

# A Perspective on the Globalization of Financial Markets and Institutions

Mr. Chairman and members of the Committee: I am pleased to be able to appear today in order to discuss with the Committee recent and prospective developments regarding the globalization of financial markets and institutions, with particular emphasis on developments in the three major financial centers of the world: New York, London, and Tokyo. Within that broad framework, I will devote particular attention to a series of issues pertaining to access of U.S. firms to money and securities markets in Japan.

## Background

Legend has it that Willie Sutton once said that he robbed banks because that's where the money was. The analogy is poor, but there can be no doubt that much of the current interest in Japanese financial markets stems from that same consideration: that's where the money is! Indeed, reflecting its very large domestic savings rate and its massive current account surplus, Japan has assumed a unique financial position in the world's community of nations. But Japan's financial position relative to the United States or to the rest of the world did not develop in a vacuum. Thus, before turning to the specific questions raised by the Committee, allow me to comment briefly on the general economic and financial environment within which we must seek to address the points of stress and tension which are so apparent.

Statement by E. Gerald Corrigan, President, Federal Reserve Bank of New York, before the Committee on the Budget, United States Senate, on Wednesday, May 6, 1987. The full testimony also included four appendices which are available from the Public Information Department of the Federal Reserve Bank of New York.

That broader perspective should include at least four major points of reference, as follows:

*First*, the dramatic rise in Japan's external surplus over the decade of the 1980s and the corresponding increase in the external deficit of the United States are primarily the result of macroeconomic considerations, including (1) the persistent and very large domestic savings gap in the United States—growing importantly out of the huge budget deficits—coupled with Japan's extraordinarily high internal savings rate; and (2) considerably more rapid growth in domestic demand in the U.S. economy, especially during the earlier stages of the current expansion. There is also the related issue of apparent differences in the ability of U.S. firms, perhaps especially manufacturing firms, to compete effectively in the external marketplace or with external competitors. All three of the factors, together with associated swings in exchange rates—swings that in my view tend to be exaggerated by the marketplace—lie at the heart of the severe imbalances in the world economy. The relative openness, or lack thereof, of Japanese financial markets is at most a marginal factor insofar as the underlying causes of trade and current account imbalances are concerned.

*Second*, reversing the imbalances that have developed over the past five years will not be easy and will take time. Moreover, if that adjustment is to take place in a context of growth rather than in a framework of contraction, we must deal with the fundamentals. More open external markets for

U.S. products and services are an important part of the agenda for adjustment, but absent underlying changes in economic policies and performance here in the United States as well as elsewhere in the world, more open *financial* markets simply will not materially help the adjustment process along.

*Third*, under the best of circumstances, the United States will be dependent on capital inflows from abroad for several years to come. That is, and to use a purely hypothetical example, even if our budget and trade deficits move lower at roughly the same speed as they increased, the United States would still have relatively large—and cumulating—current account deficits for the next few years. This, of course, implies that our external indebtedness will continue to grow, even if at a slower rate, such that net capital inflows will be needed. To the extent these necessary capital flows are impeded—for whatever reason—the implications for interest rates and exchange rates, and therefore domestic economic activity, are almost certain to be detrimental here and

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elsewhere. To put it more directly, we must take care to conduct our affairs in such a way that our foreign creditors will be willing to acquire and hold the needed amounts of dollar-denominated assets at interest rates and exchange rates that are otherwise consistent with noninflationary growth in the U.S. and world economy.

*Fourth*, whether we like it or not, the globalization of financial markets and institutions is a reality. Since that reality has been brought about importantly by technology and innovation, it cannot be reversed in any material way by regulation or legislation. Moreover, while this process of globalization and innovation is producing important benefits to suppliers and users of financial services, it also produces anomalous results. To cite an example or two, Japanese securities companies—whether owned by Japanese or foreign firms—cannot generally engage in foreign exchange trading and position-taking in Tokyo but

they do it in London and New York; U.S. banking companies cannot underwrite corporate debt and equity securities in the United States, but they do it in London or elsewhere.

More generally, national systems of supervision and regulation—to say nothing of tax and accounting policies—that were created many years ago were not designed for a marketplace of worldwide dimensions in which firms with differing charters and national origins compete head-to-head with each other around the clock and around

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the world. This situation is one of the reasons why I believe the Congress must get on with the task of fundamental reform of the structure of our banking and financial system—a task that is already well underway in several other countries.

A more rational structure at home—including a structure that works in the direction of strengthening the banking and financial system—would help encourage a more rational structure internationally. Both now and in the future, this is probably more important to the prospects for U.S. financial firms and U.S. national interests than are the relatively narrow issues of immediate dispute in particular markets.

In short, there are important and legitimate concerns that must be dealt with pertaining to access of U.S. firms to foreign financial markets. However, in seeking constructive solutions to those problems, we must be sensitive to the larger picture and we must recognize that the solutions to these larger problems are not to be found in the relatively narrow context of specific equity and access issues pertaining to the activities of U.S. financial firms abroad, as important as those issues are for other reasons.

**Major international financial markets: an overview**  
At the risk of injuring the sensitivities of our friends in Frankfurt, Zurich, or Hong Kong—to say nothing of Chicago or San Francisco—it is probably fair to say that there are three dominant financial centers in the world today: London, Tokyo, and New York. Accordingly, and to provide some further perspective, Exhibit I attempts

to categorize the scope of activities available to various classes of domestic and foreign institutions in each of these markets.

As the exhibit indicates, there are important differences from one market to the other, but as a *general matter*, these differences do not reflect strictly legal distinctions based on the national origin of the firm in question. To put it differently, all three markets have de jure conditions of broad national treatment insofar as the general range of banking and financial activities is concerned even though there are important differences between the centers and, as noted later, important de facto distinctions in terms of competitiveness of foreign versus domestic concerns. For example:

- as mentioned earlier, banks, domestic or foreign,

cannot as a general matter underwrite corporate securities in New York or Tokyo but they may do so in London.

- securities companies, domestic or foreign, may not as a general matter deal in foreign exchange in Tokyo but they may in London and New York.
- in two instances, there is a small tilt in favor of U.S. banks in that as of March of this year, U.S. banks in Tokyo may have a securities affiliate whereas domestic Japanese banks may not, and U.S. banks were permitted in 1986 to own trust banks in Tokyo whereas Japanese city banks may not. By the same token, there are a number of foreign banks (none of which is Japanese) which have grandfathered securities subsidiaries in the United States.

Exhibit I

**Permissible Activities by Type of Institution**

Activity	Type of Institution											
	(1) US Bank Holding Co		(2) Japanese City Bank		(3) UK Clearing Bank		(4) US Securities Firm		(5) Japanese Securities Firm		(6) UK Merchant Bank	
Banking License	NY	YES	NY	YES	NY	YES	NY	S	NY	S	NY	S
	LO	YES	LO	YES	LO	YES	LO	YES	LO	YES	LO	YES
	TO	YES	TO	YES	TO	YES	TO	NO	TO	NO	TO	NO
Dealing in Corporate Securities	NY	NO	NY	NO	NY	NO	NY	YES	NY	YES	NY	YES
	LO	YES	LO	YES	LO	YES	LO	YES	LO	YES	LO	YES
	TO	S	TO	NO	TO	S	TO	YES	TO	YES	TO	YES
Foreign Exchange Dealing	NY	YES	NY	YES	NY	YES	NY	YES	NY	YES	NY	YES
	LO	YES	LO	YES	LO	YES	LO	YES	LO	YES	LO	YES
	TO	YES	TO	YES	TO	YES	TO	NO	TO	NO	TO	NO
Dealing in U S Treasuries	NY	YES	NY	YES	NY	YES	NY	YES	NY	YES	NY	YES
	LO	YES	LO	YES	LO	YES	LO	YES	LO	YES	LO	YES
	TO	NO	TO	NO	TO	NO	TO	YES	TO	YES	TO	YES
Dealing in UK Gifts	NY	NO	NY	NO	NY	NO	NY	YES	NY	YES	NY	YES
	LO	YES	LO	YES	LO	YES	LO	YES	LO	YES	LO	YES
	TO	NO	TO	NO	TO	NO	TO	YES	TO	YES	TO	YES
Dealing in Japanese Gov't bonds	NY	NO	NY	NO	NY	NO	NY	YES	NY	YES	NY	YES
	LO	YES	LO	YES	LO	YES	LO	YES	LO	YES	LO	YES
	TO	YES	TO	YES	TO	YES	TO	YES	TO	YES	TO	YES
Trust Bank	NY	YES	NY	YES	NY	YES	NY	S	NY	S	NY	S
	LO	YES	LO	YES	LO	YES	LO	YES	LO	YES	LO	YES
	TO	YES	TO	NO	TO	YES	TO	NO	TO	NO	TO	NO
Account at the Central Bank	NY	YES	NY	YES	NY	YES	NY	S	NY	S	NY	S
	LO	YES	LO	YES	LO	YES	LO	YES	LO	YES	LO	YES
	TO	YES	TO	YES	TO	YES	TO	YES	TO	YES	TO	YES

NY = New York

LO = London

TO = Tokyo

YES = Full license permitted

NO = Not generally permitted

S = Permitted only through special purpose companies, such as a 50 percent owned affiliate or a nonbank bank

In short, looking at broad classes of financial activities in the three major centers does not suggest that there are systematic patterns of discrimination against foreign participants in any of the centers that are rooted in law. However, the simple "yeses" and "noes" in Exhibit I do not even begin to tell the whole story. Thus, the balance of this section will look at the individual markets in somewhat greater detail.

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#### *Banking markets*

For several decades, foreign banking institutions have had a major presence in the United States. This reflects several key factors, including: (1) the multinational population base of the United States; (2) the size and importance of U.S. markets; and (3) the role of the U.S. dollar as a reserve currency and an international medium of exchange.

Typically, foreign banks operating in the U.S. market

concentrate their activities heavily on the so-called wholesale market. While there are some important exceptions, foreign banks are generally not major factors in retail banking markets. In addition, most of the foreign banks that have a sizable presence in the United States are affiliated with well-known major banks abroad, many of which have Triple-A credit ratings. Needless to say, the prominent names of some of these institutions, together with their credit ratings, give them important recognition in their activities here in the United States.

As of year-end 1986, there were more than 250 foreign banks that had some kind of presence in the United States. In the aggregate, the assets of such foreign banks exceeded \$500 billion (Exhibit II) at year-end 1986 and constituted almost 20 percent of total U.S. banking assets. To an extent, this figure is inflated by virtue of the fact that some foreign banks—notably the Japanese—book most of their Western Hemisphere loans in U.S. offices. While not shown in the exhibit, foreign banks also account for about 20 percent of all commercial and industrial loans outstanding to United States addressees. In both instances, Japanese banks are by far the most dominant group of foreign banks, accounting for nearly half of the total assets and commercial loans outstanding at foreign banks in the U.S. In certain markets, such as standby letters of credit and standby's associated with U.S. municipal bond offerings,

Exhibit II

### **Banking Operations of Foreign Banks in the United States**

**Total U.S. banking assets (in billions)\* of major foreign countries as of December 31**  
Expressed as a percentage of total U.S. banking assets

Countries	1982		1983		1984		1985		1986	
	dollars	percent	dollars	percent	dollars	percent	dollars	percent	dollars	percent
Japan	113.0	5.0	126.0	5.0	151.3	6.1	181.3	6.1	245.4	8.7
Canada	22.1	1.0	27.8	1.2	38.1	1.5	42.3	1.7	42.4	1.5
United Kingdom	52.2	2.5	53.0	2.3	51.4	2.0	61.2	2.4	40.6	1.5
Italy	14.3	0.7	17.5	0.8	23.9	0.9	29.1	1.1	36.4	1.4
Switzerland	13.0	0.6	13.1	0.6	15.3	0.6	18.3	0.7	24.5	0.9
France	16.6	0.8	16.2	0.7	18.3	0.7	20.7	0.8	22.4	0.8
West Germany	8.9	0.4	7.4	0.3	7.6	0.3	8.8	0.4	11.0	0.4
All other countries	60.5	3.0	70.9	3.1	72.4	2.9	97.2	3.8	103.9	3.8
Total U.S. banking assets of foreign banks	300.6	14	331.9	14	378.3	15	458.9	18	526.6	19
Total assets of domestic banking institutions†	1,821.1	86	1,986.5	86	2,076.8	85	2,098.7	82	2,285.9	81
Total U.S. banking assets†	2,121.7	100	2,318.4	100	2,455.1	100	2,557.6	100	2,812.5	100

\*Amounts for each country include the total U.S. banking assets of all banks from that country, namely the aggregate of the assets of their U.S. branches, agencies, bank subsidiaries, Edge-Act and Agreement corporations and New York State-chartered investment companies (called Article XII corporations)  
†Includes the total consolidated assets (domestic and international) of all U.S. banks

Japanese banks now account for between one-quarter and one-half of the total U.S. market.

Measured in terms of numbers of institutions, the U.S. banking presence in Japan is similar to that of Japanese banks in the United States. However, in terms of asset size, in either absolute or relative terms, U.S. banks are much smaller in Japan than are Japanese banks here, with total assets in Japan of something short of \$20 billion. As in the United States, most foreign banking activities in Japan are concentrated in the wholesale markets and in activities such as foreign exchange trading. In the recent past, however, at least one U.S. bank has demonstrated some interest in selective aspects of the Japanese retail banking markets.

The reasons for the relatively small U.S. banking presence reflect a variety of factors. Historical and strategic considerations probably play a role. It is also true that U.S. banks find it more attractive to book Asian loans in Hong Kong or Singapore rather than in Tokyo. Finally, the historical rigidities of the local funding markets in Japan make it difficult to build up a large banking operation in Japan, especially in the face of

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lingering uncertainties as to the receptivity of Japan to a broad-based presence of major foreign banks.

While the size of the U.S. banking presence in Japan is small, the same cannot be said for London. Indeed, the U.S. banking presence in London is more than six times the U. S. presence in Japan. And U.S. banking assets in the United Kingdom are roughly three times greater than U.K. banking assets in the United States. To a considerable extent, the size of U.S. banking operations in London reflects the long history of the importance of the London market, its openness to foreigners, and its association with the Eurocurrency markets which are so important to U.S. companies—financial and nonfinancial alike. In short, the London market has, for many years, sought out and welcomed foreign banks, in part by maintaining a “friendly” regulatory environment.

#### *Securities markets*

The comparative nature and scope of securities market activities by foreign firms in the three major markets are distorted somewhat because the U.K. does not require strict separation of commercial and investment banking,

whereas both Japan and the United States make such a distinction. In addition, data on relative size and importance of securities market activities are not as readily available as in banking. However, these limitations notwithstanding, some approximations of size and importance are possible.

In terms of numbers of firms and employment levels, U.S. securities firms' presence in Japan and Japanese securities firms' presence in the United States are very roughly equivalent and both have been growing quite rapidly in recent years. The activities of U.S. securities firms in Japan and Japanese firms in the United States also tend to be quite similar in that both are concentrated in trading-type activities. Both classes of institutions are engaged in underwriting activities in each other's markets but, to date, virtually all such underwriting by the foreign participants in both markets takes place as syndicate members, not as syndicate leaders or managers. In the United States, four Japanese securities houses (the “big four”) are members of the New York Stock Exchange while in Japan three U.S. securities houses—and one securities company that is owned by a U.S. bank through its London merchant bank—are members of the Tokyo Stock Exchange.

In short, in many respects, the relative size and importance of U.S. securities firms in Japan and Japanese securities companies in the U.S. are quite similar and, as noted earlier, both are growing rapidly. However, despite these broad similarities, there are particular

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#### **Japanese initiatives: financial deregulation and access**

The post-war Japanese financial system was, in many respects, modeled after the U.S. system. Not surprisingly, therefore, several features of the Japanese system which are the subject of controversy today—including interest rate ceilings on deposits and legal barriers separating classes of financial institutions including commercial and investment banks—are precisely the same issues that have and continue to provoke controversy in the United States. In Japan, as in the United States, pressures for sweeping change in the structure

and regulation of financial markets were largely muted until the late 1970s and early 1980s. Similarly, while U.S. financial firms have, for some time, had a minor presence in Japan, it was not until fairly recently that pressures for greater access built in a major way. These mounting pressures for deregulation and more open access reflected the interaction of a powerful set of macroeconomic forces as well as the wave of change and innovation that is rapidly transforming financial markets and institutions around the world.

In response to these forces, the Japanese authorities—under prodding from the United States and other governments—have over the past several years made major changes in the structure and regulation of financial markets, including important reductions in barriers to foreign presence in the Tokyo markets. Taken as a whole, the actions by the Japanese over the past several years are noteworthy, especially in the relatively short time frame involved. Indeed, I believe a case can be made that the Japanese record of the past several years is better than some observers suggest and is good enough to warrant confidence that further progress will be made in the future.

Having said that, I would hasten to add that despite this progress, the situation in Japan is still one in which barriers—visible and invisible—to open and effective competition between U.S. and Japanese financial firms remain important factors limiting the activities and competitive effectiveness of U.S. firms in Japan. It is also true that as the strategic importance of the Tokyo marketplace continues to grow and competitive pressures mount, concerns about those barriers have received increasing attention. However, in a number of important instances, specific issues raised by U.S. firms have little or nothing to do with national treatment considerations.

At the risk of a great oversimplification, the points of immediate concern to U.S. firms can be classified as follows:

- *Equal treatment issues:* While purely legal barriers to national treatment of U.S. firms in Japanese markets have been eliminated, certain distinctions between the treatment of U.S. and Japanese firms are seen as having important competitive implications even though the basis for the distinction is not to be found in law. Concerns about practices for issuing government debt and limitations on seats on the Tokyo Stock Exchange would fit in this category.
- *Regulatory policies:* There are several areas of regulatory policy which are viewed by some U.S. firms as especially troublesome. These would include remaining regulatory and administrative rigidities in the money market; prohibitions on cer-

tain activities such as foreign exchange trading by securities companies; and other miscellaneous matters such as withholding taxes on interest income to foreigners and limitations on the ability to engage in short selling. While all of these policies apply equally to U.S. and Japanese firms, certain U.S. firms allege that, in practice, they are more binding on U.S. firms since they impinge on activities in which U.S. firms have special expertise.

There is, however, another important area of regulatory policy which results in important differences in treatment and that relates to capital adequacy standards for banks, a subject which is covered in greater detail later in this statement.

- *Limitations on acquisitions:* In most foreign countries, acquisitions of banks or other financial concerns by U.S. firms are either limited by law or regulation or are very difficult to achieve as a matter of practice. In Japan, the most significant current barrier to acquisition may be price, but whatever the reason, it is easier for foreign entities to acquire U.S. banking and financial institutions than is the reverse.
- *Invisible barriers:* There are a host of considerations ranging from language and custom to relationships with bureaucrats which can be barriers to market participants in any foreign center, and Japan is certainly no exception. Indeed, some observers would contend that so-called invisible barriers in Japan are more of a problem than is the case in other international financial centers.

#### **The record of the past six months**

Over the past several months, Japanese authorities have implemented several important policy changes in furtherance of the goal of more open and more competitive financial markets in Japan. These steps included the following:

- *Deposit deregulation:* Effective April 6, 1987, the Ministry of Finance (1) reduced the minimum size of time deposits which are free of interest rate ceilings from 300 million yen (about \$2 million) to 100 million yen (about \$700,000); and (2) reduced the minimum size of money market certificates from 30 million yen (about \$200,000) to 20 million yen (about \$150,000). Both the new and the old regulations apply equally to domestic and foreign institutions.

In the area of deposit deregulation and greater money market flexibility, national treatment considerations are not the central issue since Japanese institutions operate under the same rules as foreign institutions. Rather, the money market issues are more a matter of greater market efficiencies in a

setting in which firms with special market expertise—Japanese or others—can take full advantage of those skills. While the extent of money market deregulation achieved is important, further steps are needed. This area will be one of those considered at the next round of so-called yen-dollar discussions between the U.S. Treasury and Japanese authorities planned for the near future.

- *Securities affiliates of U.S. banks:* In March 1987, the Ministry of Finance formally advised that it had amended its regulations to permit U.S. banking organizations to have securities affiliates in Japan, subject to the same terms and conditions that apply to securities affiliates of European universal banks. What is particularly significant about this action is that it provides access to Japanese securities markets for U.S. banks even though such access is not available to Japanese banks. It would also permit these U.S. bank affiliates in Japan a wider range of securities activities than is permissible here in the United States.

At present, there are three U.S. banks with securities affiliates in Japan through their U.K. merchant banks and I know of four U.S. banking organizations that are seeking to obtain licenses for securities affiliates under the arrangements noted above. The requests are in the advanced stage of review such that formal applications will soon be filed with final approvals expected in the near term. Of course these arrangements would also be subject to approval of U.S. bank regulatory authorities.

- *Access to the government securities market:* Prior to 1978, all Japanese government debt was sold by the so-called syndicate method whereby the terms of such debt issues were negotiated by the government and a syndicate of financial companies. Each member of the syndicate, in turn, received a predetermined share of the securities issue. The syndicate method of issuing government debt is still the dominant method of debt issuance in a number of countries, including a few major industrial countries. It is also the general procedure followed by Federal government agencies here in the United States as well as the prevailing method for issuing most corporate and municipal debt.

Because most Japanese government debt was issued in this fashion and because U.S. firms were generally not part of the syndicate, U.S. firms did not have meaningful direct access to new issues of Japanese government securities. De facto limits on access to new issues of government securities placed U.S. firms at a competitive disadvantage not just in the government market itself but in other markets as well because of the important linkages

between government securities and other securities.

In response to this situation, the Japanese authorities have taken several steps. First, for a number of short- and intermediate-term issues, they have fully adopted the auction method such that about 35 percent of new issues in 1986 were auctioned. In addition, the Japanese authorities have eliminated the requirement of having an account at the Bank of Japan in order to be eligible to bid in such auctions. However, the 10- and 20-year maturities are still issued by the syndicate method—a fact that is especially important in the case of the 10-year bond which is the largest and most important of the issues, especially in terms of secondary market trading.

In these circumstances, effective April 1, 1987, the syndicate has agreed to increase the total share of the new issues available to foreign securities firms from 1.19 percent to 5.725 percent of the share available to securities houses and it has raised the shares available to individual foreign companies from 0.07 percent to a maximum of 1

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percent. While still small, we understand that these shares for the foreign group as a whole are commensurate with the overall size of foreign securities firm secondary market trading in yen government bonds. Finally, as discussed below, the Ministry of Finance apparently is considering additional steps which would further open the market for Japanese government debt to foreign market participants.

Taken in the context of measures initiated by the Japanese authorities over the past several years, and taken in the context of further steps that may be under consideration at the present (see below), these latest initiatives by the Japanese strike me as helpful and as reflective of continued good faith efforts to move ahead with financial market liberalization. To be sure, further effort on a variety of fronts is needed.

#### **Looking to the future**

In looking to the future, there is a clear need to reduce both the specific points of friction referred to in this statement and, more importantly, to deal with the underlying problems which are at the heart of current tensions in the international economic and financial arena.

Insofar as particular problems relating to the activities of U.S. banks and securities companies in Japan are concerned, I would hope and expect that the Japanese would continue to move forward with efforts to liberalize their domestic financial markets, thereby providing greater competitive opportunities for U.S. firms in the Japanese marketplace. As I see it, there are four specific areas that warrant particular attention:

- *Greater access to the Japanese government securities market:* In this area, I believe that the Japanese authorities may be considering one or more possible further steps including: (1) the offering through auction of new maturities of intermediate and longer term issues which would work in the direction of increasing the percentage of issues sold through auction; (2) shifting the 20-year issue from a syndicate to an auction; and (3) the use of something like the U.S. noncompetitive tender system in the 10-year maturity which could provide larger shares to U.S. market participants while still preserving the syndicate framework for that issue. Needless to say, I would welcome initiatives along these lines which could pave the way to the day in which the auction method of issuing debt was the general practice. In turn, this would be an important step in the direction of establishing market practices in the Japanese government securities markets that are more in line with practices here and in London.

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- *Increased representation in the Tokyo Stock Exchange:* As I understand it, plans are now underway to expand the number of seats—including seats held by foreigners—on the Tokyo Stock Exchange next spring when new facilities and computer capabilities will be in place. Procedurally, this will entail the establishment of a membership committee within the exchange in the near term. I am led to believe the committee's deliberations should be completed and its recommendations made to the full exchange membership late this year. Here too, I expect that the result of these deliberations would be some added representation of U.S. firms in the exchange. I would also hope the time schedule for this process could be accelerated, but I do understand the practical problems involved.

- *Money market liberalization:* As noted earlier, the next round of discussions between the Japanese authorities and U.S. Treasury representatives are scheduled to take place shortly. Those discussions will, among other things, focus on what further steps might be taken to reduce rigidities in the Japanese money market which, in turn, can make it easier for U.S. institutions to compete in the market and thereby more easily fund Japanese-based lending and securities market activities in the local currency.

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**Taking a longer term view of the situation, Japan faces many of the same problems in the financial area that we are so conscious of here in the United States. Namely, much of its overall banking and financial structure—as well as the regulatory and supervisory apparatus associated with that structure—were not designed for the current international market environment.**

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- *Bank capital standards:* While the areas mentioned above are important, the single item on which I place greatest emphasis relates to bank capital adequacy standards and specifically to the goal of moving Japanese bank capital standards into closer alignment with emerging international standards.

Efforts to establish international standards for bank capital adequacy have been underway within the Bank for International Settlements (BIS) for about three years. This effort was undertaken by the G-10 central bank governors in recognition of the fact that both competitive and prudential considerations pointed to the need for such standards as the globalization of banking was proceeding very rapidly. While efforts are proceeding in the BIS and through other multinational channels, the United States and the United Kingdom reached agreement earlier this year on a joint approach to capital standards in our respective countries. Such proposals were made available for public comment in January and final rules are expected to be put in place sometime later this year.

Senior officials of both the Bank of Japan and the Ministry of Finance have indicated that they agree in principle that Japanese bank capital standards should, in due course, be brought into broad alignment with international standards. And, preliminary discussions between senior Federal Reserve, Bank of England, and Japanese officials have been held on the subject. Further discussions are scheduled in the near term.

Achieving the needed degree of convergence in



this area will be much more difficult in the case of Japan than was true with the United Kingdom because the starting points with Japan are much further removed from prevailing practices in the United States and the United Kingdom. Moreover, as we have seen with U.S. banks, even relatively minor changes in this area can be controversial. Thus, while achieving convergence with the Japanese will be a long and difficult task. Progress along those lines is important.

As I see it, the four areas I have mentioned above are the clear priorities. Given the progress that has been made in the past, I am confident that efforts to move ahead in these and other areas will prove fruitful

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**If we are to come full circle in restoring balanced growth here at home and in the world more generally, we must also avoid any renewed outburst of inflation which would undermine prospects on all fronts.**

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and mutually beneficial. Partly for this reason, I am opposed to legislative efforts along the lines of the so-called "primary dealer" amendment that was incorporated into the trade bill passed by the House or as recently proposed by Senators Proxmire and Riegle. As I see it, such legislation could have the effect of stalling rather than accelerating discussions and negotiations, while possibly producing unintended adverse side effects—both in terms of general attitudes toward market liberalization and attitudes regarding capital inflows to the United States. It would be one thing to consider a legislative approach in an environment in which progress and good faith discussions were not taking place. However, this is not the current situation.

Taking a longer term view of the situation, Japan faces many of the same problems in the financial area that we are so conscious of here in the United States. Namely, much of its overall banking and financial structure—as well as the regulatory and supervisory

apparatus associated with that structure—were not designed for the current international market environment. The Japanese will have to come to grips with these issues just as we and others will have to do the same. In the case of the Japanese, coming to grips with these larger issues could also yield a situation in which constructive change on the Japanese side is forthcoming at their initiative, as a part of that larger process, rather than as a result of time-consuming and, at times, difficult discussions of specific points of concern and friction. In this regard, the point should also be stressed that problems of the nature discussed in this statement—specific or generic—are by no means limited to Japan.

In concluding, Mr. Chairman, let me return briefly to where I started—with the economic fundamentals. If we are to be successful in winding down our external imbalances in an orderly way, we in the United States must live up to our responsibilities—which means learning to live within our means. To be sure, actions abroad are needed and needed badly. But, as we call on others to open their markets and stimulate their economies, let us not lose sight of our end of the bargain. Our federal budgetary affairs—despite the efforts of this committee and others—are still in a state of disarray and must be put in order; the need for broad-based reform in our own financial structure must be addressed; pressing questions as to the degree of underlying competitiveness of our industrial sector must be answered; and patterns of savings and investment in our domestic economy must be brought into line with the longer run needs of rising productivity and standards of living. If we are to come full circle in restoring balanced growth here at home and in the world more generally, we must also avoid any renewed outburst of inflation which would undermine prospects on all fronts. Moreover, balanced growth in the world economy will also provide a much more constructive environment within which legitimate issues regarding financial market practices and evolution can be resolved here and elsewhere.