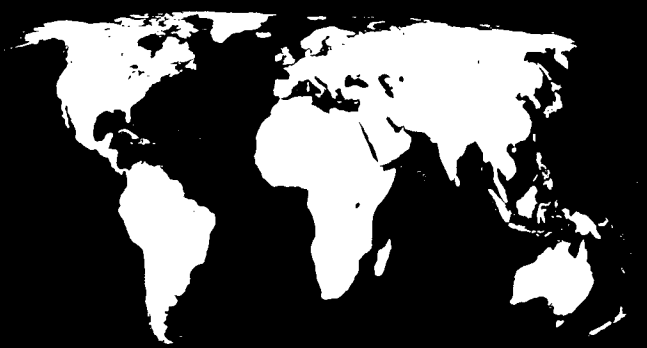


THE 1986 PER JACOBSSON LECTURE



# THE EMERGENCE OF GLOBAL FINANCE



**Yusuke Kashiwagi**

Dorothy Betts Marvin Theatre  
The George Washington University  
Washington, D.C.  
Sunday, September 28, 1986



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# **The Emergence of Global Finance**

Yusuke Kashiwagi

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# Foreword

The 1986 Per Jacobsson Lecture, entitled "The Emergence of Global Finance," was delivered by Yusuke Kashiwagi, at the Dorothy Betts Marvin Theatre of the George Washington University in Washington, D.C., on Sunday, September 28, 1986. Mr. Kashiwagi is Chairman of the Board of Directors of the Bank of Tokyo.

William McChesney Martin, Chairman of the Per Jacobsson Foundation, presided over the meeting, the proceedings of which are presented in this publication.

The Per Jacobsson lectures are sponsored by the Per Jacobsson Foundation and are held annually. The Foundation was established in 1964 in honor of Per Jacobsson, the third Managing Director of the International Monetary Fund, to promote informed international discussion of current problems in the field of monetary affairs.

The lectures are published in English, French, and Spanish and are distributed by the Foundation free of charge. Through the courtesy of other institutions, other language versions are also issued from time to time. Further information may be obtained from the Secretary of the Foundation.



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# Opening Remarks

**William McChesney Martin**

The Per Jacobsson lectures are among the happiest annual occurrences for me. With the help of the President of the Foundation, Frank Southard, I have been conducting these meetings and introducing the lecturer for a number of years now. I am very glad to undertake these tasks again.

These lectures provide us with the opportunity of meeting old friends and former colleagues. We have always tried to maintain the spirit of continuity in this organization, and I think we have succeeded in doing so.

We are indeed extremely fortunate in having Yusuke Kashiwagi as our speaker today. I have known him for quite a while. He is one of the most eminent members of the financial community. So we are very pleased to have him deliver the 1986 Per Jacobsson Lecture.

I have been reviewing the minutes of past lecture meetings and examining them in the light of economic developments. The themes of these lectures have always reflected important economic and monetary issues; and the topic of today's lecture is no exception. I recall that at my first Per Jacobsson lecture meeting, exchange rates were hardly mentioned at all, but we were all aware that in the future, exchange rates were going to become terribly important. And if you think of the events of the present time and the statements of the Secretary of the U.S. Treasury, James A. Baker III, you can see that we are right now in that period. In keeping with our tradition, today's lecture deals with a subject that is related to present-day developments. Global finance is an issue of major concern today, and we are glad that Yusuke Kashiwagi is here to speak to us on that subject. So I am pleased to introduce him now.

# The Emergence of Global Finance

**Yusuke Kashiwagi**

Mr. Chairman, distinguished guests, ladies and gentlemen: It is indeed a great honor and a real responsibility to be asked to give the 1986 Per Jacobsson Lecture.

First of all, I wish to pay high tribute to Per Jacobsson. I was privileged to meet on various occasions this great figure of international finance. I recall, in particular, the first meetings of the Group of Ten organized under the General Arrangements to Borrow, which he conceived to strengthen the International Monetary Fund and the international monetary system. Therefore, I feel a great personal satisfaction to be honored to give you some of my thoughts on an important development of international finance.

## *Introduction*

Over the past year or so the world economy has been going through a phase of major adjustment brought on by a weakening of the U.S. dollar, declining interest rates, and falling oil prices. Thus far, these adjustments have yet to produce beneficial effects on the world economy in terms of growth. On the contrary, they have led to a kind of money game in which funds available for potential investment chase around the world in search of the highest possible rates of return, with little relationship to the real economy.

If surplus investment funds continue to be channeled mainly into money games instead of being invested to create real capital, the world's productive activities may not rise to higher levels, a growing tempest of trade friction may spread across the world, and the debtor developing countries may be crushed by their growing mountain of debts. Moreover, eventually, confidence in the U.S. dollar may collapse, and the world's trade and financial systems could be very severely threatened.

I can give two explanations as to why so much surplus capital is on the loose around the world. The first is the time lag before funds generated by the decline in costs are invested in real capital. This happens because plans for investment are not drawn up beforehand to deal with windfalls arising from external factors. In that context, these funds differ from surpluses built up through the efforts of management to cut production

costs or to raise prices. The second is the advent of so-called global finance. I use the term *global finance* to refer to the ongoing revolution in the world's financial structures, a phenomenon that is creating a wide spectrum of opportunities for the employment of surplus funds.

The revolution triggered by the present decline in costs should eventually lead to renewed world economic growth. But before this potential can be realized, we must wait patiently until rational investment plans can be drawn up by businesses. In the meantime, governments need to implement maximum expansionary measures permissible under existing monetary and fiscal constraints. Global finance is not, as some believe, an unhealthy phenomenon that must be contained. The development of global finance should be fostered and directed to promote the growth of investment on a global scale.

In my address today I shall attempt to account for the changes occurring in the Tokyo market as a result of the emergence of global finance. I shall also touch on the question of what kind of international monetary system is best suited to this emerging globalization of finance.

First, let me offer my personal views on global finance itself.

### *Global Finance*

The term global finance, or *globalization of financial markets*, if you prefer, appropriately expresses the direction of the revolutionary changes now taking place in the world's financial markets. The nature of these changes has not yet been clarified precisely in all respects. In its narrowest sense, global finance is similar to the worldwide *internationalization of finance*. In another sense, it also encompasses both *securitization*, or the process whereby the barriers between commercial banks and securities companies are being broken down, and *innovation*, or the process whereby new innovative services are being added to conventional lines traditionally offered in financial markets.

I believe the concept of global finance thus incorporates the three elements of internationalization, securitization, and innovation. A common theme linking all three elements is *integration*. Internationalization is slowly but surely integrating the world's financial markets into a single global whole that operates around the clock. I will have more to say about internationalization later.

Securitization incorporates a number of facets. Essentially, it refers to a process of disintermediation by which businesses wishing to raise funds issue securities instead of borrowing from banks. Banks cannot afford to ignore this trend, for it is eroding their basic businesses. Many banks are preparing to adapt to the new circumstances by establishing their own securities services or by tying with firms engaged in the securities business. The world's money and capital markets are becoming increasingly integrated as a result. I should add, however, that the trend toward

securitization has encountered special difficulties in the United States and Japan, because in these two countries commercial banking and securities business are still separated by law.

As for innovation, the third element of global finance, recent developments in new instruments include note issuance facilities, currency and interest rate swaps, currency and interest rate options, and financial futures. These novel techniques of financing provide links among the traditional financial instruments hitherto handled in separate markets. These markets are now being integrated through such financial elements as currencies, interest rates, and terms of maturity. Consider, for example, the increasing use of interest rate swaps. This development is tending to converge interest rate levels in markets hitherto isolated from each other by such barriers as withholding-tax differentials and differences in financial regulatory systems.

Integration is thus an essential feature of the trend toward global finance. As this trend continues it is gradually bringing down market barriers based on nationality, types of instruments, and sectoral or institutional demarcations. The participants in all markets are invariably being exposed to the turbulence of worldwide competition on the same playing field.

A positive beneficial effect on the real economy can be expected as the scope of the world's financial markets becomes broader and deeper and as the costs of financial services decline. There may also, however, be negative impacts on the real economy. Escalating competition may distort market-price-forming functions in terms of interest rates and exchange rates; unfair competition may result from abuse of innovations; and failures of financial institutions may rise to a dangerous level.

Global finance first became prominent in the early 1980s. The first factor to promote it was the increasing volatility of dollar interest rates and exchange rates. From around 1979 onward wide fluctuations in these rates meant that many of the parties holding dollar positions by virtue of their involvement in trade or international finance were faced with the need to hedge their risks. Internationalization, securitization, and innovation all proved to be helpful, because each increased the range of opportunities to hedge dollar positions.

A second factor has been the rush by governments to meet new conditions by relaxing foreign exchange controls, interest rate controls, restrictions on entrance of foreign financial institutions, and tax barriers. Deregulation has not been a one-way street, however, for governments have taken a "scrap-and-build" approach that includes the introduction of new regulations to cope with new circumstances. Nonetheless, the overall level of regulation has gone down. Global finance and deregulation are mutually reinforcing. Deregulation promotes global finance, while the environment created by global finance forces governments to relax

regulations. Countries that maintain unnecessary restrictions on financial transactions risk damaging their international competitiveness.

A third factor contributing to the advent of global finance has been the amazing development of international telecommunications and the spread of computer technology. Computers and communications provide a means of processing the huge volume of complex and diverse transactions that characterize global finance; they have also significantly slashed the costs involved. The shift toward global finance has also been accelerated by a phenomenon known as institutionalization—that is, the increasing concentration of the world's investment funds in the hands of institutional investors. Other factors that warrant mention are the outbreak of the debt crisis in developing countries in 1982 and the change in international fund flows caused by the decline of oil prices in 1984–86.

These are the immediate factors that have facilitated the emergence of global finance. Perhaps I should add to them a more fundamental background factor. I refer to the increasing interdependence of the world's economies, a process that has progressed steadily since World War II. One indicator of the level of interdependence is the ratio of world trade to world gross national product (GNP). According to an estimate by Professor Lester Thurow, this ratio rose from 12 percent in 1962 to 22 percent in 1984. As the world's economies became increasingly dependent on trade, integration through trade ties grew stronger. To be sure, the trend toward global interdependence is by no means limited to trade relations. Other areas in which this process has been evolving include direct investment as seen in the activities of multinational corporations, and international financial transactions.

The trend toward a growing level of economic interdependence on a global level appears to be not only irreversible but also self-sustaining. The same can be said of the globalization of finance or global finance, which is but one integral part of this larger trend.

### *Internationalization*

Of the various elements of global finance, internationalization is central. In the financial context, internationalization is the process whereby the major national markets become integrated into a single world market that transcends geographical distance and time zones to operate on a twenty-four-hour basis. The internationalization of financial markets started in earnest during the mid-1970s, when the oil-exporting countries invested much of their massive foreign currency surpluses in the Eurodollar market. In turn, oil-importing nations that ran up large current account deficits financed them by borrowing in the Eurodollar market. As a result of these developments, the market gained greater depth, expanding in size and in the range of participants.

However, by the 1980s massive amounts of funds started to flow directly between the major national markets without passing through the Eurodollar market. This was the result of the changing balance of payments situation of the major industrial countries, as seen in the dramatic expansion of the current account deficit of the United States and the enormous current account surpluses of Japan and the Federal Republic of Germany. This sudden increase in the financial interdependence of key advanced nations added further impetus to the internationalization of financial markets.

Internationalization has in this way taken two distinct forms. One is the expansion of the Eurodollar market, both in terms of the volume of funds and through the geographical expansion of the market. With its home base in London, the market in the 1970s acquired extensions in such far-flung places as Singapore, Hong Kong, the Caribbean, and Bahrain. In 1981 it gained a foothold in the United States in the form of international banking facilities (IBFs), and in December of this year an offshore market is to be established in Japan.

The other form of financial internationalization is the external liberalization of the major national markets, particularly those of Japan, the United Kingdom, and the Federal Republic of Germany, which has led to a higher incidence of direct transactions between these markets and the markets of other countries. This trend has also encouraged the financial institutions handling the funds to set up operations in partner countries.

From a historical perspective, the internationalization of the world's financial markets has featured opposing paths of development in London and New York. The growth of the London market since the 1950s has centered on London's Eurodollar market. A unique feature of this market has been its use of foreign currencies, particularly the U.S. dollar, rather than the pound sterling. This was made possible by the sophisticated functions and superb adaptability of the City of London and the flexible policies adopted by the British authorities. The "Big Bang" is now under way in the City. This is a financial revolution with the goal of tearing down all barriers between commercial banking and securities business. This will make London a freer market than New York, which is still bound by the restraints of the Glass-Steagall Act.

In the New York market, by contrast, virtually all transactions use the U.S. dollar. New York has developed as the world's largest national market and also as the world's largest international market. Two major changes have affected the internationalization of the New York market thus far during the 1980s. The first was the establishment of IBFs at the end of 1981. The IBF, which was set up to facilitate competition with the London market, represents a revolutionary advance in that it created a Eurodollar market within the United States. The second change is the New York market's role since 1983 as a channel to finance the huge current

account deficit of the United States. U.S. policymakers can no longer consider only domestic economic trends when designing monetary measures. The conduct of monetary policy must now take into account financial conditions in other countries, a factor that has strengthened the links between New York and foreign markets.

The New York and the London markets thus represent two contrasting directions in internationalization. The internationalization of the Tokyo market is about to begin in earnest, and I predict that it will pattern itself on the New York model. That is, Tokyo will develop as an international financial market using mainly the currency of its home country. In view of the rapid change of the United States into a debtor position, Tokyo is likely to develop functions complementing New York, and the yen will undoubtedly take over part of the role now played by the U.S. dollar.

### *The Tokyo Market*

Full-fledged internationalization of the Tokyo market began late in 1980 with the sweeping amendment of the Foreign Exchange Control Law to apply the concept of "freedom in principle" to all capital transactions. The pace of liberalization and internationalization of Japan's financial systems was accelerated following the release in May 1984 of a timetable worked out by the Japanese authorities in consultation with the United States. The change has subsequently proceeded in accordance with this timetable, and on occasion new developments have been introduced ahead of schedule.

In Japan's case, the liberalization of inward and outward capital flows began in the 1970s. Because of the slow change, the Tokyo market was at first regarded internationally as just another local market in which peculiar financial systems were being preserved. Three characteristics symbolized the backward nature of the Tokyo market at that time. Although these features have now been remedied to a large degree, they deserve mention since their vestiges can still be observed in various areas of the market. The first feature was the isolation of the Tokyo market from international competition by means of strict controls imposed on cross-border capital flows; the second was the close regulation of interest rates to keep them at relatively low levels; and the third was the demarcation of strict boundaries among commercial banks, long-term credit banks, trust banks, and securities companies.

The first few decades after the war saw the Japanese economy achieve dramatic growth under the protection of its unique financial system, which was extremely efficient, given the conditions that prevailed at that time. By the 1980s, however, major shifts had occurred in the domestic and external economic environments, and changes in traditional financial arrangements were imperative.

The isolation of the Tokyo market had to come to an end because the rapid trend toward global interdependence made it unacceptable for a nation of Japan's economic size and strength to maintain closed financial markets. Interest rate controls also became untenable in the wake of the huge government bond issues that were floated after the oil crises. The amount of bonds outstanding grew enormously as a percentage of GNP, and debt-servicing costs became an ever-increasing item in the national budget. This grave deterioration in the fiscal situation meant that the Government had to sell government bonds at prevailing rates in order to ensure that new issues would be fully absorbed. Inevitably, this brought on the progressive removal of interest controls affecting other financial instruments as well.

As to the third traditional feature—that is, the segmentation of Tokyo's financial activities by type of business—the walls between financial institutions have now been lowered considerably. For example, long-term credit is no longer the exclusive preserve of a limited number of long-term credit banks. Partial approval has been given to commercial banks and securities companies to invade each other's territories. But there are inherent limits on the extent of this stepping across barriers, because the concept of universal banking is still restrained by law in Japan.

How has Tokyo developed as an international financial center? Let us look first at the scale of the market as compared with other major money and capital markets, but excluding Euromarket currencies from the analysis. By this measure, the largest market in the world is the U.S. market at \$7.1 trillion, followed by Japan at \$2.2 trillion, and the United Kingdom at \$1.6 trillion. The average annual growth rates of the money and capital markets of these countries between 1970 and 1985 offer a different perspective. In this case, Japan comes first with a growth rate of 18.3 percent, followed by the United Kingdom at 14.5 percent and the United States at 8.8 percent. These statistics show that not only is Japan's market already enormous but it is growing fast. It is pulling quickly ahead of third-place Britain and shortening the lead of the United States. (Incidentally, the size of the London Euromarket is \$0.5 trillion.)

What are the main characteristics of the Tokyo market? As far as nonresidents are concerned, the primary characteristic is that it is a market for raising funds and not so much a market for investing funds. This bias is readily discernible from Japan's balance of payments statistics. In the five years beginning 1981, just after the revision of the Foreign Exchange Control Law, the net outflow of long-term capital from Japan amounted to \$221 billion. During this period, the net inflow of long-term foreign capital totaled only \$65 billion. Even when the net inflow of \$40 billion in the short-term capital account is added to this total, funds flowing out still exceed funds coming in by more than two to one. The five-year gap of \$116 billion was financed by the surplus in Japan's current account.



In other words, we can say that Japanese exports of goods and services financed slightly more than half of the funds raised by foreigners on the Tokyo market. The remainder was financed through the Tokyo market's role as a turntable for international funds. The special significance of the Tokyo market is its ability to borrow short and lend long. As befits an international banking center, Tokyo serviced a high 20 percent of nonresidents' fund-raising needs by taking in short-term capital and making long-term loans.

A second feature of the Tokyo market is the contrast between the steady internationalization of long-term transactions and a conspicuous lag in the internationalization of short-term transactions. This imbalance does not stem from the attitudes of nonresidents toward the Tokyo market. Unfortunately, the problems lie in the market itself. I stated that Japan's money and capital markets have grown to \$2.2 trillion. Actually, the capital market alone accounts for over \$2 trillion of this amount. The size of the money market is a mere \$150 billion. The main cause of this imbalance is that, while the massive issue at market rates of government bonds since the late 1970s rapidly expanded the capital markets, delays in deregulating interest rates slowed the growth of the money market. Tokyo's money market, it must be admitted, is still underdeveloped as regards instruments and functions. The low level of nonresident involvement in short-term transactions is merely the natural consequence of this situation.

A third feature of the Tokyo market is the limited presence of foreign financial institutions, compared with the situation in the United States and the United Kingdom. The market share of these foreign institutions is also relatively small. Recently, however, interest in the Tokyo market has picked up, and the entry of overseas financial institutions is accelerating.

What does the future hold for Tokyo? Many believe that Tokyo eventually will be linked with New York and London to form the tripartite axis of globalized finance. Geographically Tokyo is situated in a time zone that enables it to serve as a bridge between North America and Europe, which is an indispensable link to round-the-clock financial operations. The market also lies at the heart of the Asia-Pacific region, which is the world's fastest-growing area. Japan is one of the world's most politically stable countries, and Tokyo has transportation and telecommunications facilities that are among the best in the world.

From my perspective, however, I believe that Japan's strong economic fundamentals may be even more important than these factors in ensuring the growth of the Tokyo market. Consider, for instance, the rates of savings. In the fiscal year 1984, Japan had a saving ratio amounting to 31 percent of GNP, substantially higher than 15 percent in the United States and 22 percent in the Federal Republic of Germany in calendar year 1984. Another measure is the excess of savings over domestic investment. In

Japan, this saving surplus reached 3 percent of GNP in fiscal year 1984. To be sure, a saving surplus implies the existence of an export surplus of about the same magnitude, and this has been the cause of serious trade friction. Still, Japan's surplus savings are expected to shrink gradually from now on. In the short run, they will be brought down by government measures to expand domestic demand, and over the long run they will be reduced by the growth of older age groups in Japan's population structure. Even so, the surplus position is likely to persist for some time. As long as savings are in surplus, Japan's net external assets will build up.

But here a historical perspective is needed. Both the United Kingdom and the United States have gone through times when savings surpluses were sustained over prolonged periods. Japan, at present, seems to have reached the same stage of development. The pound sterling was once the world's key currency, but with the decline of the United Kingdom's capacity to export capital, the pound gave way to the dollar, which was sustained by the growing economic might of the United States. If history were to repeat itself, America's rapid accumulation of external liabilities today would be pushing it toward a lesser role as key-currency nation, and Japan—together with the Federal Republic of Germany, no doubt—would be moving to the fore. The cycles of history, however, are more complex than this. Japan has neither the potential nor the inclination to take over the role of a key-currency nation. The same, I presume, is true of Germany.

If the present trend toward global finance continues, I believe that we will eventually see the development of a multi-key-currency system. The dollar will be supplemented by the yen, the deutsche mark, and perhaps by some other European currencies—and also by the European Currency Unit or the bundled currencies of the European Community. The New York market will be linked with and supported by the Tokyo and London markets and also the major continental European markets. This system of multiple key currencies, to be sure, should not be brought into being by government intervention but through the free initiative of participants in the various financial markets. The role of government should be limited merely to the removal of obstacles that hinder the formation and development of such a system.

### *International Monetary System*

Now, I would like to depict a portrait of the international monetary system that would, in my mind, be most desirable in an era of global finance.

As I have noted already, global finance is the outgrowth of financial deregulation and internationalization around the world, so it necessarily facilitates international capital movements. If appropriate exchange rates are not maintained in this process, however, global finance will not only

adversely affect the real economies but will also hinder its own development.

Appropriate exchange rates can be maintained only if the following conditions are satisfied: First, if exchange rates are at levels that reflect economic fundamentals, and, second, if excessive volatility of exchange rates can be controlled.

In the first half of the 1980s, we saw the U.S. dollar maintained at levels that did not reflect the nation's economic fundamentals and that adversely affected the U.S. economy in many respects. Thanks to the coordinated market intervention and cuts in interest rates under the Plaza Agreement of the Group of Five industrial countries, however, the misalignment of the U.S. dollar with the other currencies of the Group of Five has been fully, if not overly, corrected.

The Plaza Agreement has since been improved and developed into a multilateral surveillance scheme of the Group of Seven at the Tokyo summit meeting held in May of this year. Under this scheme, exchange rates are included as one of the ten macroeconomic indicators for surveillance, and their compatibility with the other selected indicators and with the economic fundamentals of other countries will be checked and commented on in an agreed international forum.

If conspicuous misalignments are found with regard to the macroeconomic indicators of any of the Group of Seven nations, that country will come under peer pressure from the other countries of the group. If the multilateral surveillance scheme functions as expected, the Group of Seven nations will no longer suffer from any large distortions in the group's structure of exchange rates.

If need arises for coordinated intervention in any of the currency markets as a result of multilateral surveillance, the United States, too, will have to step in the market on an equal footing with the other nations. For this reason, the United States needs to hold currencies of other advanced nations as part of its foreign currency reserves. This signifies a shift away from the traditional dollar standard to a system of multiple reserve currencies.

Thus, the Group of Seven has in place a system of preventing currency misalignments from occurring in its exchange rate structure, but a similar system has not been devised to avoid misalignments with respect to the currencies of countries outside the Group of Seven.

In fact, the misalignment of the U.S. dollar with some of those currencies remains unredressed. For instance, the U.S. dollar is overvalued in relation to some of the currencies pegged to the dollar and some others that are floating on a managed basis.

Unless some of those countries revalue their currencies against the U.S. dollar, its misalignments with their currencies will remain unadjusted in terms of effective exchange rates. This phenomenon may be considered to

be one of the factors delaying improvement in the U.S. balance of payments after the Plaza accord.

As for the misalignments of currencies of countries outside the Group of Seven, the International Monetary Fund could check on such misalignments through the use of its surveillance function and recommend adjustment. In cases where the misalignment stems from an undervaluation of the currency of the country whose economy is in good shape, however, it may be difficult in many cases for the Fund to urge the country to redress its exchange rate. Some other way must then be conceived to correct such misalignment.

Turning to the problem of exchange rate volatility, the Plaza accord implies a major shift of the international monetary regime away from a system of freely floating exchange rates to a system of more managed rates. But the volatility of exchange rates appears to have increased in the meantime. Three major reasons may be cited for this. First, foreign exchange trading and international assets and liabilities have increased enormously in recent years. Second, there is no international agreement on a system to control exchange rate volatility. And third, unilateral market intervention has been undertaken frequently to cope with the overshooting of exchange rates that occurred after the successful concerted intervention. This has increased uncertainties over exchange rates and encouraged speculation.

Some argue that foreign exchange trading should be reduced to control the volatility of exchange rates. In fact, most of the foreign exchange trading of late is accounted for by capital transactions, with only 5 to 10 percent related to foreign trade. What is more, international capital often tends to move on a large scale in response to changes in profitability and safety, making exchange rates volatile in consequence.

But any control on international capital transactions is unrealistic as well as anachronistic. The expansion of international capital transactions is not only compatible with but is necessary for the integrated development of the world economy in terms of commodity, capital, and human resources. What we should rather try to find are the means of expanding international capital transactions in ways that would contribute to the integrated development of the world economy.

Fixed exchange rates or target zones may ultimately be a means of controlling exchange rate volatility. But the Group of Seven nations—or a smaller group consisting of the United States, Japan, and the Federal Republic of Germany—may return to some kind of fixed exchange rates only if and when the United States has restored sustainable equilibrium to its current account.

Proposals for target zones abound, and some of them look quite appealing, but the monetary authorities of the United States, Japan, and

Germany seem totally uninterested. In short, a reversion to the fixed rate system or adoption of a similar system appears to be a remote possibility.

The least we can do today in an attempt to control exchange rate volatility is to refrain from trying to achieve our own objectives unilaterally. The monetary authorities of countries must be warned against trying to influence markets by announcing their particular views on exchange rate forecasts. They only tend to increase the volatility of exchange rates.

In concluding, the trend toward global finance or globalization is vital to the achievement of a stable international monetary system. I think Japan is in full agreement with this goal and is determined to make an active contribution to its accomplishment. As I indicated, the Tokyo market is growing more rapidly than the markets of the other industrial nations. This trend will certainly enhance the importance of Tokyo in the world financial market.

Let me reaffirm that Japan's determination to fulfill its responsibilities as a major economic power extends to the Japanese role in international financing.

Thank you.

\* \* \* \* \*

MR. SOUTHARD: Ladies and gentlemen: I am sure that when this lecture is published, which we will proceed to do as soon as we can, it will be a very good source of information in an area of financial developments that has only begun to be examined as carefully as Mr. Kashiwagi has done in his talk.

He has agreed to respond to questions. The back of the program has a form for writing questions. The questions will be brought up here so that Mr. Kashiwagi can answer them.

## Questions and Answers

Following the formal presentation, Mr. Kashiwagi answered questions from the audience.

*Can Japan mobilize its current account surplus toward development in the Third World, as proposed by Finance Minister Miyazawa on Friday?*

Unfortunately, I have not met with Mr. Miyazawa. I know him very well, but I don't really know what his proposal was. But I would say in the abstract that Japan's current account surplus is perhaps too large, and that, at the same time, it would be appropriate to make greater use of this very large surplus to help the developing countries. As I explained in my speech to you, Japan is a very high saver, and I think that the high savings of Japan should be used more to help the developing countries in their difficulties today.

*Will Tokyo's increasing role as a Far Eastern pillar of the world financial system be achieved at the expense of Hong Kong and other Asian and Pacific financial centers?*

This question has been raised very often, and I would say that, of course, it is not the intention of Japan to try to expand at the expense of the other markets. What would be considered desirable would be to allow each market to develop and expand in the way it can. The emergence of Tokyo as a major banking center would mean that it would enhance the importance of other centers such as Hong Kong and Singapore in the sense that they would become very important satellites in this area.

*Would global finance be beneficial to the quicker development of the Third World? If so, in which way?*

As I explained in my speech, global finance would mean quicker and better access to world investable funds, and at cheaper cost. I think that this could be very beneficial to the development of the Third World in the future. But the world role of finance has not yet been accomplished. I would say that we are now in the process of putting global financing into shape and, once that has been achieved, it would surely be of great benefit to the Third World as well as for the world as a whole.

*Will the offshore market of the international banking facilities in Japan benefit from certain fiscal and reserve-requirement exemptions?*

In the offshore market in Japan there will be no reserve requirements. So the international banking facilities would be exempt from all reserve requirements in Japan. Also, the interest paid on deposits in the offshore market would be exempt from tax. But these would be the only two benefits. The international banking facilities would not be exempt from the securities transaction tax, nor from local taxes. In the United States, they are not exempt from federal income taxes but are exempt from state and municipal taxes in some areas. This point has not yet been clarified in Japan. They will not be exempt from the national tax, but we will have to see if we can get the municipalities to grant exemptions from their own taxes.

*Does the successful internationalization of financial markets into a global market suggest that Japan should remove its Glass-Steagall restrictions on the participation of Japanese banks in this expanding market?*

I think the thrust of what I said today is on this point. I think the commercial banks, particularly banks like ourselves operating internationally, would very much like to see the Glass-Steagall sort of restrictions inside Japan removed as soon as possible.

Outside Japan, particularly in the European countries, we are already engaged in the securities business almost in the same degree as our competitors. When in Rome do as the Romans do. I think the Japanese banks would like to do universal banking not only in Europe but also in Japan. That means we have to see that restrictions on securities transactions inside Japan are removed as soon as possible.

*While central bankers agree, and we all see that the value of the dollar must fall, why do yen-based institutions continue to buy heavily into U.S. Treasury securities?*

I think that is a very good question! It is a fact that Japanese institutions continue to buy primarily U.S. Treasury securities and also dollar-denominated U.S. bonds and do not invest much in equities in the United States, much less, say, than other countries. But I think that situation is changing somewhat. The emphasis is still on U.S. Treasury securities and on U.S. bonds because of—shall I say—the very satisfactory returns on them and because of the security these instruments offer, compared with other investments that entail many risks and do not bring improved returns. But there has been much increase in the volume of purchases of American equities, particularly in the acquisition of shares in U.S. banks and corporations. These purchases come to very substantial amounts. Sometimes the deals involve half a billion dollars in one transaction.

Next, I would like to point out that Japanese institutions are now buying heavily into real estate in the United States. This has become a very large factor in the flow of capital. Just to give you one example, just recently the Twin Towers of Los Angeles—the two tallest buildings in that city—were bought by a Japanese developer for ¥ 100 billion, or roughly \$670 million. So Japanese capital is now moving not only into U.S. Treasury bills but also into equities, real estate, and other fields.

But, as I mentioned earlier, I don't think that this concentration of Japanese capital going to the United States or into U.S. dollars is really so desirable, because if Japan is the major saver of the world, I would like to see more of the savings used in countries where savings are so needed, that is, in the developing countries. But why doesn't the money from Japan flow more into developing countries? There could be many reasons, one of which may be that the Japanese Government does not provide the necessary environment that would encourage Japanese capital to move into developing countries. By that I am referring to the amount of the risk—that is, the greater risk of lending to or putting money in a country that is in the course of debt rescheduling or that is having debt problems. Unless there is some kind of encouragement, especially in the form of fiscal encouragement, it would be very difficult to increase the flow of Japanese capital into these countries at a time of international debt problems. The debt problem is a key problem of the world today, and the question is how to move more private capital into developing countries. I would think that the Japanese Government should see to it that there is more encouragement in this field by way of fiscal and other measures.

*What would you expect the effects of globalized financial markets to be on the ability of developing countries to raise funds?*

I don't know if globalization would increase the ability of developing countries to raise funds, but it will surely open the market and encourage more funds to move internationally, more cheaply and more effectively. So, I think that in the long run, globalization of financial markets would be of great help for the future ability of developing countries to raise funds.

Thank you very much.

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MR. SOUTHARD: Before we thank Mr. Kashiwagi, let me remind you that following the meeting there will be a reception to which you are all cordially invited to come. I am sure that the applause indicates how much you have enjoyed and have profited by Mr. Kashiwagi's speech. It will merit closer reading when all of you have access to copies. We thank Mr. Kashiwagi very much for the hard work he has put into the speech and for coming here this afternoon.



## Biography



Yusuke Kashiwagi was educated at the Tokyo Imperial University, now the University of Tokyo. Upon his graduation in 1941, he entered the Ministry of Finance of Japan, serving in a number of increasingly responsible positions in Japan and abroad. He concluded his service with the Ministry as Vice Minister of Finance for International Affairs. Thereupon, in June 1971, he was appointed Special Adviser to the Minister of Finance, a position he held through 1972. The following year, he joined the Bank of

Tokyo, Ltd. and was elected, successively, Deputy President and, in 1977, President. In 1982 Mr. Kashiwagi became the Chairman of the Board of Directors.

In addition to his position with the Bank of Tokyo, Mr. Kashiwagi holds various directorships and is a member of the Executive Committee of the Trilateral Commission, immediate past President of the International Monetary Conference, and Adviser of the International Finance Corporation.

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