Global Financial Centers after 9/11

The terrorist attack on Lower Manhattan raises important questions about the future of global financial centers.

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TWO AND A half years after the 9/11 attack, the future of New York City as a global financial center is being questioned. This is not the result of the destruction of one—albeit large—office complex. The attacks have called into question the advantages of spatial concentration that traditionally have driven urbanism throughout most of the twentieth century. Whatever inertia kept firms from leaving Lower Manhattan is now gone. This is especially true for the types of firms that dominate the advanced corporate service economy, as these are increasingly globalized and produce financial instruments and legal and accounting advice. The urban concentrations of these firms that emerged in the 1980s in advanced service economies were a major source of growth in cities and contributed to the expansion of a new type of high-income professional class. These sectors were crucial to the types of urban economies that emerged during the last 15 years, geared toward the global management and servicing work that characterizes global financial centers.

TERRORIST TARGETS

In an age of terrorism, spatial concentration may be a liability rather than an advantage. The destruction of the World Trade Center complex affected large and small firms, professional and blue-collar workers, high and low profit activities, rich and not-so-rich households. Since the destruction coincided with a serious economic recession, the total effect was severe: about 100,000 jobs were lost in the area encompassing 23rd Street to the southern tip of Manhattan. This represented a quarter of all jobs in that area. Most of those who lost their jobs had modest incomes—under $25,000—a reminder that high-income Wall Street was also a low-wage employment center. The destruction of commercial space was significant: 14 million square feet destroyed and 16 million square feet damaged, in sum more than 25 percent of all commercial office space in Lower Manhattan. Immediately after the 9/11 attacks, Downtown vacancy rates were 6.1 percent, and rents were $42/square foot (compared to 6.9 percent vacancy and $61/square foot in Midtown). In December, Downtown vacancy rates were up to almost 12 percent, signaling the economic deterioration of the area (compared to 8.7 percent vacancy in Midtown). By March 2002, Downtown vacancy rates had risen to 13.7 percent, and rents were down to $40/square foot (compared to Midtown's 9 percent vacancy and $57/square foot). Some of the office vacancy was taken up as commercial buildings were converted into residential. The shopping center in the WTC was the third busiest in the United States; the destruction of the towers caused a loss of 500,000 square feet of retail space and the physical destruction of more than 700 small businesses.

Large cities attract terrorists for a variety of reasons: they are centers of power, they are a focus of media attention, and they are sufficiently mixed and dense that terrorists can live and organize in them without attracting attention. Data from the U.S. State Department suggests a series of correlations between city locations and incidents of terror between 1993 and 2000: worldwide, cities with at least one terror incident from 1993 to 2000 accounted for 94 percent of the injuries resulting from all terrorist attacks, both urban and non-urban, and for 61 percent of deaths. A 2001 study of a large number of cities by Savitch and Ardashev for *Urban Studies* done before 9/11 estimated that 64 percent of the brunt of international terrorism was absorbed by cities, and that in the last decade the number of incidents doubled, rising especially sharply after 1998. There are a handful of cities that have particular symbolic value due to a mix of historical, political, and economic conditions. New York City, London, and Paris are strategic to the world economy, but also have specific political histories. Athens, Istanbul, Jerusalem, Berlin, and Rome are key nodes in a variety of specific global networks. Each of these cities is a highly visible and important target for terrorists who wish to communicate a message to a large audience.

Does the post-9/11 transformation of Lower Manhattan presage a fundamental change regarding the advantages of spatial agglomeration in contemporary economies? Such a change would affect the disproportionate concentration of resources in cities worldwide, particularly the network of about 40 cities that can be described either as global financial centers or as having global financial functions.

GLOBAL FINANCIAL CENTERS BEFORE 9/11

A quick look at the top five global financial centers today indicates some commonalities and some differences. New York City and London rank highest according to stock market capitalization and the quantity of specialized corporate services. Tokyo, Frankfurt, and Paris rank highest in corporate headquarters and large commercial banks, but New York City ranks far above the rest when it comes to assets of the world's top 25 securities firms. The corporate services sector in each of these cities varies considerably, with New York and London the largest exporters of legal and accounting services, either directly or through affiliates in other cities. On the other hand, Tokyo and Paris account for 33 percent and 12 percent, respectively, of assets of the top 50 largest commercial banks; London and Frankfurt each account for 10 percent; and New York City accounts for 9 percent.

An indicator such as the value of equities under institutional management shows a similar pattern of spread and concentration at the top of the hierarchy. The worldwide distribution of equities under institutional management includes a large number of cities that have become integrated in the global equity market. In 1999, institutional money managers around the world controlled approximately $14 trillion. Thomson Financial has estimated that at the end of 1999, 25 cities accounted for about 80 percent of the world's valuation. These 25 cities also accounted for roughly 48 percent of the total market capitalization of the world, which stood at $24 trillion at the end of 1999. On the other hand, this global market was characterized by a disproportionate concentration in the top half-dozen cities. In 1999, London, New York, and Tokyo together accounted for a third of the world's total equities under institutional management.

The production capabilities of global financial centers also involve sectors other than finance: global media, high-tech, trade, and certain types of internationalized manufacturing production. A city like New York houses the global operations of firms and markets in many sectors. The same is true for London, Paris, and, to a lesser extent, Frankfurt. Secondary centers such as Mexico City, São Paulo, and Seoul house all the major globalized sectors of their national economies, and in that regard they, too, are global financial centers.

In the 1980s the top global financial centers—New York City, London, and Tokyo—accounted for the lion's share (60 percent to 70 percent) of the world's major financial markets. In the mid-1990s Frankfurt and Paris entered this top tier. These five cities now account for a disproportionate share of all major markets and represent enormous concentrations of strategic resources. But the expansion of the financial sector also produced a second tier of about a dozen global cities. Since then the global financial system has evolved markedly. Today, the global servicing capabilities crucial to the operations of markets and firms are centered in a network of about 40 global financial centers, with a sharp tendency towards concentration in the top 20 cities, and extremely high levels of concentration in the top five.

GLOBAL FINANCIAL CENTERS AFTER 9/11

To what extent does the global system need these types of networked concentrations? The example of finance can provide the answer, because it is where New York is dominant and because one of the key forces shaping economic globalization since the mid-1980s was the increasing importance of international finance. Global financial centers handle the international operations of firms and markets dealing in almost all sectors of the economy. This has contributed to the decline—sometimes absolute, sometimes relative—of the old, established industrial centers even though large industrial firms are thriving. As these firms have internationalized their production and markets and have become increasingly dependent on global financial centers for their complex corporate functions, they feed the growth of New York and London (but not Detroit and Marseilles).

One of the ironies of the global financial system is that it is subject to simultaneous geographic spread of resources and geographic concentration of operations in a limited number of financial centers. Most of these global financial centers are parts of large cities, although the existence of important financial centers in small countries lacking large urban centers, such as Bermuda, the Cayman Islands, and Switzerland, suggests that there are important exceptions to the concentration pattern.

Neither the destruction of 9/11 nor the awareness of large cities as leading targets for international terrorism have actually reduced the degree of concentration of the most advanced servicing economic activities. Further, by the end of 2001—that is, not long after the devastating attacks had actually closed down Wall Street for an unprecedented three days—the level of concentration in the global capital market had actually grown. At the end of 2000, the leading nine stock markets accounted for 76 percent of the global stock market; at the end of 2001, this share had risen to 88 percent. Perhaps even more remarkable, the New York Stock Exchange share went from 37 percent to 41 percent (the absolute value stayed the same at about $11 trillion plus). The question is whether this trend will continue. By November 2003, the stock market capitalization of the NYSE stood at $10.9 trillion, accounting for almost half of the combined value of North America, the European Union, and Japan ($24.8 trillion). Most of the sharp decline in the stock valuations in these markets that began in late March of 2002 can now be seen as being not so much due to 9/11 but rather a result of the bubble bursting, what market analysts call corrections to excessively high market valuations. The result was an enormous withdrawal of capital from the stock market.

Not all stock markets are equal, however, and hence their trajectories at times of crisis and times of boom may diverge in a globally integrated market. The division of labor among the major centers explains some of this divergence. Both in the 1980s and today, New York City fulfilled a special function: it was the major center for financial innovation. This entails a tight collaboration with legal and accounting experts and their much-needed innovations if there was to be a global capital market. In that regard, Wall Street can be described as the Silicon Valley of finance. London remains the pre-eminent international banking and financial center. Tokyo is an exporter of raw capital rather than complex financial instruments. In the late 1990s, Frankfurt made aggressive efforts to become a major banking center, raiding London for top-level financial software designers and other talent. It has launched Eurex, the electronic trading in treasuries; has taken over the market for British Gilts;

and is poised to enter the Chicago futures market. Capitalization at the Deutsche Borse at the end of 2003 stood at about $1 trillion, one-sixth of the total EU stock capitalization of $7.26 trillion. Frankfurt's future role as a heavyweight financial center may be limited by Germany's decentralized financial system.

Paris' route to the top, on the other hand, is quite different. What has made Paris one of the top five global financial centers has a lot to do with the structural features of its banking and financial system—a limited number of financial institutions account for a large share of national capital, partly thanks to government protection policies. France also has a long tradition of international business, including global leadership in several sectors. However, becoming a global financial center has entailed the entry of many Anglo-American specialized services firms in accounting, legal, and other corporate services. The decision by Paris to try to consolidate several European continental markets resulted in the formation of Euronext (Paris, Amsterdam, Brussels). By the end of 2003, Euronext reached a capitalization of $1.93 trillion, just behind London's $2.26 trillion.

What is the importance of major financial centers in an increasingly globalized and digitized system? The answer is counterintuitive. Finance is the most globalized and electronic of all industries; furthermore, it produces a dematerialized output that can circulate instantly worldwide. This suggests that location should not matter. In fact, geographic dispersal would seem to be a good option, given the high cost of operating in major business centers. Further, the last ten years have seen an increased geographic mobility of all kinds of corporate experts and services firms. So why do we have global financial centers at all?

There are at least three reasons. First, the importance of social connectivity. While new communications technologies do indeed facilitate geographic dispersal of economic activities, they have also had the effect of strengthening the importance of central coordination and control functions for firms and even for markets. Indeed, for firms operating a widely dispersed network of branches and affiliates and operating in multiple markets, central functions are made far more complicated. Their execution requires access to top talent, not only inside headquarters but also, more generally, in technology, accounting, legal services, economic forecasting, and other specialized corporate services. Business centers in cities have massive concentrations of state-of-the-art resources that allow them to maximize the benefits of new communication technologies. Even electronic markets such as NASDAQ and E*Trade rely on traders and bankers, at least some of whom are located in major financial centers. The question of risk and how it is handled and perceived is yet another factor that makes location of operations in a physical center useful, providing close and informal contact between executives from many different sectors and with high levels of international experience.

For firms to maximize the benefits of new information technologies, they need not only a telecommunications infrastructure, but also a complex mix of other resources. Most of the value-added that these technologies can produce for advanced service firms lie in externalities. And this means the material and human resources—state-of-the-art office buildings, top talent, and a social networking infrastructure that maximizes connectivity.

Almost any location can have fiber-optic cables, but this is not sufficient for firms operating in advanced global markets. Social connectivity is crucial for obtaining the types of complex information decisive for firms operating in uncertain, high-risk global markets and conditions. While information is widely assumed to be a given, there are actually two types of information. One is datum knowledge, which is complex yet standardized: for example, the level at which a stock market closes, the privatization of a public utility, the bankruptcy of a bank. But there is another, far more difficult to obtain type of information: interpretive knowledge. This requires evaluation and judgment. It is possible, in principle, to access datum knowledge anywhere. The interpretive knowledge needed to execute major international deals cannot be obtained from existing data bases; one requires social information loops and the associated de facto interpretations and inferences that come with processing information among talented, informed people—hence the importance of services such as credit-rating agencies, which make interpretations authoritative, and available to all. For most firms operating in complex markets, however, buying the information from specialized services is not enough; they need their staff to be in a dense and varied milieu where they can mix with other professionals in different specializations. Financial centers provide the resources and the social connectivity that allows firms and markets to maximize the benefits of their technical connectivity.

The second advantage of financial centers is their role in enabling the decision and execution of complex cross-border mergers and alliances. Global firms and markets operating in a global economy need enormous resources, a trend that is leading to cross-border mergers and acquisitions. These are happening on a scale and in combinations few would have foreseen as recently as ten years ago. The 1990s witnessed the explosion of mergers among financial services firms, accounting firms, law firms, insurance brokers, and real estate services firms. A similar evolution took place in the global telecommunications industry (CNN, MTV, Fox/Sky) in order to offer state-of-the-art, globe-spanning services to its global clients. And in the last few years we have seen a completely new development: mergers and alliances among financial markets.

There has been a consolidation of electronic financial networks that connect select numbers of markets. In 1999, NASDAQ set up Nasdaq Japan, and in 2000, Nasdaq Canada. This gave investors in Japan and Canada direct access to the market in the United States. Europe's more than 30 stock exchanges have been seeking to shape various alliances. Euronext (NEXT) is Europe's largest stock exchange merger, an alliance among the Paris, Amsterdam, and Brussels bourses. The Toronto Stock Exchange has joined an alliance with the New York Stock Exchange to create a separate global trading platform. The NYSE is a founding member of a global trading alliance, Global Equity Market (GEM), which includes ten exchanges, among them Tokyo and NEXT. Also, small exchanges are merging: in March 2001 the Tallinn Stock Exchange in Estonia and its Helsinki counterpart created an alliance. A novel pattern is hostile takeovers of stock markets, such as the attempt by the owners of the Stockholm Stock Exchange to buy the London Stock Exchange.

These developments signal that the complexity of the global system cannot be seen simply in terms of competition among financial centers—there is also a networked division of functions and strategic alliances. This network may ensure the consolidation of a stratum of select business centers at the top of the worldwide network of about 40 cities through which the global economy gets managed.

The third advantage of financial centers is the presence of de-nationalized elites and agendas. National attachments and identities are becoming weaker for global firms and their customers. This is particularly visible in Europe and the United States, but may soon develop in Asia. In Latin America, deregulation and privatization, which are crucial to globalization, have partly de-nationalized what used to be national business centers. Global financial products are accessible in national markets and national investors can operate in global markets. For instance, some of the major Brazilian firms by-pass the São Paulo exchange and list on the New York Stock Exchange. While this is as yet inconceivable in many Asian countries, it could occur in the future, given the growing number of major Asian firms. Another indicator of this trend is the fact that the major U.S. and Continental European investment banks have set up specialized offices in London to handle various aspects of their global business. Even French banks have set up global specialized operations in London.

It could be argued that such de-nationalization is a necessary precondition for economic globalization. The sophistication of the global system lies in the fact that it only needs to involve strategic institutional areas—most national systems can be left basically unaltered. For example, in 1993 China adopted international accounting rules that facilitated international transactions. However, to do so it did not have to change much of its domestic economy. Japanese firms operating overseas adopted such standards long before Japan's government considered requiring them. In this regard, the "wholesale" side of globalization is quite different from global consumer markets, where national consumer tastes are often altered. This process of de-nationalization has been strengthened by state policies that enable privatization and foreign acquisition. In some ways, one might say that the Asian financial crisis partly de-nationalized control over key sectors of economies that, while allowing the massive entry of foreign investment since the 1970s, had never relinquished that control. The long-standing resistance in Europe to mergers and acquisitions, especially hostile takeovers, and in East Asia to foreign ownership and control, signal national business cultures that are somewhat incompatible with the new global economic culture. However, elsewhere, global financial centers enable a new sub-culture, a move from the "national" version of international activities to the "global" version.

THE FUTURE OF DOWNTOWN MANHATTAN

Financial concentration and agglomeration remain key features of the global financial system, and the network of global financial centers remains crucial for the global operations of markets and firms. And so does New York City. But many firms have left New York. New Jersey is experiencing a real estate boom as a consequence of these departures: Wall Street firms have taken 3.4 million square feet of office space in New Jersey, the equivalent of one-third of the total office space previously housed in the World Trade Center. Connecticut has been the other chief destination. Yet the new space taken up in both of these states does not quite account for the total of 218 acres of office space lost in the destruction of the WTC complex.

Lower Manhattan has gone through changes of use several times before, but always centered on finance. In the 1980s, after the so-called Third World debt crisis, large commercial banks and insurance companies began to leave. This made room in the 1980s for a whole new world of financial services firms, many small and highly innovative. Now many of these same financial services firms have left. The end of this economic phase has been far more abrupt than it would have in the absence of the massive attack, which brutally eliminated inertia—an inertia partly rooted in the enormous financial capabilities of many of these firms that allowed them to pay high rents and added costs for being located in the Wall Street area.

The thinning of the high-profit financial sector in Lower Manhattan resulting from the destruction of 9/11 will make room for a whole new set of sectors that benefit from access to specialized state-of-the-art services and infrastructure, and from deeply networked, spatially concentrated, small cutting-edge firms. This is the specific competitive advantage of the Wall Street area. And it is not exclusive to finance, even though finance may have dominated the history of this area. Since 1993, there has been a housing boom as commercial space has been converted to residential. New sectors will seize the opportunity to move to the Wall Street area. These sectors include media firms, which benefit from the intense proximity to multiple types of expertise and resources (financial, legal, accounting). Another group will be new firms in the high-tech and bio-tech sector that are part of new cutting-edge fields that mix different types of expertise and resources. These hybrids could become the norm in the near future, just as software developers were hybrids in the 1970s and then became a new sector in the 1980s.

The rhetoric of globalization suggests that economic activity takes place at a decentralized global scale, in virtual electronic markets, untied to specific physical places. Yet a closer examination of the currently available information demonstrates to what extent one of the most globalized and electronic sectors, wholesale finance, continues to operate in dense and concentrated centers—that is, in cities.