed as an international financial center trading in Chinese currency and to accomplish Chinese economic growth by 2020.[6]

What about the challenges to other cities in China? In a recent visit to Shanghai between May 10 to 16, 2009, I attended the Shanghai Forum 2009. Beijing was not particularly happy about Shanghai as the international financial center, according to a senior colleague at Fudan University. He explained that Chinese banking industry played a key role in Chinese financial development and the big four state-owned banks (Agricultural Bank of China, Bank of China, China Construction Bank and

Industrial and Commercial Bank of China) have the headquarters in Beijing. Traditionally, banking was considered to be the linchpin of finance and the central government has overarching control from the policy incentive in Beijing. The new status of Shanghai as an international financial center empowered Shanghai's ability to diversify its financial products to stocks, futures, derivatives and other new products, which reinforced Shanghai's regional power, reducing further the ways of control from the central government.[7]

More importantly, the central government's "special attention" to be paid to Shanghai inevitably develops a sense of 'moral hazard' resulting in further possible corruption cases and maladministration. Not to mention corruption, government's "special care" may generate inefficiency and lower Shanghai's competitiveness. As Annalee Saxenian has demonstrated in the comparative study of the high tech centers in the East coast (the route 128) and the Silicon Valley in the U.S., the special attention from the government (more government contracts and projects were given to route 128) may actually retard the ability to innovate and to face the market competition (Saxenian 1996). According to Liu Mingkang, Chairman of China Banking Regulatory Commission (CBRC), "Shanghai's financial sector only has about 100,000 professionals, compared with some 400,000 on Wall Street and more than 250,000 in London." (Xinhua 2008) Obviously, such numbers of financial professionals will not be able to boost Shanghai's financial status to rival as established international financial center.

In addition, it affects the role of Hong Kong which has always been relying almost entirely on housing and financial activities to support its economic structure. Before the financial crisis, said Frank Gong, chief economist for China at J P Morgan Chase in Hong Kong, "it (Shanghai) can't compete with even its regional rival, Hong Kong, as long as rulers in Beijing refuse to make the currency fully convertible and restrict foreign investment in China's U.S.$400 billion domestic stock market." (Mellor 2005) After the crisis and the granting of the official status of Shanghai, the general response from Hong Kong was that the central government was biased toward Shanghai and more and more future policy initiatives will be shifted to Shanghai as a result. (*Hong Kong Economic Journal*, May 18, 2009, p. 2). Nevertheless, given the economic rise of China, international investment in Shanghai will be manifested by the future potential of Chinese market. It appears that one of the lessons from the current crisis is that Shanghai is being transformed to not just to serve the fund-raising requirement for the Chinese government, but also given real incentives and to gradually compete with the rest of the global financial centers.

Dubai International Financial Centre (DIFC)

DIFC before the 2008-09 Financial Crisis

On December 1, 1971, Dubai, Abu Dhabi, Sharjah, Ajman, Umm al Qairain, Ras al Khaimah and Fujairah, those former sheikhdoms, came together to formulate a new political entity called the United Arab Emirates (UAE) (Pacione 2005: 256). Although Abu Dhabi was considered as the administrative center, Dubai is in effect the economic center of the UAE. The ruling body, a Supreme Council, is composed of the leader from each of the seven emirates, with the head of state represented by Abu Dhabi and the prime minister from the ruler of Dubai, as a general rule (Bhatti et al. 2006: 1) The idea that Dubai has, for decades, been considered to be the 'city of merchants' stemmed from its strategic location near the mouth of the Gulf as well as its geographical position as the hub for boats coming back and forth from Persia, India, China and East Africa (Al-Sayegh 1998: 87–88). At the turn of the twentieth century, Dubai occupied one of the world's largest pearl shipping industries (ibid.: 89). In other words, the natural port facilities, the pearl industry and the commercial know-how perpetuated Dubai's merchant status in the Gulf for decades.

Oil in Dubai, however, was found only in the early 1960s, and, from the very beginning, the government had realized that it was not sustainable in relying on oil alone, of which production actually peaked at about 420,000 barrels per day in 1991 (Pacione 2005: 257 and Davidson 2008: 101). To keep the economy growing and to perpetuate Dubai's economic development, its leader began to initiate various economic development projects in order to diversify its economy. One of the major economic projects was to develop Dubai's infrastructure in order to enhance its future competitiveness:

> In the mid-1980s, … Dubai's crown prince, Sheikh Maktum bin Rashid Al-Maktum, together with his two eldest brothers, Sheikh Hamdan bin Rashid Al-

> Maktum and Sheikh Muhammad bin Rashid Al-Maktum, met to discuss the emirate's future direction. At a time when other governments in the Gulf were reacting to the war by increasing their overseas investments in the West, the Al-Maktum family decided the best solution was to buck the trend by making a commitment to invest in their own domestic infrastructure so that Dubai would be able to support and enhance its existing re-export oriented commercial sector while also facilitating broader diversification away from oil in the future.
>
> (Davidson 2008: 106)

Airports, hotels, apartments and huge housing projects dominated the headlines of the newspapers in the late 1990s and early 2000s and physically dominated Dubai's skyline. Burj al Arab hotel, Palm Jumeirah and the World (and more recently the Universe) projects are not just infrastructures; they are textbook cases which frequently occupied the Discovery Channel! According to a researcher at the Gulf Research Centre, the government of Dubai is very successful in marketizing the image of Dubai or repackaging Dubai as the city of future.[8] My understanding is that it is easier said than done. But, Dubai seems to be able to make use of its huge resources base to make a case to be successful. More recently, the Strategic Development Plan 1996–2010 is to allow Dubai to enjoy the status of 'developed economy' as soon as possible (Pacione 2005: 257). It appears that Dubai's success is contradictory to the general development pattern of the Middle East as a whole, which, according Robert Looney, has systematically lagged behind the world economic growth. "For the last thirty years" he contended, "most of the region has essentially 'de-globalized' at a time when its population was doubling" (Looney 2005: 175). As one of the key economic development projects, Dubai International Financial Centre (DIFC), (contrasting from Shanghai incremental development) deserves much attention because of its scale, structural differences, government incentive and regional importance.

DIFC was established in September 2004 to challenge some world established financial centers (London and New York) to provide securities, equities, fixed income and Shariah-compliant (Islamic) securities. One of the characteristics is that it has its own legal and regulatory system which has been built upon Common Law system (Chance 2008: 51). According to the IMF assessment report of the DIFC in May 2007, DIFC was a "geographic and legal jurisdiction within the emirate of Dubai" (IMF 2007: 4). The constitution of the UAE was amended in 2004 to allow a 'financial free zone' to be established. The Federal Law No. 8 clearly pointed out that the financial services and banking facilities of the zone cannot be carried out in local currency. In addition, Federal Decree No. 35 also pledged 110 acre of land for DIFC (ibid.). Other than criminal law, all the activities of DIFC will be governed under the UK common law system, including insolvency law, trust law, personal property law, and employment law. Regulation and monitoring of DIFC is under Dubai Financial Services Authority (DFSA), which is also responsible for the registration of professional services provided within DIFC, such as accountants and lawyers, etc. (ibid.: 5). In addition, within the DIFC, the Dubai International Financial Centre Authority (DIFCA) is responsible for economic planning and development as well as company registration, administration, company law and data protection (ibid.).

DIFC focuses on six primary services: banking, capital markets, asset management, Islamic finance, reinsurance and back office operation (Bhatti *et al.* 2006: 5). Such broad range of services is buttressed with the openness and the transparency of DIFC. Among all the international financial centers listed in the GFCI3, one of the key issues is the time zone advantage. This is why London, New York and Hong Kong are so important because they spanning eight hours from one another, meaning that they trade for 24 hours a day. Dubai enjoys the same advantage, spanning equal amount of hours between Asia and Europe. After the Dubai International Financial Exchange (DIFX) was officially operational in September 2005, global big financial firms flocked in. Lloyds TSB established in December 2005, Deutsche Bank opened its branch in March 2006 and Morgan Stanley began operation almost at the same time. Trading volumes increased tremendously from U.S.$7.9 billion in 2000 to U.S.$100.69 billion in 2006 (Saidi 2008: 23). To diversify financial products, DIFX will begin to list equities derivatives from November 2008 to enhance liquidity and to attract more investors (*Gulf News* (Business) October 23, 2008, p. 1). DIFX also considers a "'fast track' process for U.S. companies to have a secondary listing in Dubai" (ibid). With the help of the latest technology such as Securities Settlement System (SSS) and the rapid growth of the stock exchange, Dubai has enormously secured its role to provide a safe and stable financial status market in the Gulf region (ibid.: 25). Other than financial services, various business schools began establishing new offices in DIFC to achieve first move advantage. For instance, Cass Business School of City University London opened a new office in late 2008 in DIFC to offer Executive MBA programme.

Nevertheless, Dubai's financial status has been increasingly challenged by the members of the Gulf Cooperation Council (GCC). For example, Qatar allowed foreign players to conduct local business. Saudi Arabia's geographical location and its market size give rise to its future potential to challenge Dubai (Bhatti *et al.* 2006: 19). As a whole, the GCC may need to further develop and diversify its financial sector because they have pegged their currencies with U.S. dollars and the government is just having too much revenue. Both factors are not necessarily beneficial to develop foreign exchange rate based financial products or even government bond market. Yet, the financial sector of the GCC should be able to support beyond GCC countries. Although Dubai is already enjoying significant advantages (such as brand name, life style, political stability, financial infrastructure, regulation and level of globalization), it should not procrastinate. Obviously, the revenue and government asset in Dubai, however, serve as counterweight to off-set some factors which may lead to better confidence building. Other than financial product development, the key question of a financial center perhaps is the ability to withstand the global financial challenges.

Dubai enjoyed lots of advantages. Other than those mentioned before, Dubai's corporate tax is very low (14.4 percent), which can rival many competitors (GFCI3 2008: 40). In Dubai, given the depletion of oil, financial services (increasingly important) are still in competition with other government investment, tourist industry, mega property projects, etc. Dubai is having a diversified development strategy, which means government attention may be less concentrated, resulting in a possible less resolute support when facing the financial crisis. In addition, argued by Mishkin,

> Good institutions, however, need to be home grown; … The development of good institutions in the advanced countries took hundreds of years as they grew and adapted to local conditions. Poor countries must ultimately develop their own institutions, and the citizens of these nations must feel they have ownership of those institutions or else the institutions will be ineffective and short-lived.
>
> (2006:13)

DIFC is like one country having two systems. Natural alienation therefore derives between the DIFC and the rest of the society, which is not especially healthy. How well DIFC can integrate Dubai's social and economic environment? With the opportunities from the oil, financial centers and real estates, moreover, "many nationals themselves have become rentiers in their own right, as the diversifying economy has provided them with opportunities to become landlords" (Davidson 2008: 178). That will translate into an ethos of procrastination and inefficiency. In the long-run, Dubai may lose its competitiveness.

DIFC after the 2008-09 Financial Crisis

According to the analysis of the IMF, the plunge of the oil prices as a result of the financial crisis, hit hard the economies of the Middle East. The fact is that, according to the *World Economic Outlook, April 2009*, "Among the oil-producing countries, the sharpest slowdown is expected in the United Arab Emirates (UAE), … A major financial center, UAE will also suffer from the contraction in global finance and merger and acquisition activity." (IMF 2009: 91)

Not only the Middle East in general and the UAE in particular did not live up to the expectation of many developed countries to come to rescue the global financial turmoil, but also did they turn to more in-ward looking strategies. Before the first G20 Summit in November 2008 in Washington, Gordon Brown, the Prime Minister of the UK, paid visit to the Gulf States (Saudi Arabia, Qatar and the UAE) to persuade the oil-rich countries to contribute to the IMF in the G20 Summit in Washington. Yet, King Abdullah of Saudi Arabia did not pledge any contribution during the Summit, but blamed the unregulated global financial institution. As a result, he announced a five-year development project of UD$400 billion to establish Saudi's infrastructure. (Momani 2009: 17) Similarly, other Gulf States (including UAE) followed suit and announced their own domestic stimulation plan. In fact, even from the social level, the general public of the Gulf did not support the injection of money to the IMF. Between November 18 to 24, 2008, a survey was conducted across the Gulf and the Middle East on the opinion of the injection of money to the IMF, among the 1,119 respondents, 65 percent disagreed, 18 percent agreed and 17 percent did not know. (ibid, 19)

Although the Gulf Central Bank (GCB) has long been perceived among the member states, the financial crisis inevitably compounded the move toward a much closer monetary union. The Ministry of Economy and Finance from the GCC met on September 17-18, 2008 and recommended the proposal for the Gulf Monetary Union (GMU), which was approved in Muscat in December 2008. (Saidi and Scacciavillani 2009: 25) Some key institutional frameworks of the GMU are as follows:

1. Inflation rates should not exceed by more than 2 percent the weighted average of inflation rates in the GCC.
2. Average short-term interest rates should not exceed by more than 2 percent the average of the lowest three rates.
3. Foreign exchange reserves should cover goods imports for at least four months.
4. Annual fiscal deficit should not exceed 3 percent of gross domestic product.
5. The public debt ratio should not exceed 60 percent of GDP for the public government and 70 percent of GDP for the central government.
6. The GCC currencies should maintain a fixed peg to the U.S. dollar.

(ibid: 27-28)

The deadline for a common currency in the GCC should be in January 2010, yet, incentive among the member states in the Gulf is not particularly strong. According to the assessment of the Gulf Research Council, everything is a big change. The switch over from national currency to common currency, the implementation of the monetary union and the legal aspects all require time and adjustment of the member countries. (*The GRC Economic Research Bulletin* 2008: 27) As we have discussed, the Gulf state did not feel strongly to help the international financial system after the financial crisis. Yet, a sense of regionalism has been geared up because of the global financial crisis.

Shanghai and Dubai as Emerging Financial Powerhouses?

Developing countries and emerging economies face a dilemma in terms of financial liberalization and the opening of the domestic financial market. According to Louis Pauly,

> They discovered too that such movements could be triggered not only by any objectively reasonable loss of confidence by those investors in the integrity of domestic financial institutions or in the value of the national currency; they could be triggered by confidence-sapping shocks originating far away.
>
> (2008: 267)

To make profit and to do well in the financial industry, emerging countries should be able to establish a financial institution that can support the international financial system (Mishkin 2006: 12). Shanghai and Dubai therefore can set an example to the global financial market that emerging financial centers can become responsible stake-holders to shoulder global financial system. Shanghai has developed the state-of-the-art infrastructure and government incentives (as international financial center in China in 2020). Dubai has been able to use the Common Law system in the DIFC to facilitating any economic transaction. Those are good signs to bring international financial system back into the soul of the emerging financial center.

One key challenge behind Shanghai and Dubai is that they are all back up by the government. The central question investor will ask is that will the government intervene the financial center at will? What would be the benefit of having certain level of government back up? We may want to take the clock back to the Asian financial crisis in 1997 and to locate any lessons.

More and more literatures nowadays suggest that a certain degree of government intervention was essential to restore confidence of the societies that were bombarded heavily by the Asian financial crisis. According to Stefanie Walter's study, only Hong Kong was successful in defending its exchange rate stability whilst keeping away the money speculators between July 1997 and August 1998. Hong Kong relied heavily on its financial and banking sector which contributed almost 85 percent of its GDP (2008: 428). In facing the financial crisis, Hong Kong Monetary Authority faced a dilemma, either to follow the purely market force by de-linking the pegging exchange rate between Hong Kong dollars and U.S. dollars or to heavily intervene in the stock market and to use a visible hand to safeguard the exchange rate. In balancing the cost and benefit, the Hong Kong government determined to go for intervention because "Policymakers were aware of the private sectors preferences… During that year the authorities made it clear that exchange rate stability was their top policy priority" (Walter 2008: 429).

The experience of far reaching consequences of the Asian financial crisis and successfulness of Hong Kong are useful in creating a platform for our discussion of the development of the international financial centers in Shanghai and Dubai. The central argument is that only when financial services have reached to a critical mass - are international financial centers strategically important to governments and the 'national interest' and thus necessary to safe-guard in an emergency. Of course, the collapse of the Northern Rock in the United Kingdom and its eventual taken over by the government proved something wrong about the myth of 'too big to fail'. The current global financial crisis suggests that state rescue plans and direct 'buy-in' from the banking sectors are dramatic measures which are needed at such a critical juncture, justifying some degree of the presence of the government in the financial system. These seem to be emerging issues in relation to derive a useful platform between government support and market incentive in the future global financial development.

Conclusion

In a nutshell, both Shanghai and Dubai are considered to have advantages in some tangible factors, such as tax incentive, infrastructure and volume of trading. Their creation of international financial centers needs further testing to see whether they can perform well in the sea of financial market. The 2008-2009 financial crisis in the U.S. was perceived very differently between Shanghai and Dubai. Shanghai has become more proactive in creating its status as international financial center. Dubai has become more conservative and looks more in-ward, with a view to further develop its regional strength by expanding the GCC Monetary Union. Whether there is any fundamental change of the structure of the international financial system after the new global financial crisis is not yet materialized. Nevertheless, after a topsy-turvy global financial crisis from the Wall Street in October 2008, according to Jonathan Garner and other Morgan Stanley strategies, 'We believe the world economy is in a painful transition to becoming emerging markets-led.' For the time being, therefore, our cases of Shanghai and Dubai will certainly make a good argument about how and in what ways financial centers can achieve a balance between money, market and state involvement in the coming new era of the global financial system.

Notes:

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[1] Various versions of this paper was presented in the East Asia–Gulf Workshop co-organized by the Centre for the Advanced Studies of the Arab World (CASAW) at Durham University and the Gulf Research Center on October 22–23, 2008 in Dubai and China in the Arab World and Emerging East Asia-Middle East Nexus Workshop organized by CASAW on September 29-30, 2009 at Durham University, United Kingdom. Thank you for Professor Anoush Ehteshami and Dr Yukiko Miyagi's invitation. I would like to thank Christopher Davidson, Christian Koch, Liu Hongzhong, Samir Pradhan, Mohamed A. Raouf, Ren Xiao and Eckart Woertz's comments and advice. Thank you for a special funding from SGIA at Durham University to support the trip to Shanghai in May 2009 for further interviews. Thanks are due to the Editor of *APP* and some very useful comments from the two anonymous reviewers.

[2] G20 actually is not very precise because the Summit was not only represented by state leaders of the largest 20 economies in the world alone. Other leaders, such as the Managing Director of International Monetary Fund, the U.N. Secretary, Director General of World Trade Organization, Chairman of the Financial Stability Forum, World Bank President, the President of the European Union, among the others also participated in the Summit. See (*The Independent*, April 3, 2009, p. 8)

[3] George Soros was born in 1930 in Budapest, Hungary. He graduated at London School of Economics in 1952, influenced hugely by Karl Popper. He emigrated to the United States in 1956. By 1969, his Quantum Fund was launched. It was a huge success. For instance, if you invested U.S.$1,000 in 1969, you could obtain U.S.$2,150,000 in 1994, a compound growth of 35 percent. In 1979, He launched Open Society Fund (donated $350Mn in 1996). One of his most famous (you may say notorious) moves was to speculate on British Sterling in 1992, earning U.S.$1 billion in just a few days. After the Asian financial crisis in 1997, he was condemned by then Malaysia's Prime Minister bin Mahathir in a World Bank meeting in Hong Kong in September 1997 as a menace. Starting from 2002, he was investigated by the U.S. government. He has been a prolific writer in condemning the government of George W. Bush (for example see Soros 2004).

[4] There must be some other financial center index of rankings. But, if you type Global financial index to Google, the first one that came out is this report.

[5] Those variables are rules of law, economic strength, local financial establishment, financial independence, trustworthiness, social welfare, infrastructure, etc. See (Wang 2007: 54).

[6] It was a public document. It was also reprinted in the Brochure of the Lu Jia Zui Forum 2009 which was organized on May 15-16, 2009 in Shanghai. See (*Lu Jia Zui Forum 2009: Publication*: 2009: 5)

[7] Interviewed May 15, 2009, Shanghai.

8 Interviewed October 23, 2008, Dubai.

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