SECURITY & THE NEW ECONOMIC GEOGRAPHY

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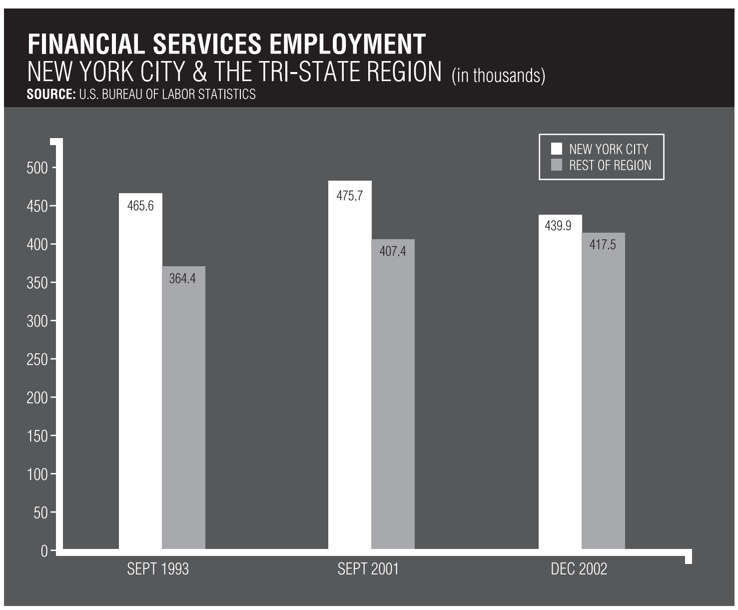
In a single day, the terrorist attacks of September 11 killed or displaced nearly half of the employees of Lower Manhattan's financial services firms. Although many have since returned to Downtown offices, the event has raised serious questions as to whether Wall Street will ever again represent a cluster of financial firms that approaches its pre-September 11 size. In addition to the challenge of revitalizing Downtown's overall business climate, heightened security risks have given a new impetus to decentralization forces that were at play prior to September 11.

In August 2002, the Securities Exchange Commission, the Federal Reserve and the Treasury Department drafted a much-debated white paper indicating that backup sites for the core functions of clearing and settlement organizations and securities firms be established at a minimum distance (as much as 200-300 miles) from primary locations. In a recent version of the paper, the regulators did not set a minimum distance, but did recommend that backup sites be in locations that did not use the same transportation and telecommunications networks or water as the main office.



In addition, the financial firms themselves began to reassess their location priorities in light of the need for secure, redundant facilities. While terrorism received the most public attention, security planners are also concerned with a range of other natural and man-made disasters, from hurricanes to nuclear accidents. This provides a wide spectrum of likelihood, potential damage, and distance required between primary and backup sites for each type of occurrence. It also sets up an internal tension between business needs that might argue for a consolidation of certain functions and a security interest in dispersing operations.

This dynamic raises issues, not just for Downtown or New York City, but for the entire Region. Financial services, and the securities industry in particular, has been the most important driver of the Region's economy for decades. While centers such as Jersey City and Stamford have benefited from both the growth and decentralization of Manhattan's finance cluster, new guidelines or firm decisions could push these firms out of the Region entirely. At the same time, the Region's vast pool of skilled labor, its network of large, Class A office districts, and its transportation and telecommunications networks could provide an attractive alternative for firms to increase security without sacrificing operational efficiencies by maintaining redundant operations in other centers within the Region. How this tension plays out may well determine if the Region maintains its status as the premier financial capital of the nation, if not the world.

The decentralization of financial services is only part of the story, however. Other high-value services, particularly information and business services, have been growing more rapidly than finance. To some extent, these have filled the vacuum left by firms decentralizing from Lower Manhattan and are the primary growth sectors in places such as Long Island, northern New Jersey and the Hudson Valley. For example, while finance jobs grew by only 2 percent in New York City during the eight years prior to September 11, business and professional services grew by 36 percent. During the same period, the finance sector was flat on Long Island but business and professional services grew by 32 percent. Part of the growth is due to demand and outsourcing from financial firms, but much is also responding to local and global demand from a variety of industries, including media, corporate headquarters, manufacturing and other sectors.

As we consider infrastructure and economic development to shape the region, several questions regarding decentralization will need to be addressed. What is the outlook for retaining financial services here? What are the primary concerns of firms making relocation decisions? What are the implications for the five boroughs of New York City and regional centers outside of the city? What actions need to be taken to develop a multi-centered region that can attract both finance and non-finance firms? In addressing these questions, it is important to understand certain dynamics of the region's changing economic geography.

First, the decentralization of financial services is a long-term trend that is likely to continue, even if there were no new security issues. Since Wall Street firms began migrating north to Midtown early in the last century, decentralization has been a continuous process. Back-office operations began decentralizing out of Manhattan in the 1970s and 1980s. By the 1990s, some central office functions began to locate in other office markets, particularly Jersey City. However, this should not be viewed as a zero-sum game for New York City and other parts of the Region. Much of the decentralization represents firm expansions during upcycles in the economy, rather than relocations. For example, in the eight years leading up to September 11, financial services employment grew by 2 percent in New York City but by a full 12 percent in the rest of the Region. By contrast, since September 11, the finance sector contracted by nearly 8 percent in the city but still grew by 2 percent in other areas. The growth outside of the city is due primarily to some of the initial dislocation following the destruction of the Trade Center. The sector has contracted throughout the region since then.[1]

Second, the region's urban core, including Lower Manhattan, still retains many of the attributes sought by high-value financial and service firms. Indeed, the fact that initial relocations from Downtown after September 11 went mostly to high-cost locations in Midtown and Jersey City attests to the importance of these factors.[2]

Finally, the weight that firms give to the different components of their location decisions—the need for frequent face-to-face interactions, labor accessibility, operational efficiency, space costs and security—is constantly shifting. In this complicated equation, a considerable advantage for this region is the degree of choice that we provide within the same labor market. Downtown and Midtown office markets, new centers throughout the city, and regional centers in an arc from Trenton to New Haven can serve different functions and constitute a network of integrated business locations. The challenge is to provide the transportation, communications and institutional links that will allow this network to serve a constantly evolving set of business needs.

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[1] This analysis is for the entire finance sector, which includes banking, insurance and real estate as well as securities firms. Data for more securities firms, which is not yet available for some areas outside of the city, would likely show more dramatic contrasts.

[2] See The New York Regional and Downtown Office Market: History and Prospects after 9/11 by Hugh Kelly in Economic Development Working Group Reports, Civic Alliance to Rebuild Downtown New York, September 2002. Available online at www.civic-alliance.org.