Money in New York

The Capital of Capital No More?

By DANIEL GROSS
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Every day in Lower Manhattan, tourists stroll along the Capitalism Trail. They might start in the yard of Trinity Church, where Alexander Hamilton, the first Treasury secretary and architect of the early United States financial system, is buried. Nearby, on Broad Street, they amble past the hulking headquarters of the New York Stock Exchange. They might stop for a water break in front of 23 Wall, the fortresslike building at the junction of Broad that was the headquarters of J. P. Morgan & Company and was known in its heyday as the Corner. As John Brooks wrote in his book “Once in Golconda,” the Corner was in the early 20th century “the precise center, geographical as well as metaphorical, of financial America and even of the financial world.”

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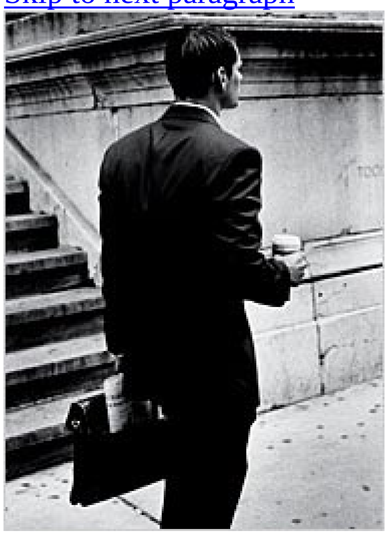

Ralph Gibson

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Would New York be a better or worse place to live if there were fewer wealthy people living here?

34% Better
27% Worse
27% No difference (volunteered only)
12% Not sure/No answer

In this and all poll questions, totals may not add up to 100 percent because of rounding. Questions were multiple choice; answers marked "volunteered only" were not among the choices offered to respondents.

Illustration by Hort

The Corner is now a luxury condominium called Downtown by Philippe Starck. The most common financial transactions there probably involve paying the Chinese delivery guy or tallying bills from the luxury retailers — Thomas Pink, Hermès and Tiffany — that have opened outposts down the block. Wall Street has not been Wall Street for a long time. Big investment banks like Lehman Brothers, Morgan Stanley and Bear Stearns decamped for Midtown years ago, and the largest securities trading floor in the world — belonging to the Swiss bank UBS — is in Stamford, Conn. The N.Y.S.E., which is transforming into an electronic exchange, will close two of its remaining four trading rooms next month. The question today — one being asked with increasing frequency and anxiety in certain quarters — is whether New York as a whole is going the way of Wall Street. Are New York's days as the world's epicenter of finance coming to an end?

If you've paid even glancing attention to the antics of hedge funds and private-equity barons over these last few years, the question might seem absurd. Walk by the rows of Town Cars idling on Park Avenue, past the Seventh Regiment Armory, where the Blackstone Group chairman Stephen Schwarzman held his multimillion-dollar birthday party, past the hedge-fund aeries on Central Park West and Fifth Avenue, and New York City still seems to be the global capital of capital. This summer's credit crunch notwithstanding, the Dow Jones Industrial Average is at near-record highs, and the Hudson's banks are overflowing with cash.

But in today's burgeoning and increasingly integrated global financial markets — a vast, neural spaghetti of wires, Web sites and trading platforms — the N.Y.S.E. is clearly no longer *the* epicenter. Nor is New York. The largest mutual-fund complexes are in Valley Forge, Pa., Los Angeles and Boston, while trading and money management are spreading globally. Since the end of the cold war, vast pools of capital have been forming overseas, in the Swiss bank accounts of Russian oligarchs, in the Shanghai vaults of Chinese manufacturing magnates and in the coffers of funds controlled by governments in Singapore, Russia, Dubai, Qatar and Saudi Arabia that may amount to some $2.5 trillion, according to Stephen Jen, a Morgan Stanley economist.

Much of this money is being put to work at home. "Now countries like China are generating enormous amounts of capital," says Felix G. Rohatyn, the veteran banker who engineered the financial rescue of New York in the 1970s. "And of course they are going to want a piece of this distribution and the marketing." China is staging the initial public offerings of state-owned companies on local exchanges as a means of building up Chinese capital markets — the $7.7 billion I.P.O. of China Construction Bank in Shanghai last month is just one example.

This growth represents a triumph of everything Wall Street stands for — the ability of capital to seek returns across borders, the growing integration of the world's economy and the triumph of market activity in previously closed areas. And to a degree, this is good news for New York's asset managers, as private-equity firms and hedge funds now can raise capital from fresh sources. Nonetheless, the diffusion of wealth has unleashed angst among New York's financial elite, who may soon rue the excesses of recent years as a last-gasp blowout.

Last November, the Committee on Capital Markets Regulation, a collection of chief executives, economists and policy makers intent on halting the apparent decline of America's (and hence New York's) competitive standing in finance, presented a report full of ominous warnings: "Evidence presented here suggests that the United States is losing its leading competitive position as compared to stock markets and financial centers abroad." In January, Mayor Michael Bloomberg and Senator Charles Schumer of New York released a report from McKinsey & Company that diagnosed the malady in detail.

“Today, in addition to London,” the report’s authors intoned, “we’re increasingly competing with cities like Dubai, Hong Kong and Tokyo.”

Some of the trends highlighted in these reports are troubling for the United States financial-services industry and for New York, its spiritual and historical home. The Committee on Capital Markets Regulation noted that the U.S. share of global initial public offerings — those outside the company’s home country — fell from 50 percent in 2000 to 5 percent in 2005. Until recently, the directors of China Construction Bank would have seen no alternative to a New York offering. Only New York had the experienced underwriters, the highly transparent, trustworthy markets and the deep pool of capital to handle such a deal. That’s no longer the case. In 2001, New York’s stock exchanges accounted for half of the world’s stock-market capitalization. Today, the total is more like 37 percent. In 2005, 9 of the 10 largest I.P.O.’s took place outside the United States. The world’s largest-ever I.P.O., the $19.1 billion offering of Industrial and Commercial Bank of China, was staged in Hong Kong in 2006. In the lucrative field of investment banking, sales and trading revenues, the McKinsey report concluded that “European revenues are now nearly equal to those in the U.S.”

These data points represent not so much a shifting from one power center to another but rather a change in how financial power is distributed. In this decade, the global economy has become multipolar. “On the one hand, we have tremendous strengths,” says Robert Rubin, the former Treasury secretary and now chairman of the executive committee at Citigroup. “We’re located in the largest economy in the world. On the other hand, London is creating a regulatory environment that seems to me is equally as effective in terms of safety and soundness. Hong Kong and Singapore are clearly determined to develop as centers. The Chinese are investing in Shanghai.”

Like automakers and consumer-products companies (Coca-Cola derives 70 percent of it sales outside North America), New York’s leading financial institutions are trying to become global operators less reliant on domestic markets. In the last few years, the N.Y.S.E., the iconic symbol of Wall Street, has gone public, hired an aggressive, worldly C.E.O. (the former Goldman Sachs president John Thain) and merged with Euronext, which owns a derivatives market in London and stock exchanges in Paris, Brussels and Amsterdam. In its most recent quarter, NYSE Euronext derived 44 percent of its revenue and 62 percent of its operating income from outside the United States. Nasdaq, the second-largest New York exchange, was thwarted in its bid to buy the London Stock Exchange, but is taking a stake in OMX, which operates stock exchanges in Nordic countries in partnership with a Dubai investment firm.

The big investment banks closely identified with New York are increasingly international, too. Goldman Sachs recently boasted that half of its revenues came from overseas. Overseas growth is good for shareholders and managing directors, who share in the profits. But an alliance with a Chinese investment bank doesn’t necessarily translate into jobs for the messengers and support staff at Goldman Sachs in New York.

What does all this diffusion mean for New York's economy? Potentially, a great deal. Steve Malanga, senior fellow at the Manhattan Institute, estimates that there are 175,000 securities-industry jobs in New York, which pay an average wage of $350,000. The Committee on Capital Markets Regulation notes that the securities industry accounts for 4.7 percent of the jobs in New York City but 20.7 percent of the wages. But the impact is even larger, since the spending of Wall Street hotshots supports a huge number of other jobs. Between 1995 and 2005, the sector grew at an average annual rate of 6.6 percent in New York and provided more than a third of business income-tax revenues, according to McKinsey. "There's no doubt that much of the financial and fiscal and economic revival of the city in the 1990s and then again after 9/11 can be attributed to the health and in fact dominance of Wall Street internationally," Malanga says. A long-term decline, in which the financial-services business slowly moves offshore or out of state over a period of years, would certainly inflict great damage. Without a manufacturing base, New York would become more dependent on its other large sectors like tourism, health care, government and education, none of which possess Wall Street's capacity for spinning enormous profits.

It seems inevitable that we will see many more studies about the loss of New York's status. Unless they can persuade Congress to stop globalization and the free flow of capital around the globe, there isn't much New York's billionaire financiers can do to stop the city's relative decline.

Because of the high costs of living and doing business in New York, the city is likely to continue to lose market share. Take the case of BATS, an alternative trading platform based in Kansas City, Mo., that has come out of nowhere to gain a 9 percent share in the market for trading United States stocks. "Our location is one of the principal factors that enabled us to go from start-up to the third-largest equities exchange in the U.S. in a matter of 18 months," says Joe Ratterman, its president and chief executive officer. The company's computers reside in a New Jersey data center, and it has two sales representatives in New York. But the rest of its 33 employees work out of a 10,000-square-foot office complex with views of downtown Kansas City. In a business in which competition is based on cost — BATS appeals to investors looking to save a few pennies on trades — a start-up in low-cost Kansas City has the same advantage over the N.Y.S.E. that a Chinese manufacturer does over a competitor in Ohio.

New York has stood at such inflection points before and survived. "Between 1860 and 1920, the economy changed several times, from agricultural to industrial, and from industrial to financial," says Thomas Kessner, author of "Capital City: New York City and the Men Behind America's Rise to Economic Dominance, 1860-1900." "And each time, New York City was able to take advantage of the position it had achieved in previous standing and leverage that into leadership in the new era."

New York came into its own as the nation's banking center by the end of the Civil War, serving as the connection between Old World capital and New World ambition. (Much of the money used to build the railroads and other industries came from Europe via New York.) As American industrial companies gained scale and scope, they flocked to New

York and to the banker J. P. Morgan, who lashed corporations together into giant trusts. John D. Rockefeller's Standard Oil moved to New York. Because of this activity, "the entire second tier of support — trust attorneys, accountants and bankers — grew up here," Kessner says. "By 1900, New York had outdistanced every place but London in terms of the volume of business."

Over the next decades, as Europe was wracked by two wars, the United States finally built a solid financial infrastructure through bodies like the Federal Reserve and the Securities and Exchange Commission. In the 1990s, the end of the cold war, the spread of capitalism, the expansion of free trade and the economic growth of China all seemed to play into New York's hands. New York was the financial seat of the world's unchallenged superpower and the engine of a technology-fueled economy that held up while convulsions shook Latin America, Russia and Asia.

New York City's concentration of finance professionals may help preserve its status in this new era of global capital. BlackBerrys, Federal Express and NetJets may allow anybody to carry on business from any place on the globe. But a startling number of people in the financial industry believe they need to be in and around New York. Hedge funds can indeed be run from anywhere. But they need cash, and they need prime brokers — large banks that lend them money and clear their trades — and they need traders and lawyers, accountants and private bankers, psychologists and decorators. Nowhere is the concentration of professionals who cater to the needs and desires of the very rich greater than in New York. "There are still a lot of meetings, a lot of information needs to be exchanged in person, and that's what really keeps people together," says Charles Jones, a finance and economics professor at Columbia University Business School. Meanwhile, the dollar, while painfully weak against many foreign currencies, still functions as the international medium of exchange. "I think as long as the dollar remains the reserve currency, New York will remain the financial capital of the world," Rohatyn, the veteran banker, says.

One way New York might transition at this turning point is to become more of a diversified economy focused on the needs of the global wealthy. Over the years, the lower-margin, less-profitable part of financial services — back offices, trading operations, mutual-fund management — has left expensive Manhattan in search of lower costs. That has left the city with higher-margin services that cater to wealthy institutions, corporations and individuals, like investment banking, hedge funds, private-equity firms and private bankers. High-end money management and advice, in other words, could become one of many goods and services — auction houses and hotels, personal trainers and personal shoppers, helicopter services and estate lawyers — that will attract the world's wealthy to New York. So rather than high-end luxury services fueled largely by Wall Street wages and bonuses, New York will have high-end luxury services that themselves fuel the economy.

It's no coincidence that the blocks surrounding 57th Street and Fifth Avenue contain not only the nation's most valuable retail space but also its most valuable commercial office space. This latter-day Corner is dominated by street-level ultraluxury retailers like Van

Cleef & Arpels, Tiffany and Bergdorf Goodman and by ultraluxury financial-services firms like Kohlberg Kravis Roberts, Thomas H. Lee Partners and Icahn Associates. And yet J.P. Morgan's old Corner still seems to exert a gravitational force. The people living, dining and shopping on the new Wall Street today don't necessarily work there. They're drawn there for its character, for the new posh condos and for the many opportunities it affords residents to spend money.

For years, Wall Street firms have urged companies to liberate the value of their real estate. The transformation of J. P. Morgan's 23 Wall Street into Downtown by Philippe Starck brings the advice home to the financial district. This summer, a condo at the William Beaver House, a new tower on the corner of William and Beaver Streets, near the stock exchange, sold for the equivalent of $2,836 a square foot, the highest per-square-foot price yet paid for a residence in the financial district. The buyer, according to The New York Times, was "a wealthy financier from Madrid." And so New York's luxury economy scores another gain. More business for the broker who arranged the sale and for the decorators and workmen who will transform the space into a home befitting a wealthy financier from Madrid. Another resident in a neighborhood formerly dominated by office workers. Another customer for Thomas Pink.

As trading goes electronic and as its business becomes more global, it's not unthinkable that in 2017, NYSE Euronext, having become an entirely virtual exchange, might hire Frank Gehry to sheathe its hulking headquarters in titanium and sell the lofts to Russian steel magnates and Indian outsourcing barons for $5 million apiece.

Daniel Gross writes the Moneybox column for Slate and the Contrary Indicator for Newsweek, where he is a senior edito