Fordham International Law Journal

Volume 21, *Issue* 2 1997 *Article* 3

Perspectives on Global Capital Markets

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Abstract

Paul A. Volcker's opening remarks for "The Global Capital Market: What's Next?" Mr. Vocker introduces a discussion on globalization and whether the changes that globalization has made in economic policy will have long-term viability.

PERSPECTIVES ON GLOBAL CAPITAL MARKETS

*Paul A. Volcker**

We meet today to discuss the subject of "The Global Capital Market: What Next?" It's a brave man who is going to speak with great authority on what's next. I presume only a group of lawyers would venture to take on this abstruse and large subject.

I have a limited role. My function mainly is to listen and raise some provocative questions. I assume that with my advancing years, I am supposed to provide some perspective. Let me briefly do so.

We can hardly get a sentence out of our mouths these days without talking about globalization, whatever the subject is. I would like to remind you that in the area of international finance, globalization is not new. In fact, so far as I know, the high-water mark for international investment was around 1913, on the eve of World War I. Recently, a political scientist reminded me that that was also a period when everybody was congratulating themselves on peace and prosperity and that the prospect of war and destruction was extremely remote. At that time, the United Kingdom, of course, was the center of the financial world: in the years before World War I, the United Kingdom was exporting capital equivalent to about ten percent of its gross national product. I do not know of any developed country that has approached that degree of capital outflow in recent years. Naturally, the ten percent capital equivalent represented a net figure. It may be true — and I assume it is — that there are larger gross figures, due to the modern infrastructures we have to facilitate capital flows and quick decision-making.

I do want to emphasize, however, that while a lot has changed, much has not. At the turn of the twentieth century, carrier pigeons did not dominate the world of international finance. Communications could move pretty rapidly then with the telegraph and the Morse Code. We had securitization. The idea of international bond issues is hardly new. It dates well

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back into the nineteenth century. We had lawyers: I sometimes wonder whether the laws that were enacted a hundred years ago are complicating or facilitating things these days. Most of all, herd instincts in the international and domestic arenas impacted markets during the nineteenth century as they arguably do today, with waves of investment and optimism or disappointment.

Of course, there have been changes. I suspect there is a lot more diversity among borrowers and lenders these days. Markets have become more depersonalized. They are packaged and repackaged in a way that the ultimate borrower or lender may not have as much contact with each other as they presumably did a long time ago. I think there are a lot more short-term flows, more movement back and forth, all at an accelerating rate. I would point out, too, that in the industrialized countries' markets there is a lot more volatility today than there was a hundred years ago. At the very least, there is a degree of volatility in foreign exchange markets that would not have seemed natural at all at the beginning of the century. There is no gold standard today and developed countries do not have fixed exchange rates.

Now, let me suggest that beneath all of these issues there are some fundamental underlying questions which have been set forward for our participants to discuss. I suppose the broadest question centers on the balance of capital supply and demand in the world. One of the curious phenomena, true for some time now, is that the richest country in the world, the United States, has also been its biggest borrower. According to economic textbooks, money is supposed to flow from the rich to the poor. To some extent, the money has been flowing from the poor to the rich, particularly to the United States. The United States, due to its size, can make a substantial difference to the whole world. That reflects a very low level of savings in the United States and a tendency for very high levels of savings among the poorer countries. If one looks at general trends, the rate of savings in other developed countries, which typically has been substantially higher than in the United States, is also tending to decline.

Now, we are looking at the next stage in international capital markets. All the industrialized countries, in one degree or another, led by Japan, reflect something of a generational crisis. The industrialized world will experience an increase in the number of retired people in the coming decades and a large decrease in the number of workers per retiree, assuming that no cataclysm or enormous change in the age of retirement occurs. This trend will impact domestic and international capital markets, because the retirees are presumably spenders and the workers are savers. With fewer workers and more spenders, an interesting question arises as to where we will get the money to support the transfer of consumption that this socio-economic trend implies.

A moment ago, I touched upon the volatility of international capital flows, or domestic capital flows. Let me just mention, however, one aspect of that from the international standpoint, as illustrated recently by Mexico, Thailand, and Eastern Europe. A country that follows what are perceived to be good policies, and in fact may be good policies, will understandably attract investment. Capital will then inundate these countries that are relatively small compared to the size of world capital markets. Therefore, a somewhat marginal swing in portfolio managers' decisions to invest money in a particular country can provide a very large amount of money in that country relative to the size of its economy. When those decisions change, which they can rather rapidly, a lot of money can flow out of a country in a short period of time and present extremely difficult problems of economic management. How this trend will develop in the years ahead is an important question for world policymakers as well as for market participants.

Regarding the Glass-Steagall Act[1] and the legislative outlook, we happen to have participants in this panel from Japan and the United States, where both political systems are considering institutional change. In the United States, perhaps more markedly than in Japan, lawyers have aided and abetted a lot of change without much legislation. I recently testified on American legislation. Gordon Baxter, trying to remember an issue that had come up in a hearing ten years earlier, read a statement that I had made at the time before a similar congressional committee. I could have used that previous testimony verbatim in 1997. This illustrates that the American legislative process has moved extremely slowly, but there has been an enormous amount of *de facto* change.

I just returned from a short trip to Japan, where I participated in a conference on deregulation in Japan. Conference

1. 12 U.S.C. §§ 24, 78, 377, 378 (1988).

participants set forth enormously ambitious proposals. We debated whether the actual legislative process would be as slow as that in the United States, given the politics and bureaucracy and the current contest in the United States between the different market participants. We shall see, and Mr. Gyohten can tell us.

I will conclude with an underlying question which concerns us all as citizens and participants. There have been enormous changes in economic policy and ideology, notably open markets, liberalism, and international capital flows, to name a few. While we all encourage those changes, the question remains whether improved economic performance will reflect these changes within a reasonable period of time. While we like to think so, the evidence to date is rather mixed.

Without going into the details, and forgetting about the debt crisis of the 1980s, recent growth has not marked Latin America in the current decade, despite economic growth characterizing the years prior to 1980 when economic policies were quite different. The outcomes in Eastern Europe and Russia are still uncertain. Japan has had a very sluggish growth period. In recent years, Europe has had unemployment rates not seen since World War II. In terms of economic performance, the United States stands out as the great gem of the ocean, or two oceans. In the United States, however, even if we believe the figures, there is some lingering doubt as to the stellar economic performance because productivity growth has been slow compared to the earlier post-war period.

Deregulation, freedom, and liberalization are particularly noticeable in the important area of capital markets. I think during this conference we can raise questions about and comment on the prospects of when that very dramatic change in economic policy that is considered so constructive will actually have the kind of payoff that assures its long-time viability.