

# newsletter

December 2005

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## 26<sup>th</sup> SUERF Colloquium

### *Money, Finance and Demography – the Consequences of Ageing*

October 12–14, 2006, Lisbon

in co-operation with the Universidade Nova de Lisboa  
jointly organized with and sponsored by the  
Banco de Portugal and by Millennium bcp

## *Call for Papers*

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## **General Information**

### **Location**

Universidade Nova de Lisboa  
Campus de Campolide  
1099-032 LISBOA

### **Hotel Accommodation**

Arrangements will be made in 3–4 hotels at different price levels. Detailed information on prices and addresses and the application form will be given in due course.

Note: There will be a limited number of grants available for participants in need.

### **Social Programme**

An official conference excursion will be arranged to take place in the afternoon and evening of Saturday, 14<sup>th</sup> October, 2006.

# Notes on the theme of the Colloquium

Demographic structures and in particular the age distribution of the population have far-reaching implications for the economy. In Europe, there is a strong long-term ageing trend. Increasing life-expectancy and declining fertility are the main explanations. Public pension spending is projected to rise substantially in the next decades in most European countries as a share of GDP. Defined benefit schemes are in difficulties in some countries, while many countries are trying to encourage private pensions.

Demographic factors will play a decisive role in shaping budgetary policies and will affect monetary policy and its transmission, will raise issues regarding the stability of the financial system and will influence the structure of supply and demand for financial services as well as asset allocation.

Against this background, SUERF has decided to invite researchers with an interest in the interplay between demographic and financial developments to submit papers for discussion at the 26<sup>th</sup> SUERF Colloquium in (Lisbon) in October 2006.

## On the Commissions:

In addition to the plenary sessions, the commissions reporting session, and the Marjolin Lecture, one and a half days are reserved for presentation and discussion of some 36 papers in three parallel commissions. SUERF is interested in contributions from academics and members of the central bank, banking and insurance communities

which deal with the topics addressed below. Policy-oriented papers will be given preference.

More detailed bullet points are available from the Chairpersons.

## Commission I

### The Real Economy, Public Finances and Demography

Chairpersons:

**Morten Balling**

Professor, Department of Accounting,  
Finance and Logistics  
The Aarhus School of Business  
[mb@asb.dk](mailto:mb@asb.dk)

**Vasco Santos**

Professor, Faculty of Economics  
Universidade Nova de Lisboa  
[vascos@fe.unl.pt](mailto:vascos@fe.unl.pt)

Submitted papers may address inter alia the following issues:

- Productivity and real growth issues
- Migration and employment issues
- Effects on budget expenditure and debt as well as sustainability issues
- Tax policy, pensions and savings issues
- Financial versus real resources implication of ageing
- The balance between public and private financing arrangements
- Types of tax incentives to save for retirement
- Possible punishment of early retirement

#### Invited Speakers:

**Daniel Gros**, CEPS

**Anne Lavigne**, Université d'Orléans

**Martin Werding**, ifo Munich

**Christophe Courbage**, Geneva Association

## Commission II

### Monetary and Financial Stability, Supervision and Demography

Chairpersons:

**Ryszard Kokoszczyński**

Director, Bureau of  
Macroeconomic Research  
National Bank of Poland  
ryszard.kokoszczyński@mail.nbp.pl

**Manuel Sebastião**

Executive Director  
Banco de Portugal  
msebastiao@bportugal.pt

Submitted papers may address inter alia the following issues:

- The impact of ageing on inflation and the interest rate (structure)
- Ageing and the (future) stability of the financial system
- The impact of ageing on exchange rates and the international monetary system
- The intra- and intergenerational distribution of ageing risks
- The funding ratio of pension funds
- The use of fair value accounting by pension funds
- The regulatory view on pension fund investment policies
- The optimal mix of DC and DB elements in pension schemes
- Other regulatory issues

#### Invited Speakers:

**Karl-Olof Hammarkvist**, Stockholm School of Economics

## Commission III

### Financial Institutions, Markets and Demography

Chairpersons:

**Frank Lierman**

Chief Economist  
DEXIA BANK BELGIUM  
frank.lierman@dexia.be

**Manuel Alves Monteiro**

former Head of the Lisbon Stock Exchange and  
Executive Director of Euronext  
amonteiro@mail.telepac.pt

Submitted papers may address inter alia the following issues:

- The financial innovation (inflation-linked, longevity, perpetual ... bonds)
- The future of company pension schemes
- The institutionalisation of individual savings via e.g. mutual funds
- The revitalisation of sleeping capital in the hands of aged people (succession, heritage, etc.)
- The asset allocation of pension funds and group insurances (IAS 19, deficits, absolute versus relative return, etc.)
- The implications for equity and bond markets
- The developments in the housing markets (reverse mortgages, real estate prices, etc.)
- The strategies of financial institutions (banks, insurance companies, asset management companies, etc.)

#### Invited Speakers:

**Etienne de Callatay**, Bank Degroof, Brussels

**Theo Peeters**, KU Leuven and Ageing Study Group in Belgium

## Preliminary Programme

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### Thursday morning 12 Oct., 2006

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**Venue:** Universidade Nova de Lisboa,  
Nova Rectory

**Registration**

**Opening Session Welcome Addresses**

SUERF President

**Keynote**

**Speakers: Plenary Sessions**

**Vitor Constâncio**, Governor,  
Banco de Portugal

**Fernando Teixeira dos Santos**,  
Minister of Finance, Portugal, tbc

**Ignacio Visco**,  
Central Manager for International Affairs,  
Banca d'Italia

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### Thursday afternoon 12 Oct., 2006

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**Commission work in three parallel sessions in three seminar rooms.**

**Venues:** Three different commission rooms at the  
Faculdade of Economia,  
Universidade Nova de Lisboa

Evening reception

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### Friday 13 October, 2006 – full day

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**Commission work in three parallel sessions in three seminar rooms.**

**Venues:** Three different commission rooms at the  
Faculdade of Economia,  
Universidade Nova de Lisboa

Late

afternoon: SUERF General Assembly

Evening reception

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### Saturday morning 14 Oct., 2006

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**Venue:** Universidade Nova de Lisboa,  
Nova Rectory

**Plenary Session**

Concluding panel discussion (SUERF  
President and the Chairpersons of the  
three commissions)

**Marjolin Lecture**

**Barry Eichengreen**

George C. Pardee and Helen N. Pardee  
Professor of Economics and Political  
Science, University of California,  
Berkeley

**Robert Marjolin Prize**

Award for the best contribution to the  
Colloquium given by author(s) below the  
age of 40.

*approx.*

12.00 noon *End of the Colloquium*

**Afternoon OFFICIAL CONFERENCE  
EXCURSION WITH DINNER**

A detailed Programme will be available in  
the Spring 2006

## Call for Papers

The Council of Management of SUERF invites prospective authors to submit an abstract of 2–3 pages (or the full paper, if available) **before April 15, 2006**. Papers published prior to the Colloquium are not eligible. We only accept submissions by e-mail using the completed form contained on our website [www.suerf.org](http://www.suerf.org)

Abstracts should be submitted to [suerf@oenb.at](mailto:suerf@oenb.at)

Contact address:

Beatrix Krones, SUERF Executive Secretary  
 SUERF c/o OeNB, Otto-Wagner-Platz 3  
 A-1090 Vienna, Austria

Tel.: +43-1-404 20-7206  
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 Beatrix.Krones@oenb.at

Notification of acceptance or non-acceptance will be provided **no later than 31 May, 2006**.

The **final draft version** of the accepted paper must be received by **August 31, 2006**.

The Colloquium registration fee for the presenter (one only per paper) is waived. SUERF will pay for the accommodation costs of the presenting author during the Colloquium, if the presenter's institution is not in a position to cover these costs. However, the norm has been established that speakers from commercial / financial institutions pay their costs in full. A small number of grants to partially reimburse speakers' travel costs, are available, with decisions being made on a case-by-case basis. Applications for such grants, indicating the reasons for need; must be received **by June 30, 2006**.

### The Marjolin Prize

The author(s) of the paper selected by the SUERF Council of Management for having made the best contribution to the Colloquium will be awarded the *Prix Marjolin* (EUR 2000). The award is restricted to authors (also co-authors) below the age of 40 on the first day of the Colloquium 2006.

# Forthcoming SUERF Events in 2006

## SUERF Seminar

### *The Changing Face of Corporate Financing*

jointly organized with Credit Suisse Group  
 16<sup>th</sup> March, 2006  
 CS Forum St. Peter, Auditorium,  
 St. Peterstrasse 19, CH-8001 Zurich



**CREDIT  
SUISSE**

### Preliminary Programme

- 09.15 Registration / coffee
- 09.25 Welcome address **Alois Bischofberger**, Chief Economist, Credit Suisse Group
- 09.30 Introduction **David T. Llewellyn**, SUERF President, Professor of Finance and Banking at the University of Loughborough
- 09.50 *Capital market versus banking oriented financial systems: Influences on corporate strategy and corporate finance*, **Rudolf Volkart**, Director of Swiss Banking Institute, Professor of Finance at the University of Zurich
- 10.10 *Instruments for bridging financing gaps*, **Maurice Pedergnana**, General Secretary of Swiss Private Equity & Corporate Finance Association SECA, Professor at the Institute for Financial Services Zug
- 10.30 *Coffee break*
- 10.50 Presentations by practitioners from the Swiss financial industry
- 11.30 Discussion  
 Chairperson **Alois Bischofberger**, Credit Suisse Group
- 12.00 Closing statement **David T. Llewellyn**, SUERF President
- 12.10 Drinks reception and sandwiches

For the final programme please visit [www.suerf.org](http://www.suerf.org)

#### Contact persons on organizational matters:

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	Otto-Wagner-Platz 3, A-1090 Vienna	<a href="mailto:beatrix.krones@oenb.at">beatrix.krones@oenb.at</a>
for local help:	Credit Suisse, Zurich, Norma De Giuseppe	Tel.: +41 44 333 63 41
	<a href="mailto:norma.deguseppe@credit-suisse.com">norma.deguseppe@credit-suisse.com</a>	Fax +41 44 333 56 79

SUERF Seminar

*De-regulation and Integration  
in European Banking*

(working title),

jointly organized with the  
National Institute for Economic and Social Research (NIESR)



24<sup>th</sup> March, 2006 at the NIESR, London

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SUERF Seminar

*The Adoption of the Euro: Challenges  
and Vulnerabilities on the Last Stretch*

jointly organized with the Central Bank of Malta  
4–5<sup>th</sup> May 2006, Valletta, Malta



Details on the above SUERF Events and announcements of additional events including the  
2006 SUERF ANNUAL LECTURE will be available shortly on the SUERF website at  
[www.suerf.org](http://www.suerf.org)

Members will also be informed by mailings.

# SUERF and Bank of Finland Joint Conference, held on 22<sup>nd</sup> / 23<sup>rd</sup> September, 2005 in Helsinki

## *Open Market Operations and the Financial Markets*

Report by Morten Balling, SUERF Council of Management  
David Mayes, Jan Toporowski, Bank of Finland



This was the second of the conferences held with the Bank of Finland in recent years and the first in their refurbished facilities. The conference theme was deliberately tightly focused and as result the contributions were related and contributed to a fascinating discussion of an area that is of immediate importance to market participants and central banks alike but has received only limited coverage in the literature. The publication of the proceedings should help fill the gap.

Open markets operations are often regarded as a highly technical part of the operation of financial markets and do indeed have this feature. However, how central banks can provide liquidity and have their influence on financial markets and hence through to their objective of price stability and control of inflation is essential to their *raison d'être*. Traditionally central banks have had their effect at the short end of the market but as time passes, markets become more efficient and inflation stabilizes this may become more difficult. We have already seen the problems this can pose in Japan and the fear of it in the United States developed a discussion a couple of years ago. This conference therefore sought to draw the various threads together in a common framework, inviting the best known experts in the subject as well as contributions by the members of SUERF. As organizers we are of course biased but this turned out to be an enjoyable and productive event with a good atmosphere. Speakers at the conference came from 4 continents. The details of the presentations follow.

The first few presentations were designed to give a picture of the parts of the global scene and the developments in the subject. **David Laidler**, University of Western Ontario, gave the first keynote address: "Theoretical Foundations for Monetary Policy." The speaker noted that in recent years there has been a growing tendency to stress yields and downplay stocks. Open market operations (OMOs) look more important if focus is on the money supply rather than on interest rates. The so-called "Radcliffe View" dominated the design of monetary policy in the 1960s and early 1970s. Later, inflation problems set the scene for monetarist anti-inflation regimes with focus on the rate of money supply growth. However, demand for money functions turned out to be unstable so money growth targeting gave way to more or less formal inflation targeting regimes. Monetarism evolved into New Classical Economics in the 1970s with the "money-supply-surprise" model as its centrepiece. The standard monetary policy model contain some form of IS-curve, an expectation augmented Phillips curve and a central bank policy reaction function. The speaker referred several times to M. Woodford's (2003) monograph "Interest and Prices." The speaker concluded by advocating "sceptical eclecticism" based on several apparently unrelated ideas rather than single minded devotion to any particular model.

The second keynote address was given by **William A. Allen**, City University: "The Microeconomics of Open Market Operations: Interest Rate Bands, Intra-Day Credit

and Reserve Averaging.” The early objective of OMOs was to manage the quantity of central bank money available to the commercial banking industry and the economy. OMOs still have some quantity-related objectives. In OMOs, the central bank takes the initiative in transactions. Under standing facilities, the initiative is taken by the commercial banks. The framework and the division of labour often imply that the central bank determines overnight rates while the market determines long-term rates.

**Laurent Clerc**, Banque de France presented the paper: “Monetary Policy in a Changing Financial Environment: A Case for the Signalling Function of Central Banks’ Operating Framework.” Deregulation and new information technology have profoundly transformed the financial landscape. This implies also changes in the transmission channel for monetary policy. Traditional banking has declined, payment and settlement systems have improved. Central bank base money has declined steadily relative to other means of payment. As a consequence, the magnitude of central banks’ monetary policy operations has shrunk relative to the size of the financial markets central banks are assumed to influence. The speaker gave a survey of how different central banks have adjusted their operating frameworks to cope with the market changes. Short-term interest rates are used as key instrument, there is a growing reliance on standing facilities (with interest rate corridors), and a dominance of reverse transactions. These changes challenge the justification for OMOs.

**Dan Thornton**, Federal Reserve Bank of St. Louis, presented a paper: “Open Market Operations and the Federal Funds Rate.” In the US, OMOs are conducted by the Trading Desk of the Federal Reserve Bank of New York. The speaker applied a few equations to describe the Desk’s operating procedure. The data suggest that the Desk follows the operating procedure relatively closely. The Desk did not change its behaviour significantly when the funds rate target was raised but responded differently when the rate target was decreased. Contrary to conventional wisdom – that the Fed controls the federal funds rate through OMOs – the author finds little support of an important liquidity effect at the daily frequency. In fact, OMOs account for a very small proportion of the variation in the equilibrium quantities in the reserves and federal funds markets.

**Ulrich Bindseil**, European Central Bank, presented a paper co-authored with Flemming Würtz: “Open Market Operations – their role and specification today.” The authors describe the development of economic thinking concerning OMOs in the 20<sup>th</sup> Century. In the early 1920s, OMOs became the key official monetary policy instrument. In a short period at the late 1970s, the related “reserve position doctrine” was adopted by the Fed. Since the early 1980s, the importance of the doctrine has declined. Central banks can implement monetary policy by using different combinations of standing facilities and OMOs. Today’s perceived state of the art is a so-called “symmetric corridor approach.” OMOs are no longer considered to be the superior instrument of monetary policy implementation. Yet, the instrument still has some distinct advantages. It allows for a lengthening of the duration of central bank assets, and it may contribute to an active interbank money market.

**Toshihiro Ihori**, University of Tokyo, presented a paper: “Sustainability, Inflation, and Public Debt Policy in Japan.” In the paper, the growth of the Japanese fiscal deficit and the consequent need to issue more and more Government bonds is studied. The author makes assumptions concerning GDP-growth, rate of inflation, the taxation system, saving behaviour and size and structure of Government debt in order to evaluate the long-term sustainability of the Japanese Government budget. In Japan, the central bank acts as an independent policy maker and its concerns regarding inflationary targeting is more conservative than that of the government. According to the speaker, the fiscal authority is too weak to cope with political pressure from various interest groups. He argued that there is a need for a stronger debt target. This would imply a stronger commitment of the government to a deficit-reduction program.

**Francis In**, Monash University, presented a paper co-authored with Xinsheng Lu: “The Impact of the Reserve Bank’s OMOs on Australian Financial Markets.” The policy objectives of the Reserve Bank of Australia are realized mainly through its daily OMOs. The primary target is the official interest rate level. The paper examines the impact of OMOs on interest rates and on foreign exchange rates in spot and futures markets. Outright transactions are purchases and sales of government securities with remaining terms to maturity of up to 18 months. An exponential GARCH modelling procedure is applied. The results indicate that the impact of

OMOs on the currency markets is asymmetric. Responses of interest rates and foreign exchange rates in the market to OMOs are somewhat delayed. OMOs do not seem to have significant contemporaneous impacts on the long-term interest rate markets.

**Michael J. Fleming**, Federal Reserve Bank of New York, presented a paper co-authored with Monika Piazzesi: “Monetary Policy Tick by Tick.” The paper uses high-frequency data to assess the effects of Federal Open Market Committee (FOMC) announcements on the US Treasury Securities market. The authors find that monetary policy surprises have significant effects on yields and that these effects decrease with maturity and are quite small for longer-term securities. Despite this, they find that longer-term yields are highly volatile around FOMC announcements. Trade volume jumps at announcement, remains much higher than usual for about 45 minutes, and remains somewhat higher than usual for 1½ to 2½ hours. The presentation was followed by a lively discussion during which one participant characterized the application of monetary policy announcements as “Open Mouth Operations.”

**Jens Forsbaeck**, Lund University, presented a paper co-authored with Lars Oxelheim: “On the interplay between Money Market Development and Changes in Monetary Policy Operations in Small European Countries 1979–2000.” The paper contains a wealth of institutional features from 11 small open European economies from 1979 to the launch of the EMU. All the countries have experienced internationalization, deregulation and innovation. The operational framework of monetary policy is intimately related to the institutional environment in which it is conducted. For example, the structure of the money market determines the extent and type of OMOs that are feasible. A causation in the opposite direction is also relevant: When monetary authorities prefer market-oriented policy instruments they help to foment a broader market development. The study relies on the very convincing hypothesis that the development process should be understood as a continuous interplay between market outcomes and policy choices. The role of quantitative controls has been diminishing while the role of discretionary instruments has been increasing.

**Sheila Dow**, University of Stirling, presented a paper co-authored with Matthias Klaes and Alberto Montagnoli: “Monetary Policy by Signal.” The speaker

started by distinguishing between model uncertainty and signal uncertainty. Most central banks do not think that one single model can be chosen. Many academics seem to be more prone to disregard model uncertainty. Issues of information asymmetry and transparency have been central to much of the development of the theory of monetary policy over the past three decades. According to the Rational Expectations Hypothesis (REH), the central bank and economic agents act on the same model. However, a new monetary economics consensus seems to have replaced the REH and suggests that inflation as such is harmful for economic growth and efficiency, so that achieving low and stable inflation is the main step towards a sound macroeconomic environment. The new consensus establishes the rationale for the inflation-targeting framework. Model uncertainty can take various forms. Signal uncertainty is associated with the outputs of the monetary policy decision-making process. This may imply uncertainty in the public’s interpretation of monetary policy.

The next speaker was **Beata Bierut**, De Nederlandsche Bank. The title of her paper was: “On the Optimal Frequency of the Central Bank’s Operations in the Reserve Market.” The objective of the paper is to assess the effects of different frequencies of OMOs in terms of achieving the central bank’s operating target, i.e. controlling short-term interest rates. Central banks tend to steer liquidity mainly through OMOs. Within the inventory-theoretic model framework of the paper, a central bank that wants to use OMOs to minimize the volatility of interest rates around the operating target has to solve a stochastic optimization problem. The paper’s most important question is: Should central banks intervene more often in order to minimize deviations from the interest rate target? The answer – based on the analysis – is no.

The last paper was presented by **Michal Kempa**, University of Helsinki and Bank of Finland. The title of the paper was: “Money Market Volatility – a Simulation Study.” The speaker applied an interbank simulation model with commercial banks and a central bank. The central bank is supposed to supply liquidity actively by OMOs and passively by offering standing facilities. The impact of OMOs on the transaction pattern in the money market and on interest rate volatility is shown to depend on the presence or absence and form of reserve requirements. The author experiments with various ways to sup-

ply liquidity to the money market. The most important finding of the paper is that targeting the aggregate instead of individual bank liquidity is not enough to maintain a low level of market volatility.

The conference ended with an evening visit to Hämeenlinna Castle, and dinner there, at which the after-dinner speaker was **Sinikka Salo**, Member of the Board of the Bank of Finland on the topic of **Open Mouth Operations!**

In 2006, Bank of Finland in cooperation with SUERF will publish a conference volume with all the papers presented at the conference. The conference volume will include contributions from the discussants that have not been quoted here.

## News from the Council of Management

- The **2005 General Assembly** for SUERF Members was held on **30<sup>th</sup> November** in Brussels. Apart from a report on the current development of SUERF and a summary of recent and forthcoming events, seven Members of the SUERF Council of Management were re-elected and five Observers were elected into the Council of Management for a three years term (1<sup>st</sup> January, 2006 – 31<sup>st</sup> December, 2008). Professor Lex Hoogduin had informed the SUERF Council of Management that he was no longer standing for re-election to the SUERF Council, as he has in the meantime left De Nederlandsche Bank to take up a new position at Robeco. The composition of the Council of Management is shown below.

With five SUERF Studies and three Newsletters published and with five organized events during 2005, SUERF is still keeping the high level on activities that was started in 2000. Although the financial situation of the Association is sound, the Vice-President stressed the vulnerability of the Association due to mergers and acquisitions and that the currently sound financial situation can therefore change easily. SUERF as a member-based association is therefore fully depended on support from membership fees.

A more detailed summary on SUERF activities in 2005 will again appear in the **Annual Report** in the Spring 2006 Newsletter.

- It is with great regret that I have to inform you that, after serving for nearly four years on the Council of Management, Professor **Lex Hoogduin** left the SUERF Council of Management to take up the prestigious position of Global Chief Economist of Robeco. While SUERF is truly excited to see Lex move to such an important and influential position, it will be a great loss for the Council of Management. Lex, as a representative of SUERF's central bank constituency, has been an ardent supporter of the objectives and activities SUERF all along. He provided us with wise counsel and a wealth of novel ideas that have been strengthening the reputation and visibility of SUERF. On behalf of the Council of Management I would like to thank him for his strong engagement and wish him every success in his future career. I am confident of Lex's continued support of SUERF and I am certain that we can welcome him as a distinguished speaker at future SUERF events.

**Eduard H. Hochreiter**  
Secretary General, SUERF

## SUERF Council of Management

David T. Llewellyn, President	Jürgen Pfister, Vice-President
Eduard H. Hochreiter, Secretary General	Eric Pollefliet, Treasurer
Morten Balling, Chairman Editorial Board	Willy Friedmann
Luís Miguel Beleza	Philipp Hartmann
Alois Bischofberger	Ryszard Kokoszczyński
Wim W. Boonstra	Frank Lierman
Claudio E.V. Borio	Catherine Lubochinsky
Franco Bruni	Fernando Restoy
John P. Calverley	Marc-Olivier Strauss-Kahn
Harris Dellas	

For complete addresses of the Council Members and Curricula vitae see: [www.suerf.org](http://www.suerf.org)

## Book Reviews • Book Reviews • Book Reviews

### *Finance and Development - Surveys of Theory, Evidence and Policy*

Edited by Christopher J. Green, Colin Kirkpatrick, and Victor Murinde. Edward Elgar, Cheltenham, UK, 2005, 464pp  
Hardback, ISBN 1 84376 030 4, £ 95.00

Contents: Preface 1. *How Does Finance Contribute to the Development Process and Poverty Reduction?*

Part I: *Financial Markets and the Macroeconomy* 2. Savings and Financial Sector Development: Assessing the Evidence 3. Flow of Funds: The Relationship between Finance and the Macroeconomy 4. Stock Market Development: What Have We Learned? 5. Financial Regulation in Developing Countries: Policy and Recent Experience 6. Banking Regulation after Recent Financial Crises: Lessons for Developing and Developed Countries 7. Policy Issues in Market-Based and Non-Market-Based Measures to Control the Volatility of Portfolio Investment

Part II: *Households, Firms, and Financial Institutions* 8. Finance and Poor People's Livelihoods 9. Finance for the Poor: The Way Forward? 10. Rural Financial Markets 11. Small and Medium-sized Enterprises in Developing Economies 12. Company Financial Structure: A Survey and Implications for Developing Economies Index

Contributors: T. Arun, M. Brownbridge, P. Cook, E.V.K. FitzGerald, C.J. Green, D. Hulme, S. Johnson, C.H. Kirkpatrick, D.T. Llewellyn, S.M. Maimbo, I. Matin, G. Mavrotas, V. Murinde, R.W. Ngugi, F. Nixon, S. Prasad, S. Rutherford, O. Ruthven

**Reviewed by Ryszard Kokoszczyński**  
**University of Warsaw and**  
**National Bank of Poland<sup>1</sup>**  
**Member of the SUERF Council of Management**

Economists disagree about the role finance in economic growth and there is a growing body of literature attempting to clarify our understanding of this role. We have also a growing number of recent surveys in this area, with Ross Levine's research playing a dominant role among them (cf. Levine 1997, Demirgüç-Kunt and Levine 2001, Levine 2004, but also Thiel 2001). These surveys seem

to agree that a developed financial system is beneficial for growth. This notwithstanding, there is no consensus on the important question: is financial development a precondition for economic development or is economic growth stimulating development of financial sector (or, maybe, both develop in parallel)? Ross Levine has been arguing – albeit with ample qualifications – that it is finance which influences economic growth. However, there are still many areas needing additional research. The book reviewed here provides a comprehensive collection of papers covering mostly one of those areas, e.g.

<sup>1</sup> The views expressed in this review are those of the author and should not be interpreted as those of the National Bank of Poland.

the links between financial development and financial structure on one hand, and economic growth and poverty reduction on the other. The latter issue is, in my opinion, particularly important, as it is not widely covered in the recent literature (with the notable exception being Jaillilian and Kirkpatrick 2002).

In this new book a group of 18 distinguished authors presents comprehensive survey of current issues in the field of finance and development. They have been prepared specially for this book and they cover a very wide range of subjects, including both macro and microeconomic dimensions of this link. Individual chapters are devoted to savings, stock market, financial and banking regulation, capital flows, financing poor people's livelihoods, microfinance, rural financial markets, small and medium enterprises and corporate finance in developing countries.

Introductory chapter, written by the editors of the whole volume, draws the detailed picture of intricate links between finance and development, in particular in developing countries. Authors share with no doubt the opinion that finance matters for growth. They stress that there is a very small body of evidence that financial development can reduce income inequality and poverty. The link between finance and poverty reduction goes via firms' and households' behaviour, but again, our knowledge of corporate finance in developing countries is very limited. They also suggest that stock market development is important for investment, that it may stimulate assets ownership, and that small enterprises are important for poverty reduction. Further chapters are directed into bringing together theoretical models and empirical research which can support these hypotheses.

Part I of the book is devoted to macroeconomic issues. It opens with a chapter on savings and financial sector development. Previous research has usually been focused on either financial development and growth or savings and growth. Savings–financial development dimension tended to be overlooked. Theoretical models give an inconclusive outcome for links between savings mobilization and financial development – there is again a problem with the direction of causality here. However, both theory and empirics suggest strongly that financial sector (in particular, financial intermediaries) development has a positive and significant impact on savings, though its impact on relaxing liquidity constraints may

give opposite results. The net effect is impossible to predict in general case, because of the role of country-specific factors. Effective poverty reduction requires an easy access to saving institutions (simple procedures, development of microfinance institutions) as well as overall stability and good supervision and regulation of the financial sector.

Other chapters of Part I cover more detailed subjects. Some chapters bring similar conclusions for both developed and developing economies. This is the case of stock market development and its role in economic growth and also of banking regulations and lessons for their shape from recent financial crises. Other chapters' content is more specific for developing countries. In some cases their conclusions are relatively strong, like the clear advantage of moving towards market-based procedure to control portfolio investment volatility, both in market-based and in bank-based financial systems. In other cases, like in the framework for financial regulation in developing countries, what is the best model is still being debated.

The second part of the book is almost exclusively devoted to developing countries. Its initial chapter presents a new research perspective: poor people not only lack capital to invest, but they need provision of financial services for effective management of their livelihood. That brings a wide range of policy prescriptions directed not only into better access to credit, but also to savings instruments, liquidity insurance etc. This chapter is nicely supported by another one concentrating on rural financial markets. We are shown both formal and informal parts of them. However, both theoretical and policy questions on various links between financial sector reforms and various options poor people may have to finance their livelihood require an intensive further research.

There are two other chapters worth mentioning in this part. Firstly, there is chapter on small and medium-sized enterprises and it plausibly shows their critical importance in developing economies. Secondly, there is a chapter on corporate finance in developing countries. It presents comprehensively theoretical background of company financial structure and surveys numerous empirical works covering this issue.

This book nicely bridges the gap between general research on the role of finance for economic growth at

large and the role finance play for developing economies and poverty reduction. It shows that in some areas our knowledge derived from studying developed countries, though with some qualifications, may be helpful in understanding developing countries' problems, but definitely not all of them can be answered without specific research. The authors identify also a great number of promising ideas for the future research and conclude the book with a (too) modest statement that we do not know exactly how finance contributes to the development process and poverty reduction but we are trying to find out. That statement –lightly rephrased - may also summarize my general opinion on this book. For anybody who is trying to find the answer to that question, this book is a very good point to start; both thanks to the wide coverage, including theory, case studies, empirical research and policy issues, and to the detail and depth of its contents.

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## *Fiscal Policy in Economic and Monetary Union – Theory, Evidence and Institutions*

**Marco Buti, Director of the Economies of the Member States, European Commission and Daniele Franco, Director, Public Finance Division, Research Department, Bank of Italy, Edward Elgar, 2005, 320pp Hardback 1 84542 017 9 £ 69.95**

Contents: Foreword 1. EMU's Fiscal Rules in a Historical Perspective 2. The Maastricht Treaty and the Stability and Growth Pact 3. Medium-term Fiscal Targets 4. Cyclical Stabilization 5. Interactions between Monetary and Fiscal Policies 6. Public Investment 7. Long-term Sustainability 8. Fiscal Federalism 9. Politics and the Pact 10. Fiscal Rules and Statistics 11. Reforming EMU's Fiscal Rules 12. National Budgets and the EU Budget 13. Postscript: A New Stability and Growth Pact? Bibliography Index

### **Reviewed by Astrid Lemmer Deutsche Bundesbank**

The Euro has been part of our lives for many years now, and the currency union is widely considered as being a success story. However, it seems that the same cannot be said regarding public finances in the EU. The authors uncover the pitfalls of fiscal policy in a Monetary Union. The Member states gave up their autonomy on monetary and exchange rate policy and yet have not delegated the responsibility for their fiscal policy. In a monetary union it could be a dominant strategy to live at the expense of other participating states, since negative market reactions to an expansionary fiscal policy are not exclusively paid for by the expansive acting state. Anticipating this, it was agreed to tackle this moral hazard by setting rules. The

fiscal policy framework, namely the Maastricht criteria and the Stability and Growth Pact, are therefore now legal centrepieces in the principles of the European Union.

The introductory broad considerations regarding the intention of the 1997 adopted Stability and Growth Pact, address briefly major policy issues that occurred with the introduction of the rules, e.g. the potential lack of flexibility of fiscal policy. After that the task is to show how a medium-term target should be set. Therefore the notion of safety margins is explained and in the authors point of view there is a case for national specific targets. Having shown that these targets allow enough room for automatic stabilizers to work freely without breaching the 3%-reference value, the following chapter examines the role

and effectiveness of automatic stabilizers. Following the analysis in a simple aggregate demand and supply model and a quick review of empirical findings, a simulation with the European Commission model QUEST is presented. Acknowledging some shortfalls of the model analysis the authors draw the conclusion, that output can reasonably be stabilised in case of temporary shocks.

Some of the main reasons and thoughts for fiscal rules are dealt with in depth in the following chapters. The set up of these analyses is unique to the extent that the assessments are made recognising and capturing the main features of the EU fiscal rules. In this line the interaction between monetary and fiscal policy is looked at. The results show a rationale for not coordinating these policies *ex ante*. But the authors point out that considering certain circumstances a “soft coordination,” that is for example gaining the same understanding of the type of shock and achieving a common view on the output gap, would be useful.

Also the potential retrenchment on public investment caused by the Stability and Growth Pact is discussed. It is pointed out that during the transition to reasonable debt levels, cuts in public investment have often been quite noticeably. It could therefore be valuable to implement clauses on a national level to avoid unfavourable investment cuts.

As long-term sustainability is a key reason for fiscal rules, the authors address the problems of measuring it. They provide an overview of different indicators and a structure of methodologies used. In the end they point out seven crucial issues that need to be regarded in developing the technique of long-term projections, with which the guidance for budgetary policy could be improved.

In the Chapter on “Politics and the Pact” politically motivated fiscal policies are revealed. Since short term gains of higher deficits at the national level are apparently more important to national politicians than the long term costs of violating the rules, the compliance with the rules has eroded markedly. The authors presume that electoral budget cycles would have to be accepted but that it would be helpful to focus on structural balances and to rely on peer pressure to limit fiscal non-compliance.

Then a broad approach to identify necessary reforms of the EMU’s fiscal rules is provided. The authors check the

initial rules against the background of an ideal standard and come up with some general proposals. But they also suggest some less radical changes. Some of the propositions, like the country specific medium term objectives, are now part of the changed fiscal framework, but others are still open claims.

Since the Stability and Growth Pact was implemented the governing rules have been criticised. Problematic fiscal developments have occurred that have given rise to even more demands for changes and finally led to alterations of the initial set of rules. In the final chapter of the book a brief overview of the main changes is presented. And the crucial question is asked: Will the new rules be effectively enforced? The authors present pros and cons, not daring to predict an ultimate answer. However, they are convinced that the Pact will remain at the core of policy debate in Europe.

Presumably not everybody agrees on all the conclusions drawn. An even stronger emphasis on the dichotomy of economically reasoning *vis-à-vis* public choice arguments of the rules would have been valuable. The danger of economically funded sophisticated rules being abused by myopic political decisions could have been presented more prominent. Regarding the first “cases” dealt with under the new rules of the Stability and Growth Pact, this still seems to be a core problem.

The book presents articles written in recent years by Marco Buti, Director of the Economies of the Member States, European Commission and Daniele Franco, Director of Public Finance Division, Research Department, Bank of Italy (supported by different Co-authors). This compilation does not lack actuality. The authors, being at the forefront of the academic and policy debate, are certainly matching the need for a comprehensive insight in the most relevant details and some theoretically aspects of the EU’s fiscal rules.

# *Handbook of Central Banking and Financial Authorities in Europe New Architectures in the Supervision of Financial Markets*

**Edited by Donato Masciandaro, Paolo Baffi Centre, Bocconi University and Department of Economics, Mathematics and Statistics, University of Lecce, Italy, Edward Elgar, 2005, 584pp Hardback 1 84376 789 9 £ 125.00**

**Contents:** Foreword by Charles Goodhart Introduction by Mario. Monti Part I: Central Banks and Financial Supervision 1. Central Banks as Monetary Authorities and Financial Stability 2. The Role of Central Banks in Fostering Financial Stability. 3. Central Banks and Single Financial Authorities: Economics, Politics and Law Part II: The Emerging Role of Single Financial Authorities 4. Integrated Agencies and the Role of Central Banks 5. United Kingdom 6. Austria 7. Denmark 8. Sweden 9. Norway 10. Estonia 11. Hungary 12. Germany 13. The Netherlands 14. Ireland Part III: What Role for Central Banks and Single Financial Authorities? 15. The International Network of Financial Authorities 16. Central Banks and Financial Authorities in Europe: What Prospects? 17. The European Central Bank and Financial Supervision 18. The Transformation of Financial Regulation and Supervision in the EU 19. The Role of the Central Bank in Financial Supervision: The Case of Italy Index

**Contributors:** B.S. Aamo, T. Allen, L. Balogh, H. Bjerre-Nielsen, I. Bonde, J. de Haan, A. De Vincenzo, P. del Río, S.C.W. Eijffinger, A. García Herrero, C. Goodhart, A. Grünbichler, K. Lannoo, L. Liive, D.T. Llewellyn, P. Marullo Reedtz, D. Masciandaro, M. Monti, N. Moss, S. Oosterlo, H. Prast, D. Schoenmaker, M. Schüler, A. Sykes, I. Van Lelyveld, J. Westrup

**Reviewed by Catherine Lubochinsky  
ASSAS Finance, University Paris 2  
Member of the SUERF Council of Management**

Everyone involved with financial regulation and supervision should have already read this book which offers not only a thorough overview of where Europe stands but also gives a dynamic approach of how and why Europe has been –and will be– shifting towards a more unified financial authority.

Part one contains 3 papers (by García Herrero and del Río, Oosterloo and de Haan and Masciandaro) on the role of central banks in financial supervision, underlying the two functions of contributing to monetary stability and to financial stability. Besides the debate on the synergies between the two, the 3 papers tackle the issues of financial stability for which, being a polymorph concept, it is difficult to set a framework. Nevertheless, it is the blurring frontiers between the banking, securities and insurance industries that have led an increasing number of European countries towards a higher degree of unification for financial supervisors.

If one needs to be convinced by the emerging role of single financial authorities, part two of the book offers an extended presentation of all the European countries having adopted such a scheme. The introductory chapter (Llewellyn) recognises there is no single model for an optimal institutional structure (pros and cons for different architectures) but there is a general trend of reducing

the number of regulatory and supervising agencies. The following chapters give a deep insight of why, when and how several countries chose a single financial authority: United Kingdom, Austria, Denmark, Sweden, Norway (the first European country to establish such a structure in 1986), Estonia, Hungary, Germany, the Netherlands and Ireland (with a unique structure combining the central bank and the financial services authority). The major, and common, arguments used are the integration of the financial sectors with financial conglomerates, the economies of scale in supervising, and the international cooperation.

The final part of the book (part 3) adopts a more prospective view about the future of the respective role / coordination of central banks and single financial authorities and addresses the issue whether there should be a single European financial supervisor. Moss' chapter provides an interesting picture of all the institutions involved at the international and regional level (p.375). The following chapters investigate what the prospects are in terms of the future architecture of the financial supervision and regulation in Europe. It is difficult not to be convinced that, in order to establish a level playing field across the area, a move towards centralisation is inevitable, even if the supervision of the core business can remain at a local/sectoral level.

Masciandaro has edited a handbook on a very topical subject that will indeed give rise to many challenging

debates in the European Union in the near future. The papers gathered offer a complete view of the benefits and drawbacks of the different existing and potential structures of financial regulation and supervision agencies. Including the specific experience of ten countries gives a practical / empirical dimension and... reduces the "home bias" knowledge of many economists!

## New SUERF Studies

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**2005/5** *Inflation Targeting and its Effects on Macroeconomic Performance*, by Thórarin G. Pétursson, December 2005, ISBN 3-902109-30-0

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## Future SUERF Events

The Council of Management has decided on the following next events for 2005. Other events will follow during the year and will become available on the website and in the Newsletters in due course. You are therefore invited to visit the website regularly – [www.suerf.org](http://www.suerf.org) – to receive the most updated information.

The Council of Management is always pleased to consider suggestions for joint events from members.

16 March 2006 Zurich	<b>SUERF Seminar</b> <i>The Changing Face of Corporate Financing</i> jointly organized with Credit Suisse Group.
24 March 2006 London	<b>SUERF Seminar</b> <i>De-Regulation and Integration in European Banking</i> (working title) jointly organized with the National Institute for Economic and Social Research (NIESR).
4–5 May 2006 Malta	<b>SUERF Seminar</b> <i>The Adoption of the Euro: Challenges and Vulnerabilities on the Last Stretch</i> , jointly organized with the Central Bank of Malta.
12–14 October 2006 Lisbon	<b>26<sup>th</sup> SUERF Colloquium</b> <i>Money, Finance and Demography – the Consequences of Ageing</i> , jointly organized with the Banco de Portugal in co-operation with Universidade Nova de Lisboa. <b>See also the Call for Papers in this Newsletter.</b>
Autumn 2006 Klagenfurt, Austria	<b>SUERF Seminar</b>

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