MONEY MAKES THE WORLD GO ROUND: GEOGRAPHIES OF GLOBAL FINANCE

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I. Historic Context

-finance has a long history of being globalized
17th c. Amsterdam
-18th-19th c. London
Adoption of gold standard
-late 19th c. U.S. banking became big business
1930s regulation:
- interstate banking restrictions
- Glass-Steagall Act separated commercial & investment banks
1947-1973 Bretton-Woods Agreement:

- IMF and World Bank
- fixed exchange rates pegged to $US, and $US to gold ($35/oz)
- stable, national, regulated financial markets
1970s-90s transformed financial markets:
a. 1973 collapse of Bretton-Woods and shift from fixed to floating exchange rates
b. petrocrises, deindustrialization, rise of NICs
c. rise in Third World and U.S. debt


(Real $1995 Billions)
Explosive growth of U.S. trade deficits, government deficits, corporate and household debt
U.S. trade deficit
Federal deficits
OUR NATIONAL DEBT:

$14,069,489,804,892$

YOUR Family share

THE NATIONAL DEBT CLOCK

$119,027$
To fund its debt, U.S. relies heavily on foreign capital.
d. Waves of deregulation

**Deregulation Causes Surge in Financial Services Wages**

The BLACK LINE is the ratio of Financial Sector wages to private sector wages. 1910 to 2008.

- Financier Greed Destabilizes the Market and Banks
- Economic Stability
- Reagan Deregulation

**Regulatory legislation**
- 1933 Glass-Steagall Act
- 1933 Securities Act
- 1934 Securities Exchange Act
- 1939 Trust Indenture Act
- 1940 Investment Advisers Act
- 1940 Investment Company Act
- 1956 Banking Holding Company Act

**Deregulatory legislation**
- 1980-1984 Removed interest-rate ceilings (from Glass-Steagall Act)
- 1994 Riegle-Neal Interstate Banking & Branching Efficiency Act (repeals parts of Bank Holding Co. Act)
- 1996 Investment Advisers Act amended
- 1999 Graham-Leach-Bliley Act (repealed Glass-Steagall & parts of Bank Holding Co. Act)
- 2002 Sarbanes-Oxley Act
- 2008 Economic Stimulus Act
- 2008 Housing and Economic Recovery Act
- 2008 Emergency Economic Stabilization Act (TARP)
- 2009 American Recovery and Reinvestment Act
A rogue’s gallery of culprits

- Alan Greenspan
- Henry Paulson
- Larry Summers
- Tim Geithner
- Martin Feldstein
Deregulatory highpoints:
1. Interstate banking prohibitions removed
2. S&Ls allowed to invest in commercial property
3. Ceilings lifted on stock commissions
4. Foreign membership on stock markets
5. Repeal of Glass-Steagall: banks allowed to play the stock market
-> global explosion in size, importance, and complexity of financial sector

Share of the financial sector in GDP (in per cent)

* The financial sector comprises financial intermediation, real estate, renting and business activities.

Source: OECD.
New financial instruments:
Derivatives
Collateralized debt obligations
Credit-default swaps
e. microelectronics revolution
fiber optics
Deregulation and telecommunications afforded financial capital unprecedented mobility.
Consequences
1. Electronic Funds Transfer Systems

-digitization -> money and information became 2 sides of same coin
-huge pools of extremely liquid funds circle globe electronically
-banks can take advantage of interest rate and exchange rate differentials, avoid political unrest
- World's forex markets alone trade $2 trillion daily (compared to $40 billion in goods & services)
90% of currency trades are $U.S.
Electronic money reduces transactions costs and increases the velocity of money (GDP/money supply).
-national borders mean little in this context
difficult to control national money supplies

- less national leverage over interest, inflation, and exchange rates
E-cash is one manifestation of a global economy that is constructed in cyberspace rather than geographic space. The fundamental problems that e-cash poses for governance result from this disconnect between electronic markets and political geography. The very idea of controlling the money supply, for example, assumes that geography provides a relevant means of defining the scope of the market. It assumes that economic borders are effective, that the flow of money across them can be monitored and controlled, and that the volume of money within a fixed geographic area is important. All of those assumptions are increasingly questionable in a digital world economy.
2. Securities markets:

- volume and volatility rose exponentially
Total market value of U.S. stocks as a percent of GNP*

Peak: 190% March 2000

75% Jan. 23, 2009 (estimate)
growth of electronic screen-based trading
NASDAQ founded 1971
Trades 50% US equities
NASDAQ lacks trading floor; it exists only in cyberspace
Average trade takes 25 seconds
Electronic trading threatens trading floors ("from pits to bits")
However, electronic trading increases stock market volatility.
3. Global financial decision making power is concentrated in a handful of large cities.
-command/control centers of global economy:

New York  London  Tokyo
(a) finance, banking, securities
(b) specialized expertise in business services
(c) centers of media, fashion, tourism
Global cities are more connected with each other than their own nations.
-access to clients & suppliers, specialized labor, information, infrastructure
-face-to-face communication is essential for non-routine functions
4. Offshore Banking
- Caribbean, European, Middle East, SE Asian, S. Pacific microstates
-driving incentive is favorable tax laws (i.e., they are tax havens)
-topography of regulation: as technical barriers to capital flow decrease, regulatory ones increase in importance

Composite Governance Indicator (2004)
Cayman Islands: by deposits, 4th largest banking center in the world
-very few real impacts: in Caymans, 538 banks employ only 1,000 people
Money laundering and financial crime: The Cayman Islands in a global perspective

...
Panama

Historical legacy of the Canal
Influx of Latin American drug money? Haven for narcotrafficantes and narcodollars?

TAX EVASION OR MONEY LAUNDERING NEEDS? TRY PANAMA!
Offshore banking centers face concern over tax evasion, money laundering, drug cartels, arms traffickers, terrorists, and corrupt government officials.
Many clients use complex webs of holding companies to blur legal lines of liability and protect assets.
A TYPICAL MONEY LAUNDERING SCHEME

Collection of Dirty Money

Placement

Dirty Money Integrates into the Financial System

Integration

Payment by "Y" of False Invoice to Company "X"

Layering

Transfer on the Bank Account of Company "X"

Loan to Company "Y"

Wire Transfer

Purchase of Luxury Assets
Financial Investments
Commercial/Industrial Investments
A key issue in the success or failure of offshore banking centers is the degree of confidentiality that investors feel they can obtain.
III. The 2008+ Financial Crisis: worst since the Great Depression
This diagram summarizes some of the causes behind the housing bubble that peaked in 2006. The housing bubble set the stage for the subprime mortgage crisis. Many of these elements have complex interactions not shown. The ripple or domino effect through the housing and financial markets as home prices declined is described in a separate diagram.
1% Low Start Rate

Stated Income

No Documentation Loans

100% Finance Available

Interest Only Loans

Debt Consolidation

SE HABLA ESPAÑOL
Low interest rates and stagnant incomes

Median household income (in 2010 dollars)

1999 peaked at $53,252

1996 $49,112

2010 $49,445
Predatory lending, subprime mortgages

U.S. Subprime Lending Expanded Significantly 2004-2006

Sources: U.S. Census Bureau; Harvard University- State of the Nation's Housing Report 2008
Securitized mortgages traded on financial markets

Securitized mortgage lending has disappeared

Source: MBA, DB Global Markets Research
falling prices, homes “underwater”
Change in U.S. Housing Prices: 2000-2010

Purchase only index for lower 48 states estimated using sales price data (not inflation adjusted)

Before the Crash
2000–2006

After the Crash
2006–2010

Ten Year Price Change
2000–2010

Price Change
- 120% to 160%
- 80% to 120%
- 40% to 80%
- 0% to 40%
- -20% to 0%
- -40% to -20%
- -60% to -40%

Data from: Federal Housing Finance Agency
U.S. Properties with Foreclosure Activity

Source Data: RealtyTrac Press Releases of “U.S. Foreclosure Market Report”
Housing dragged rest of economy down with it.
US unemployment rate better than expected in January 2012, now down at 8.3%.
The “free market” solution?
Government bailouts!

WE MAY HAVE MADE SOME COSTLY BANKING DECISIONS...

BUT THANKS TO OUR FRIEND, HANK PAULSON...

WE CAN USE THIS THING TO COVER OUR ASSETS.

$700 BILLION TARP
TROUBLED ASSET RELIEF PROGRAM
Stimulus package

The American Recovery and Reinvestment Act

2009 Stimulus Package: $787b

Source: www.recovery.gov
Debate: Keynesian stimulus v. austerity, budget-cutting

European austerity measures have not worked.

Are austerity measures a plan to “starve the beast?”