New York loses out in world financial markets

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A report commissioned last month by New York City's Republican Mayor Michael Bloomberg and New York's Democratic Senator Chuck Schumer, "Sustaining New York's and the US' Global Financial Services Leadership" [1], demonstrates graphically the decline of the United States economy compared to Europe and Asia in the key area of finance capital.

The issue is clearly exercising the minds of top politicians and business chiefs in the US. According to the *Wall Street Journal*, Treasury Secretary Henry Paulson is much concerned with the problem, and a key committee has also been set up under the chairmanship of former Bush economist Glenn Hubbard to investigate it.

The US is still, by far, the biggest financial centre in the world with a total financial stock of $51 trillion compared to $38 trillion in Europe, $20 trillion in Japan and $13 trillion in Asian countries excluding Japan. However the growth of financial stock in the US, 6.5 percent, is considerably lower compared with 8.4 percent in Europe, 7.5 percent in Japan and 15.5 percent in the rest of Asia. "Overall, the figures suggest that Europe is steadily assuming a more dominant position in the world's financial markets," the report warns.

It is where the growth is taking place that particularly concerns the writers of the report, who note that in the crucial areas of investment banking and sales and trading businesses, the total revenue in Europe is practically on a level with the US.

This business includes the first-time flotation of companies on the share market. In so-called initial public offerings (IPOs), there is a particularly serious position for US financiers. As the report puts it, "The world's corporations no longer turn primarily to stock exchanges in the United States, such as the NYSE or NASDAQ, to raise capital internationally."

For IPOs with a value of over $1 billion the market share of the US in 2001 was 57 percent, for Europe 33 percent and for Asia 10 percent. By 2006 the US share was a mere 16 percent whilst Europe's increased to 63 percent and Asia's to 22 percent.

The biggest first-time flotations in Europe were privatisations which turned, as might be expected, to their national stock markets. But large-scale Chinese and Russian IPOs, which might have gone to New York in the past, turned to Hong Kong and London respectively. London is particularly benefiting from foreign company issues—six out of the 10 largest IPOs were from foreign companies compared to one out of ten on NASDAQ and none out of ten on the New York Stock Exchange.

It is not just in large-scale company financing that the US is losing out. For small companies, it is now possible also to raise money by offering shares in so-called small-cap listings. Here, London is dominating the field with its Alternative Investment Market (AIM) for this high-risk but high-yield area. The report suggests that the Microsofts and eBays of the future could well choose this market. Since 2001, 870 companies have listed on AIM, compared to only 526 on the US equivalent, NASDAQ. It is also growing much faster; since the beginning of 2005, it added twice as many new small companies (484) than NASDAQ (224). On AIM, there are "less onerous" regulations, initial listing requirements are "less stringent" and the fees are cheaper.

Another major part of this area where the US is particularly losing out—mainly to competition with London—is in the derivatives and debts market [2].

Derivatives are financial contracts calling for money to change hands at some point in the future, as determined by reference to other items, such as share prices, currency rates, or interest rates. They began as a means of enabling businesses to hedge against risks associated with fluctuations in markets, or changes in financial conditions, but have undergone an explosive growth.

Highest revenues are in so-called over-the-counter (OTC) derivatives, customised to meet requirements of buyer and seller, as opposed to those which are traded in exchanges with standardised contracts. According to the report, OTCs have increased at an average annual rate of 27 percent over the last three years so that their notational value (value of underlying assets rather than revenue) is $370 trillion. "Europe has the largest share of global derivative revenues and London is the main trading center for most of these markets," the report states. Europe has a 56 percent share of the $52 billion global revenue from derivatives.

London is particularly successful in the hedge fund market—highly speculative investments that often use derivatives [3]. London overtook Zurich last year, with hedge fund assets growing at an annual rate of 63 percent, compared to 13 percent growth in the US. Of the 50 largest funds, 18 are now in London, an increase of three from 2002, with New

York's share declining from 28 to 18 over the same period.

Given the wealth of statistics showing how the US is losing out in the increasingly competitive world of international finance, the report makes some attempt to console American big business by pointing to globalisation ("external forces") as an inevitable development undermining US hegemony. Financial markets are now growing in many countries and advances in technology and communications can free finance capital from the limitations of national boundaries. One top businessman is quoted as saying, "New York and the US need to get comfortable with having a smaller share of a larger pie as globalisation occurs."

But there is clearly a feeling that something is wrong, and the report concentrates on issues that make investment in New York less attractive than London and other centres.

Firstly, the regulations governing investment in the US are seen as too onerous, especially those imposed after the Enron fraud. Under the 2002 Sarbanes-Oxley Act (SOX), companies have to abide by rules that are very complex and expensive to implement, compared to the UK's more lenient regulatory model, which is perceived as "better suited to a global financial centre."

In a speech last November, Treasury Secretary Paulson suggested that the recent popularity of private-equity buyouts is due to publicly traded companies wanting to avoid the burden of "regulatory requirements" on the stock exchanges.

Secondly, the environment in the US is much too litigious—"the prevalence of meritless securities lawsuits and settlements in the US has driven up the apparent and actual cost of business—and driven away potential investors."

Thirdly, there is a shortage of skilled manpower in the financial sector in the US. Not only is this due to problems in the American education system making it difficult to find enough mathematically competent workers—there are also worsening US immigration restrictions that make it impossible to employ the kind of highly educated foreign workers that London does, and that deter customers from the Middle East, Russia and other areas from even entering the country.

Not surprisingly, in its article on the Bloomberg-Schumer report, the *Wall Street Journal* played down these difficulties. They point to the fact that other countries are having to tighten their rules also and claim that Sarbanes-Oxley rules are being widely adopted.

Other commentators take an opposite view, with the *Financial Times*, cheerleader for the London markets, pointing to the Bloomberg-Schumer comments on European Union financial regulations due later this year. Rather than becoming an extra burden, by creating a single market in finance as well as trade, these changes are likely to enhance the position of the City of London and Europe as opposed to the US.

In an article entitled "How George Bush has shot US capital markets in the foot," the *Independent* related the experience at Davos, the World Economic Forum, where financiers and investment bankers could be found extolling the advantages of the City of London over New York. It did not paint such a rosy picture as the *Financial Times*, however, explaining that the explosive growth of derivatives was a topic of great concern. "Even top financiers confess to being at a loss to know whether this growth has succeeded in its purpose of reducing the volatility of capital markets and the global economy or whether it has only built up new concentrations of risk, which nobody has yet identified and will be tested in the next downturn."

German Chancellor Angela Merkel announced at Davos that during her leadership of the G8 nations this year she would demand an investigation into hedge fund operations—no doubt concentrating on the minimal regulations in London.

Underlying the much stiffer competition facing US finance is not just the issue of regulations, but the more fundamental question of the long term decline of American capitalism. The *Independent*'s economics editor, Hamish McRae, pointed this out.

The US is the world's largest debtor, relying on foreign savings, mainly from Asia, to cover its current account deficit, he emphasised. "One of the reasons why the dollar is so weak is because owners of those savings, particularly the Chinese authorities, seem to be diversifying out of dollar investments and into euro and sterling ones," McRae writes. "Middle Eastern money, for obvious reasons, is tending to go to other jurisdictions too."

This is not just a matter of politics: "It is the vastly bigger issue of American money in all its forms no longer dominating the world markets."

McRae is undoubtedly correct in this. But he is wrong in suggesting the US establishment is unable to grasp this reality. He claims they are aware of the "slippage" in the position of New York, but do not see the overall picture of decline. On the contrary, the support for imperialist wars of conquest in US ruling circles, and the lack of any serious opposition to the Bush administration other than tactical, shows only too well they have grasped the reality of economic decline and will attempt to use military superiority to compensate for it.

Notes:

[1] http://www.senate.gov/~schumer/SchumerWebsite/pressroom/special_reports/2007/NY_REPORT%20_FINAL.pdf

[2] See the Wikipedia explanation of derivatives: http://en.wikipedia.org/wiki/Derivative_(finance)

[3] See http://news.bbc.co.uk/1/hi/business/4499290.stm for an explanation of hedge funds.