COMMENTS ON SESSION 3

Gerald P. Dwyer Jr.
Federal Reserve Bank of Atlanta

I have very different types of comments on the two papers for this session, and, in fact, they're very different types of papers. I'll present my thoughts in the order the papers were presented.

Recovering from Crises

I learned a lot from John Welch's presentation, listening to it and reading it in advance. That means that I'll have less to say about his presentation than I might otherwise. I don't have quite as firm an opinion about some things as John Welch and William Gruben do though.

That said, my first comment is, I don't think that I understand the title. The title says, "Recovering from Crises: Good Policy or Good Luck?" It seems to me that it doesn't have to be either one or the other. Recovering from crises could well be some combination of both. Maybe it's just that the title is misleading.

That teasing aside, the lessons that the authors say can be learned are that fast recoveries are possible and that a country can recover even if it doesn't address the causes of the crises. That's the claim that I understand from the presentation.

I thought that claim was odd because the primary discussion at the end is Argentina. Although John is not willing to commit to which category Argentina falls into, I am willing to commit. I think that Argentina's monetary policy has been good, especially compared to prior monetary policy in Argentina. But Argentina has had poor fiscal policy. Overall, Argentina has had bad policy. Brazil has better fiscal policy and good monetary policy. If you look at the recoveries, Argentina doesn't have one and Brazil has strong growth. It seems to me that there really is a conclusion about Argentina: If you have bad policies, you have problems.

As for back luck—well, bad luck is always bad.

The Future of Domestic Financial Markets

I think that the paper by Fernando Lefort and Eduardo Walker is very interesting and very well done. The basic question is: Do domestic financial markets in Latin America have a future? The authors think the answer is yes, and they think that's an important answer. Their claim is that financial markets in Latin America have a comparative advantage in doing certain things.

That's a large part of the argument, but there's another part as well. Recently, there are decreases in the size and importance of domestic markets in Latin America. The authors argue that these decreases are really transitory and that it's just a result of the Asian financial crisis. I am convinced by their evidence that the recent decreases are transitory.

I am not sure that I agree about financial markets having a comparative advantage in information on local firms. Let me tell you my thoughts starting from a different viewpoint than Lefort and Walker. I will arrive at an answer similar to theirs in some respects, but I will arrive at it in a different way. I will look at the evolution of world stock financial markets and then infer the implications for financial markets in individual countries.

At least from the U.S. perspective, it seems very obvious that the whole world is moving toward what is sometimes called "24/7," which basically means that twenty-four hours a day, seven days a week, you can be on-line and buy and sell things. Information is cheap, and it's getting cheaper. Information's also becoming more readily accessible, and informational asymmetries are diminishing. This decrease in the cost of information and increase in its availability is not new. In fact, it has been going on for a long time. The history of stock exchanges in the United States during the last 150 years illustrates my point, so I'll focus on that.

The consolidation of financial markets across the world today mirrors the history of stock exchanges in the United States. About 150 years ago, there were stock markets in many major cities in the United States. Publicly traded firms listed on exchanges near their home offices. For example, if you wanted to buy or sell stock in a railroad headquartered in Boston, the stock was listed in Boston and the market was made there. You were unlikely to buy or sell the stock in New Orleans, New York, Cincinnati, or other places. It was possible to buy or sell the stock elsewhere, but the large majority of trades occurred in the market near the firms' headquarters.

Most of those stock exchanges are gone now. Some are still around, but they mainly trade stocks listed on the New York Stock Exchange (NYSE), the American Stock Exchange (AMEX), or Nasdaq. I think that this same phenomenon is occurring around the world now. Access to technology is becoming cheaper, as is the free flow of goods and information. (Some people would say we are inundated in information.)

The question then becomes, Where do national financial markets fit in? There is no reason to expect them all to disappear, if for no other reason than because nobody wants to work 24/7. More than likely, the world financial market will be a set of financial markets in different time zones and different countries. I don't think that everything will be centralized in one place.

This suggests a slightly different perspective on the question of national stock markets. It is not obvious to me that there is much, if any, incentive to have a 24/7 centralized stock exchange. On the contrary, I expect that there will be more than one stock exchange. I think that the financial market most prominent in terms of price discovery—the financial market on which most trades occur and that determines the current worldwide value—will shift over the day and vary with the particular stock.

One reason I say this is because the big concern in the United States isn't whether all the different markets in the United States will disappear. Instead, the Securities and Exchange Commission's big concern is that there are too many places where people can trade stock. Investors trade stock all over the place. You can buy or sell IBM stock in at least seven or eight different places in the United States at any given time, not just in one place and definitely not just on the NYSE. Trading also occurs on other exchanges, on the "third market"—particular firms that buy and sell NYSE-listed stocks—and at brokerage firms, which execute trades internally. Part of the reason why this trading can occur in many different places is because everyone knows prices on the NYSE instantaneously. The availability of that information may be a good or a bad thing. That aside, people refer to trading in many different places as "fragmentation," which sounds like a bad thing. The word "fragmentation" is intended to sound like a bad thing, even though fragmentation quite possibly is good for investors.

There is no reason to think that this phenomenon—trading the same thing in many places—won't happen in terms of trading in different countries. I think that stocks from Chilean firms will trade in the United States, as some of them do now as American Depository Receipts. I think that they will trade in Chile as well. Chilean stocks may well trade in Mexico, Japan, London—quite a few different places.

Do I think that national stock markets have a comparative advantage in initial public offerings of stock, as Lefort and Walker do? I'm not sure that large informational differences between large and small firms will really persist. Initial public offerings in the United States occur in New York, generally on the Nasdaq market. They don't take place in San Francisco for California firms and in different parts of the country for other firms. There is a cost of listing. More than anything else, this listing cost is a function of local rules and laws. As a result, I can see firms doing initial public listings on some set of venues and then trading on others based on the certification from that listing.

Listings in the United States are on only a few markets, mainly the NYSE, NASDAQ and the AMEX. In the United States, the major reason that firms' stocks trade in different places is not because they are listed on different exchanges but because there are different types of investors who want to trade in different places. Investors prefer trades in different places because they have different priorities concerning execution.

On the international scene, I think that trading in different countries also will be affected by the use of different currencies and by different legal structures. If I am in Chile and I want to buy IBM stock and there is somebody else in Chile who wants to sell IBM stock, it's simplest just to buy the locally available shares. The different laws across countries are at least as important as currency differences. How is the trade settled? Who is liable in the case of a failed trade? It's simpler for now and probably for the foreseeable future if I buy and sell shares locally rather than trading across borders.

I don't think national stock markets will disappear at all. I think there will be financial markets around the world that will be trading the same securities. I think that the stock market most prominent in terms of price discovery may well shift over the day, traveling with the sun. It is quite possible that some national markets will disappear, but certainly not all of them. At the same time, some places that don't have markets now are likely to have them in the future.

Thank you very much.