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General Remarks on the Challenges of Globalization

Remarks by George Vojta: My task is to address the subject of the global financial architecture in light of recent crisis experiences. Many able, experienced people are participating in an ongoing discussion that focuses on appropriate future changes to the architecture. I am heartened by the fact that the global community has taken up this subject with great seriousness. If the quality of this discussion can be sustained—and I believe it will be sustained—the outcome can be constructive and beneficial for the global community.

Many observers and market participants believe that the financial community was poorly prepared for the crisis episodes of 1994–95 and 1997–98 and that the issues that arose were poorly managed. In some respects, we are too hard on ourselves; indeed, significant losses were incurred by many, massive damage was done to several countries, and, for some, effective adjustment and reform were hindered, not helped, by the direct involvement of the public sector in support packages. Nevertheless, the financial system survived, and we have a platform on which to go forward.

Beginning in late 1997, there were suggestions that significant change was needed in the financial architecture; some critics asserted that radical reform was necessary. Proposals for a global central bank, global super-regulation, and global bankruptcy courts were made in seriousness and with the best of intentions. On the negative side, some people voiced severe criticisms of the rescue packages led by the International Mone-

tary Fund (IMF) and World Bank, and some called for elimination of the IMF and World Bank as unnecessary, counterproductive institutions. But as time passed, a consensus developed that rejected these far-reaching proposals as impractical and concluded that adoption of a more pragmatic set of changes, some of which require several years to achieve, was the best course for the future. Some modest but constructive suggestions were put forward in the context of reaffirmations that the existing market-based global system and attendant financial architecture should be maintained.

Martin Feldstein, Barry Eichengreen, Chairman Alan Greenspan, and the Council on Foreign Relations, among others, encouraged emerging-market countries to limit short-term, foreign borrowings to an amount that was covered by free reserves, to avoid defending a pegged exchange rate during periods of market stress, and to concentrate on improving regulation and management of their financial systems and communicating better with creditors and investors. Other more controversial suggestions included proposals for collective rights clauses in bond financings, establishment of contingent lines of credit from the IMF and the market to be used during periods of market instability, and limited, but temporary, restrictions on short-term capital movements to prevent or manage destabilizing outflows. To date, acceptance of these suggestions—obviously a matter of individual country choice—is uneven and limited.

The G-7 summits extended the pragmatic view of systemic reform. The G-7 also rejected a path of radical change and opted to embrace a standards-based approach as the soundest path to appropriate enhancement of the global financial system. The G-7 (plus the G-10 and G-22), working with the World Bank, IMF, and Bank for International Settlements (BIS), in particular, initiated and stimulated a comprehensive effort to define global best practices in key areas with the objective of encouraging countries participating in the global economy to implement them. This effort is beginning to produce results. Standards are being articulated for transparency of country financial data; fiscal and monetary policy; accounting, auditing, governance, and bankruptcy regimes; bank supervision; securities regulation; and several other areas. Given the many historical instances in which the IMF failed to persuade countries to adopt sound policies, there is understandable skepticism that this approach can work.

Notwithstanding this caution, the standards-based path to systemic enhancement is the most practical of conceivable alternatives. To improve the possibilities for success, the process must be modified. Non-G-7 coun-

tries have not been as involved in the main standards forums as they should be. As a result, their point of view is underrepresented. If the proposed standards are to be effective, the non-G-7 countries must accept them, flesh them out, or modify them as appropriate; most important, they must adopt a path of implementation to achieve compliance within a specific time frame. Another open question is the extent to which the non-G-7 countries will be prepared to disclose their position with regard to the proposed standards and their chosen path of implementation for the edification of investors, lenders, underwriters, and so forth. It is not wrong that the G-7 have the initiative in proposing standards. These countries (and the G-10/G-22) control a preponderance of the resources (capital, people, and technology) that other countries need to support long-term growth and development. The G-7 have a right to propose the standards-based conditions that they require to be involved and exposed in the non-G-7 markets. It is equally appropriate that the non-G-7 countries have the option of stipulating the terms, conditions, and time frames for their acceptance of the proposed standards. To date, there is no robust process for involving the non-G-7 countries in these discussions and for negotiating differences between what is proposed and what can be implemented. Until this gap is remedied, it is unrealistic to expect that the proposed standards will be accepted generally.

A second deficiency in the process is the modest involvement of the private sector. This omission is significant because, by consensus, private sector resources are the *only adequate* resource pool for effectively supporting positive growth in the world. To attract private sector support, the standards must motivate various segments of private sector activity, ranging from trading to portfolio and strategic investment, to take positive risk positions in non-G-7 markets. The discussion of architecture needs to focus more explicitly on the relationship between the proposed standards and private sector motivation to stay actively involved in non-G-7 markets.

Prior to the crisis periods of 1994–95 and 1997–98, the private sector tended to base positive decisions to invest in non-G-7 markets on favorable self-assessments of political stability, macropolicy, and evidence of a reasonably positive attitude toward domestic and foreign private investment by host countries. In countries in which transparency was lacking, and legal remedies and protection of contract and property rights by local institutions were uncertain, the private sector relied on the ability to access local authorities to resolve problems or disputes that would arise. During

the crisis periods of the 1990s, in many instances the private sector found recourse to local authorities and local institutions to be ineffective and unresponsive to problem-resolving needs. It is not surprising that the current initiative to establish standards seeks remedies in the form of explicit commitments to transparency and institutional reforms to address issues involving contract and property rights.

If the foregoing is a reasonable description of where the process of systemic reform stands today, the way forward can be deduced with reasonable certainty. Effective systemic reform requires years of sustained effort in non-G-7 countries to manage the path to compliance with the emerging global standards. As various countries visibly embrace this path of reform and significant progress toward this goal is recorded, they will simultaneously achieve greater support from the global community, especially the private sector, for their development.

If the current process results in the promulgation of generally agreed (at least initially by the G-7/G-10 countries and the key multilateral institutions) standards, future developments can be anticipated. Once again, the proposed standards for non-G-7 countries represent the conditions required for meaningful participation in the global economic and financial system. The incentive to manage the movement toward and ultimately achieve compliance is that countries will be able to access global resources, particularly from the private sector, on increasingly advantageous terms in support of national growth. The penalty for failure to accept and comply with the standards will be exclusion or restricted participation in the global economic and financial system. As and when this standards-driven environment emerges, non-G-7 countries will have a binary choice to accept and comply or not to accept and comply. There is no escaping the fact that these standards derive mainly from the market-based, capitalist AngloSaxon experience. This reality, in and of itself, causes understandable resentment and sparks accusations of a new economic "imperialism." But the truth is that the AngloSaxon market-based economies, driven by the private sector as the primary agent for wealth creation, currently represent the best model for long-term growth. Command economies and state-dominated socialistic economies are bankrupt as workable alternatives. Those who seek a third way are pursuing a goal that, in my view, is not achievable. Harsh though it is, this is the world in which we live.

What can be expected by way of responses to agreed-on standards from the non-G-7 countries? Let me make the slightly heroic assumption that

compliance with the emerging standards together with sound macro-performance would bring a country to investment-grade status relative to the global community. If all non-G-7 countries have knowledge of the published standards, they initially will fall into seven categories:

1. A group of countries that have not adopted increasing national growth as a primary priority, preferring instead to optimize an ideological or power maintenance priority, will reject or ignore the standards.
2. Another group of countries will reject compliance with the standards, which they deem to be inappropriate for them.
3. Another group of countries will acknowledge the appropriateness of the standards but profess a lack of resources to accomplish compliance in any reasonable time frame.
4. Another group of countries will embrace some or most of the standards but will modify some or chose to maintain some local standards that are at variance with the proposed global standards.
5. Another group will embrace the core of the proposed standards and initiate and manage a serious, visible program to achieve compliance.
6. Another group of countries will declare themselves at or near compliance with the standards and commit to achieving full compliance in a reasonably short period of time.
7. A small number of countries may achieve substantially complete compliance shortly after full consensus on the standards is realized and published.

It is possible to group all countries into these seven categories. In my view, this initial categorization can be the basis for evolving a new scheme for sovereign risk ratings (as well as derivative ratings for institutions within countries) by the public sector and the for-profit private sector. Category 1 and 2 countries will be declared far below investment grade and essentially unsupportable by the global community, particularly the private sector, in any broad, market-based financial and commercial sense. Because their circumstances are so far removed from the standards, category 3 countries also will be declared not to be investment grade and to be largely unsupportable on practical considerations, even though they may profess a positive attitude toward compliance. Category 4 countries, depending on the degree to which the global standards are modified or substituted for, could achieve the equivalent of *supportable* noninvestment-grade status, provided

they express in word and deed the political will to embrace growth and foreign and private sector investment. Category 5, 6, and 7 countries represent the gradations of investment-grade countries that will emerge, again provided that they credibly profess and execute the political will and commitment to market-based, private sector-led growth. As time and experience accumulate, countries may change categories—up or down—as their profile changes for better or worse. As their country rating improves, they will experience positive rewards from their interface with the global economy and vice versa. As this process gains momentum, we can expect that the international institutions, the rating agencies, and the private sector will converge to this standards-based perspective in evaluating countries and counterparties within countries for their own purposes.

Finally, I would like to say a word about surveillance. Which institutions should monitor compliance with the standards and publish progress or lack of progress reports? It is clear that the IMF, the World Bank, and the BIS intend to play this role and are being encouraged to do so. Political issues, issues of confidentiality, and issues of competence are being raised in regard to broadening their surveillance role, but doubtless these institutions will rise to the challenge and embrace this role in some form. The private sector also will play a significant role in surveillance through rating agencies, private institutions such as think tanks, and leading private enterprises. A multiplicity of surveillance activity is all to the good. There is and will be no “barrier” to entry into the surveillance game by any party that chooses to be involved. It is important for the non-G-7 countries to understand that their position on compliance with emerging global standards will be a matter of public record; information on these matters already is and will remain in the public domain. Even if a non-G-7 country chooses to ignore the standards, that fact will be readily ascertainable and counted as a negative in its ratings. Finally, all countries will be rated irrespective of how they approach the issue.

Becoming comfortable with being evaluated more objectively, regularly, and visibly, particularly by the private sector, will be difficult for many non-G-7 countries. But they do not have a choice; consequently, it is in their national interest to cooperate with these efforts and to work proactively toward shaping and achieving the new standards *if* increasing wealth is a serious national priority.

Constructive reform of the global financial system—if it comes—will be the result of improved standards of management in all countries

desirous of participating in the global system. The path is difficult, but realistic. Steady progress in execution by the non-G-7 countries is critical. The positive conclusion is that systemic reform can be achieved for the greater good on this basis.

Comment by Georges Ugeux: I would like to address the challenges of globalization. By way of preface, I would like to tell you that the securities industry is confused, and the broker-dealers are confused. At the New York Stock Exchange (NYSE), the broker-dealers tell us that they are hedging their bets. Those who are at the forefront of the erupting international capital markets—the great international broker-dealers of this world—do not know where the markets are going. So how would we—the exchange—know and how would the Securities and Exchange Commission (SEC) know where we are going?

We have never been as challenged as we are today. My career has been involved historically with the bonds market and with creation of the euro bond market. Although both foreign exchange and bonds were trading on the stock market a few decades ago, they are gone now. I keep reminding my colleagues of the recent model of the equity market without stock exchanges.

I am sure that the pace of change is not as fast as the comments of the newspapers would lead us to believe. The dislocation of a liquidity of \$15 trillion of market capital on the NYSE is not going to happen overnight. Our market share has not really changed. It declined from 83 to 82.9 percent, but that might have been a statistical error.

I would like to address five issues related to the challenges of globalization. The first challenge is that we have to keep what is currently the Holy Grail of all exchanges around the world and is the center of liquidity. One way or the other, if we fail to do that, we are failing our mission. The broker-dealers seem to forget that we are in the reinsurance business. We are insuring that the litigation over prices is kept at the lowest possible level.

The second challenge is the question of time zones and extended hours. I am not looking at extended hours in the evening where people would want to trade instead of listening to Al Gore and Bill Bradley or maybe watching the Yankees. I am talking about real extended hours, such as from 3:00 a.m. to midnight. That is the real time zone question.

The third issue is communication. The paper by Alberto Cybo-Ottone, Carmine Di Noia, and Maurizio Murgia talks about the growing number

of alliances and consolidations being announced. In the world of cross-border alliances, there is no correlation between the reality and the announcements.

The fourth challenge is alluded to by the Tradepoint case, which illustrates the future of markets and the flexibility of regulators.

And my fifth point is the regulatory paradox. I am going to look at two things here: experimentation versus integrity of the market and the U.S. market versus the rest of the world. These are two totally different issues, particularly from an antitrust standpoint.

We have tried to address all of these challenges at the New York Stock Exchange. We are currently looking at every possible initiative that could improve the liquidity that we have today. I am sure that some of you might think that we are spending our strategic meetings considering a single mission, which is to save ourselves. But, actually, we are looking at what is essential to our client base. Probably the most interesting part of our internal discussions has been the effort to define our huge constituencies and stakeholders, including the U.S. government and the floor brokers. Our principal clients are the listed companies and the investors. Everybody else is an intermediary.

We recently met in Bangkok with the Federation of the International Stock Exchanges. In that discussion, we tried to compare global alliances between exchanges with airlines. As a result of that discussion, I realized that stock markets today are the equivalent of airlines that are owned by travel agents. That is all that I will say on mutualization.

The question of time zones is impossible to answer. We have initiatives on the two fronts, and the reason is the following. We could decide to trade from 3:00 a.m. to midnight. This would pose a difficult challenge to our human and other resources, but we would consider doing that if it were the only way to compete with twenty-four-hour trading systems. I am not talking about a futuristic view; I am talking about Instanet and Bromberg today.

I am not talking about competing with new initiatives, which existed well before electronic communication networks were known as ECNs. We cannot exclude that model. I do not think that it is the smartest model, but it might be the one that we have to follow for competitive reasons.

What gives us cold feet is that on September 23 the great alliance that was created a year before in Europe canceled the project to create a European passport. Of everything they had been talking about, this proposal to

create a pan-European market was the only one that made sense. The likelihood of building an Asian market is even more remote.

So on the question of time zones and extended hours, we are bound to follow a strategic analysis that has two tracks. We have managed to create platforms, and we are under tremendous pressure to have a twenty-hour trading period.

The third element concerns communication and announcements. There is a reason why the NYSE is never mentioned as a possible alliance. We decided from day one that we were not in the business of making announcements.

In the summer of 1998, we began to look at what a global alliance means, and we came to a conclusion. Creating a global alliance is such a huge challenge, and it is only possible to announce a little bit of progress made in one field or another. Some people have approached the global alliance as a technological problem, which can be resolved. However, the technology side of creating global platforms around the world is the easiest part of the problem.

We have not yet consolidated the North American market. To be candid, we had better start by looking north. We have so many similarities north of the border that creating a global market looks easy. We have been working on creating an alliance with Canada for a year, and we probably need another couple of years before we do something serious. This is the amount of time needed to create an alliance with the most similar, closest, easiest, most connectable market imaginable.

If that alliance takes two years to accomplish, think about one with Tokyo. We are participating in a working group with Tokyo, and we are starting to talk about interconnectivity, what can be done, and how it could be done. It seems clear that there is a market to be created between the U.S. exchange and the Japanese entrepreneur. However, under today's rules and regulations, that agenda is not doable. We need to prepare a new regulatory landscape.

That leads me to my fourth point, which is the Tradepoint story. And here I am telling you something that we have been saying to the SEC very seriously. The NYSE has not expressed an official view of the Tradepoint ruling, because of the size of the exception, which is costing a million dollars a day.

My fifth point is the regulatory paradox, which is probably the toughest part of what we do in the global market. The regulatory paradox takes

so many forms at the moment that it is very difficult to integrate the thinking of today's regulators with any long-term strategy of exchanges.

We were surprised by the Tradedpoint bailout. Clearly, we believe that regulation presents several problems. The first one is that independent governments have national regulators. So each time we cross-list an issue, we must contend with regulation. Let me give you the example of Nasdaq. It is nice to think that 1,000 Nasdaq securities could trade in Japan, but the SEC in Japan wants to register them. It takes two years and a lot of money to trade in Japan. Japanese companies that seek to be traded on Nasdaq in Japan have to comply with the Securities Act of 1933, and the reason why they seek to be listed in Japan and not in the United States in the first place is that they do not want to do it. Cross-listing is a very, very narrow example, and probably the easiest one, yet even here we are getting into serious issues.

At the same time, we spent a year refining how to calculate profit under the set of regulations that apply to our listing standards and the number of days of delay we have to give a company.

How are we going to create what is needed for global markets with regulated exchanges and avoid the ECNs becoming basically a regulatory hold? For years we have invested huge amounts of money in regulating the market. The regulatory side does not pay for itself. There is no way that we will let that part of our franchise go, let alone give it for free. That is the substance of what DeGrasso told the Senate.

When we look at global markets, we must decide whether we have to look at the U.S. market or whether the question is between us, Tokyo, Hong Kong, Instanet, and Bromberg, which is a totally different debate. NYSE has taken several steps to determine the market structures that are going to prevail. First, we identified our customers as being the listed companies and investors. We are giving institutional investors much more direct access and are seeking to ensure that we give them what they need. Second, we revisited the issue of ownership and trading rights, which is demutualization. The third element, which we should never forget, is that although we are talking about globalization of the stock market, we are taking a very myopic view of the world. Each of our markets trades both very active stocks, which are the global stocks, and much less active stocks.

In each market, the stock markets have a function to create new capital for new initiatives of small and medium enterprises. If you disconnect the

revenues from global trading, none of those exchanges can survive financially. So the economic dimension of the problem has to be taken into consideration. The national and international elements are extremely important. We have to look at both and not get carried away by just one dimension.

The only way that globalization will happen in a reasonably smooth way is by building an increasingly international partnership with the regulators and the government on cross-border issues. We have one of the most extraordinary regulators in this country, but globalization challenges them at least as much as it challenges us. Pointing fingers at them and at us will not work. The challenge of globalization is being around the same table and conveying the kind of regulated market that we believe we can and want to keep for investors and for companies. That is the ultimate challenge of globalization.