

newsletter

December 2007

SUERF Conference

Financing of SMEs in Europe

11/12 September 2008

Conference Room, Sénat, Palais du Luxembourg, Paris

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Call for Papers

Small and medium size enterprises (SMEs) play a key role in the European economy: they account for 99 % of all European Enterprises and provide two-thirds of all private sector jobs. More than 100 millions of Europeans are SME-employees. Start-up firms belong almost by definition to the category. Innovation in SMEs contributes significantly to economic growth. Bank business lending is to a large extent based on credit evaluation of SMEs. Against this background, it is not surprising that the availability of SME financing has attracted political attention. The European Commission and OECD have recently published reports on financing of SMEs and their entrepreneurial activity.

! ANNOUNCEMENT – see pages 4–11!

27th SUERF Colloquium – preliminary programme

**New Trends in Asset Management:
Exploring the Implications**

12–14 June, 2008 in Munich

SUERF – The European Money and Finance Forum, with the support of the former **AFCB, Association Française des Centrales de Bilans**, has decided to organize a conference with Financing of SMEs in Europe as conference theme, with a focus on panel or balance sheet data.

The discussions at the conference will be divided into four sessions:

- 1) Does a European model exist for SMEs?
- 2) SMEs and credit risk analysis.
- 3) Banks and financing of SMEs.
- 4) SMEs and regulatory issues.

We invite authors to submit a 2-3 pages abstract or a full paper if available addressing the following questions:

Session 1 – Does a European model exist for SMEs?

- What are the main features of SMEs in Europe?
- How do these features relate to the financing of SMEs?
- Is there a SME financing gap in Europe?
- What evidence do we have about the ownership structure of SMEs in Europe?
- Who are the people behind company start-ups in Europe and how many of them have been successful?
- In which parts of Europe is family ownership of SMEs most important?
- Does the European Venture Capital Industry invest globally or does it focus on European start-up firms?
- Are European private investors ready to buy shares issued by SMEs?
- To what extent do European mutual funds include SME-investments in their portfolios?
- Is there a European shareholder culture developing that might improve the future financing opportunities of SMEs?
- SMEs versus large firms: dominance effect or complementarity?
- How do SMEs cope with globalization?

Session 2 – SMEs and credit risk analysis

- Which are the important steps in credit risk assessments of SMEs?
- Are SMEs more risky than large firms?
- What is the optimal balance between accounting and non-accounting data to analyze credit risk?

- How can investors and banks measure entrepreneurial quality?
- Can an entrepreneur's capacity for innovation be quantified?
- Can potential investors and lenders seek advice at technological institutes or university departments when they want to evaluate the feasibility and potential profitability of business development projects?
- Is there an optimal capital structure for SMEs?
- Which methods should be used to implement stress testing of SMEs' loans portfolio?
- To what extent can the incentive structure in the contract between a SME and the lenders be used to achieve an appropriate distribution of risk?
- Are options and/or convertible debt appropriate financial instruments to reallocate SME business risk?
- Is pooling of risky projects in special vehicles an appropriate way of diversifying credit risk?

Session 3 – Banks and financing of SMEs

- What are the main financing patterns for SMEs in Europe?
- Do we have evidence on the impact of EMU on SMEs?
- What can be done to reduce the information asymmetry between banks and entrepreneurs?
- What should bankers learn about innovation and entrepreneurship in start-up firms?
- How should banks evaluate the value of SME-owned patents and other immaterial rights?
- What is the appropriate way for a bank to deal with the risk of an SME default?
- Should banks own shares in their SME-borrowers?
- To what extent should banks be involved in the governance of their SME borrowers?
- To what extent should banks include restrictive covenants in their lending contracts with SMEs?
- How patient should banks be with innovative SMEs in financial difficulties?
- Does risk of SME failure scare banks away?
- Should banks own Venture Capital Firms that invest in SMEs?
- Do loans to start-up firms lead to long-term SME customer-bank relations?
- Should banks set an overall limit to their exposures to innovative SMEs?
- Do the LBOs affect positively or negatively SMEs' financial structure and long term performance?

Session 4 – SMEs and regulatory issues

The optimal regulatory response to the SME issues and the relatively low level of venture capital financing in Europe depends on the relative importance of demand and supply problems.

- Do we not have enough able entrepreneurs willing to take risks and consequently low demand for early stage financing or, do we have constraints on the supply of capital to small innovative firms?
- Should it – in order to address the demand side – be a political goal to increase the entrepreneurs' and the European private investors' "appetite for risk" with a view to increasing the global competitiveness of Europe?
- Should Europe have a common regulatory framework for Venture Capital Firms?
- Does an expected positive effect on economic growth justify Government subsidies to innovation activity in SMEs?
- Aiming at the supply side: What can be done by European policy makers to improve the financing of SMEs in the EU?
- Are legal provisions concerning default and creditor protection regarding SMEs similar in the European countries?
- Which kind of investor protection is appropriate in relation to SMEs?
- Are disclosure requirements regarding the activity of SMEs sufficient?
- Which types of regulation of SME financing at the European level are used currently and which types can be expected to be used in the future?
- Should investors, entrepreneurs and SMEs be allowed to deduct (a part of) their risky investments in start-up projects in their income tax?
- Is there a trade-off between the target of reducing the administrative burden and improving the financial disclosure (reduction of information asymmetries)?
- Is "positive discrimination" an appropriate answer of public policies aiming at fostering SMEs' long-term growth?
- Are bank loans to SMEs treated appropriately in the Basel II regulatory framework?

The Council of Management of SUERF invites prospective authors to submit an abstract of 2-3 pages (or the full paper, if available) before 31st March 2008. Papers published prior to the conference are not eligible.

Abstracts/Papers should be submitted by e-mail attachment to the

SUERF Executive Secretariat

Beatrix Krones, Executive Secretary

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www.suerf.org

Preliminary Programme
27th SUERF Colloquium

*New Trends in Asset Management:
 Exploring the Implications*

jointly organized with  Bayerisches Finanz Zentrum
 12–14 June, 2008, Munich, Germany

HVB Forum
 Kardinal-Faulhaber-Straße/Prannerstraße (corner), D-80333 München / Munich



Notes on the theme of the Colloquium

Asset management has become more prominent in recent years as manifested by at least four trends. First, the amounts involved have increased strongly as private sector assets have continued to grow and governments and central banks have more assets under management (sovereign wealth funds and larger foreign exchange reserves). Second, assets are managed more actively, both by large institutional investors, like pension funds and insurance companies and also by mutual funds and similar funds mainly set up for private investors. Third, the scope of asset management has been extended. Once mostly limited to traditional long-only equity and fixed income investments, asset management now encompasses a wide range of "alternative" investments including hedge funds, structured products, private equity, com-

modities, foreign exchange, real estate and even climate-linked products. Fourth, investment strategies have become so sophisticated that much higher risks can be managed than a decade ago. These trends are having effects on the asset management industry itself and the economy at large as asset classes and investment strategies evolve, asset prices and wealth affects become potentially more important for economic outcomes and the stakes for financial stability become potentially bigger.

This Colloquium will discuss these phenomena and their implications from three different perspectives:

- that of central banks and supervisory bodies
- of academia and financial research centres
- of asset managers and financial practitioners.

General Information

Location

The Colloquium will be held at their very modern conference venue, HVB Forum, offered by HypoVereinsbank in the city centre of Munich.

HVB Forum

**Kardinal-Faulhaber-Straße / Prannerstraße (corner)
 D-80333 München / Munich**

Sponsors:



Conference Secretariat:

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Costs for Members and Non-Members of SUERF

Non-members of SUERF may decide to join SUERF to take advantage of the very much reduced Colloquium fees for members. Being a member does not only mean qualifying for the reduced Colloquium fee but also being invited to all other SUERF events (such as Seminars, Annual Lecture, Conferences) that are free of charge to members. **Therefore: the earlier you subscribe for this year, the more you will benefit in 2008 from your membership.** Members also receive our publications: three Newsletters and a minimum of four *SUERF Studies* per year. Members are provided with a password

to download all *SUERF Studies* from our website www.suerf.org. New Corporate Members are entitled to send one participant without paying the Colloquium fee and more staff members at the reduced fee. Please see the Subscription Forms attached to this Newsletter: If you wish to take advantage of this offer, you are asked to complete the subscription form and to return it to the SUERF Secretariat together with your registration form. If you do not want to become a SUERF member, but wish to participate, you are requested to pay the full amount of EUR 2.500.

Colloquium Registration Fees

SUERF Members	Early registration discount for registrations until 15 April 2008*		Registrations as of 16 April 2008**)
	EUR		EUR
Students (proof of student status!)	EUR	50	EUR 60
AIMs (Academic Institution Members)+	EUR	100	EUR 120
Personal Members	EUR	250	EUR 300
Staff members of Corporate Members	EUR	550	EUR 660
Non-Members not wanting to join SUERF	EUR	2.500	EUR 2.500

*) Only for payments with **American Express, VISA** or **Master Card**

) **payments must be received by 31st May

+) AIM = group membership

Cancellation policy:

- No cancellation fee for cancellations made by 31st May
 - 50 % of the fee for cancellations made as of 1st June
- Or: participants arrange for someone else to attend in their place.**

Included in the registration fee are the lunches on 12th and 13th June and the evening reception/dinner.

Depending on need a limited number of grants are available for residents from Central and Eastern Europe (academics and members of non-profit institutions). Applications must be addressed by 29th February 2008 to the SUERF Secretariat.

Registration

- Please return the completed **Registration Form** to the SUERF Secretariat.
- Please make hotel reservation directly with the conference hotel by using the **Hotel Reservation Form** to get the special conditions. The hotel will confirm your booking with you.

Note that you will receive a confirmation of your registration and excursion booking from the SUERF Secretariat. No invoices will be sent! The amount due

for Registration (and Excursion(s)) is to be paid **before 31st May, 2008** into the **SUERF Account** (see the registration form) or you allow us to charge your credit card by returning the completed form. The early booking bonus is only applicable for registrations made until 15th April and paid by credit card.

Corporate Members or other Institutions which support SUERF are invited to send one or more delegates at the above fee. **New Corporate Members** are entitled to send one participant free of costs and additional delegates at the above fee!

Hotel Accommodation

Arrangements have been made with three hotels at different price levels. All hotels are located in the vicinity of the venue and of each other. For detailed information on special rates and addresses, see below.

1) Hotel Königshof 5* Karlsplatz 25 D-80335 München	Superior double room/single use	€ 205/night <input type="checkbox"/>
	Superior double room/double use	€ 270/night <input type="checkbox"/>
	Deluxe double room/single use	€ 245/night <input type="checkbox"/>
	Deluxe double room/double use	€ 340/night <input type="checkbox"/>
	<u>Breakfast buffet € 23/day/person</u>	
2) Hotel Excelsior 4* Schützenstrasse 11 D-80355 München	Single room, incl. Minibar	€ 140/night <input type="checkbox"/>
	Double room/single use, incl. Minibar	€ 160/night <input type="checkbox"/>
	Double room/ double use, incl. Minibar	€ 180/night <input type="checkbox"/>
	<u>Breakfast buffet € 18/day/person</u>	
3) anna hotel Schützenstrasse 1 D-80355 München	Double room/single use	€ 175/night <input type="checkbox"/>
	Double room/double use	€ 195/night <input type="checkbox"/>
	<u>incl. breakfast, minibar</u>	

See <http://www.geisel-privathotels.de/>
for all 3 hotels

(All taxes, LAN wireless, use of wellness area at Königshof are included)

Social Programme

For the afternoon of Saturday, 14th June, 2008 an **optional Official Conference Excursion** to the “Bavarian Sea” the **Chiemsee** with a guided visit to Schloß Herrenchiemsee and with dinner will be arranged – partners are of course welcome.

Partner Programmes:

On Thursday afternoon, 12th June, 2008, a **guided Munich Tour** with afternoon tea/coffee will be arranged (ca. 2,5 hours).

On Friday (full day), 13th June, 2008 a **guided bus tour and visit to the famous Castle Neuschwanstein** with lunch will be offered. In addition dinner can be booked in Munich.

REGISTRATION FORMS for all three excursions and detailed Programmes will be available shortly.

Procedure for the Colloquium

The official Conference language is English. After the opening Plenary Session, the participants will meet in discussion groups, the Commissions. The authors will give a short presentation of their papers followed by a general discussion. **Papers presented at the commissions will only be made available for participants for downloading from the internet. A password will be**

provided. No papers will be made available at the conference!

On Saturday morning, there will be a **Concluding Panel Discussion** followed by the **Marjolin Lecture** delivered by Professor **Robert C. Merton** and the presentation of the **Marjolin Prize**.

The Marjolin Lecture and the Marjolin Prize

The **Prix Marjolin** (EUR 2000) will be awarded to the author(s) of the paper selected by the SUERF Council of Management for having made the best contribution to the Colloquium. The award is restricted to author(s) below the age of 40 on the 14th June, 2008 (all authors of the chosen paper must fulfil this restriction).

Robert Marjolin (1911–1986) was one of the most distinguished European economists of his generation and a leading architect of post-war Europe. From 1948 until 1955 he was the first Secretary General of the OEEC (Organization for European Economic Co-operation). This organization was established to channel US Marshall Aid into the reconstruction of Europe. Marjolin was a leading negotiator of the Treaty of Rome for France and Vice President of the European Commission for finance and economics for ten years. He served as a Professor of Economics at the University of Paris and the University of Nancy, and in the private sector as advisor to leading European and US Companies.

In awarding the Prix Marjolin SUERF wishes to honour his memory by supporting a young outstanding author's publication.

The Marjolin award will be presented by the Marjolin Lecturer 2008, Professor **Robert C. Merton**, Harvard University. The awarded contribution will be published by SUERF.



Robert C. Merton

Biography

Robert C. Merton is the John and Natty McArthur University Professor at the Harvard Business School. He is past President of the American Finance Association and a member of the National Academy of Sciences. In 1993, He received the inaugural Financial Engineer of the Year Award from the International Association of Financial Engineers. In 1997, Professor Merton received the Alfred Nobel Memorial Prize in Economic Sciences for a new method to price derivative securities.

A former senior advisor to Salomon Inc. and J.P. Morgan and a co-founder and principal of Long-Term Capital Management, he is currently Chief Science Officer of Trinsum, an international strategic and financial advisory firm which provides strategic consulting, corporate finance and investment banking advice, asset management and SmartNest, a pension solution system. [<http://www.trinsum.com/>]

Professor Merton holds a B.S. in Engineering Mathematics from Columbia University, an M.S. in Applied Mathematics from California Institute of Technology and a Ph.D. in Economics from Massachusetts Institute of Technology. He holds honorary degrees from the University of Chicago and seven foreign universities. [<http://www.people.hbs.edu/rmerton/>]

PRELIMINARY PROGRAMME

Thursday, 12 June, 2008 morning

Venue:	Maximiliansaal, HVB Forum Kardinal-Faulhaber-Straße / Prannerstraße (corner entrance), D-80333 München / Munich,
8.30–9.00	Registration
9.00–9.15	Opening Session – Welcome Addresses Catherine Lubochinsky , SUERF President and Professor of Economics, University Paris 2* Wolfgang Gerke , President, Bayerisches Finanz Zentrum e.V., Munich*
Keynote Speakers:	Plenary Sessions
9.20–10.10	Andreas Wölfer , Member of the Board, Bayerische Hypo- und Vereinsbank AG, Munich Discussion
10.10–10.30	<i>Coffee break</i>
10.30–11.20	Sushil Wadhvani , CEO, Wadhvani Asset Management, LLP, London* <i>Should Monetary Policy Respond to Asset Price Bubbles?</i>
11.20–12.10	Axel Weber , President, Deutsche Bundesbank* Discussion
12.10–14.00	<i>Lunch</i>

Thursday, 12 June, 2008 afternoon

14.00–18.00	Commission work in parallel sessions
19.00	<i>Reception of the State of Bavaria - Staatsempfang</i> Dinner speech: Emilia Müller , Bavarian Minister for Economic Affairs, Infrastructure, Transport and Technology <i>Verschimmelsaal, Residenz München, Entrance from Residenzstraße / Hofgartenstraße,</i> <i>(Partners are welcome but need to register)</i>



Friday, 13 June, 2008 morning and afternoon

9.00–18.00	Commission work in parallel sessions
18.00–18.45	SUERF General Assembly
19.00 <i>Dinner</i>	Dinner speech at the HVB Forum Dominik Kremer , Head of North Europe, Pioneer Investments, Munich*



Saturday, 14 June, 2008 morning

9.00–11.00	Concluding Panel Discussion
Chair/Moderation:	David T. Llewellyn , Member of the SUERF Council of Management and Professor of Economics and Banking, Loughborough University* Chairpersons of the three commissions* Andrew W. Mullineux , Professor of Global Finance, Birmingham Business School+* Robert Raymond , Honorary Director General at Banque de France and of the European Monetary Institute, and SUERF Honorary Member** William R. White , Economic Adviser and Head of the Monetary and Economic Department, Bank for International Settlements, Basel+**
11.00–11.15	<i>Coffee Break</i>

* = confirmed speakers

Marjolin Lecture

Chair/Moderation: **Catherine Lubochinsky**, SUERF President, and Professor of Economics, University Paris 2*

Marjolin Lecturer: *Observations on Future Trends in Asset Management: Challenges and Opportunities*
Robert C. Merton, John and Natty McArthur University, Professor at the Harvard Business School, Boston*

General Discussion

Robert Marjolin Prize

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

approx. 12.15 *End of the Colloquium*

ca. 14.00 Departure **OFFICIAL CONFERENCE EXCURSION WITH DINNER**

COMMISSION WORK

◆ COMMISSION I:

Evolving interaction of asset management with the economy

Chairmen: **Már Gudmundsson**, SUERF Council of Management and Deputy Head, Monetary and Economic Department, Bank for International Settlements, Basel
mar.gudmundsson@bis.org

Wim W. Boonstra, SUERF Council of Management and Chief Economist, Rabobank Nederland, Utrecht
w.w.boonstra@rn.rabobank.nl

Thursday, 12 June, 2008

Commission Work

Session I and II from 14.00–17.00

Friday, 13 June, 2008

Commission Work

Session III and IV from 9.00–12.45
Session V and VI from 14.30–17.30

Submitted papers may address i. a. the following issues:

- Asset pricing, risk premia, and the yield curve
- Effects of more active AM of pension funds and insurance companies
- Role of private equity in finance
- Debt vs. equity based economy (*from shareholders to fund managers*)
- International imbalances and globalisation of AM
- Impact of asset management of pension funds and insurance companies
- Asset prices, wealth effects and bubbles
- Carry trade; drivers and effects

Speakers for Commission I:

(List to be completed / * = invited speakers)

John P. Calverley, Chief Economist and Strategist, American Express Bank Ltd., Toronto, *Interaction Between Asset Prices, Debt and Liquidity (working title)**^{*}

◆ COMMISSION II:

Changing approaches to asset allocation

Chairmen: **Morten Balling**, SUERF Council of Management, and Professor of Finance Emeritus, Aarhus School of Business, Aarhus
mb@asb.dk

Frank Lierman, SUERF Council of Management, and Chief Economist, Dexia Bank Belgium, Brussels
frank.lierman@dexia.be

Thursday, 12 June, 2008

Commission Work

Session I and II from 14.00–17.00

Panel Discussion: *Mutual Fund Management in Europe: Trends and Innovations (List to be completed)*

Stefan Duchateau, CEO of KBC Asset Management, Brussels⁺*

Friday, 13 June, 2008

Commission Work

Session III and IV from 9.00–12.45

Session V and VI from 14.30–17.30

Submitted papers may address i. a. the following issues:

- Changing asset classes (e.g. real estate, commodities, derivatives)
- New investment strategies (e.g. structured products)
- Changing institutional structures (e.g. hedge funds, private equity)
- New paradigms of risk
- Expected returns and realized performance
- The role of leverage
- The New focus on Asset Liability management
- Central banks as asset managers (*should they become more active?*)
- Behavioural Finance
- The relationship with the trading industry
- Socially Responsible Investment?

Speakers for Commission II:

(List to be completed / + = invited speakers)

William De Vijlder, Managing Director, CIO, Fortis Investment Management Belgium, Brussels, *New Approaches to Asset Allocation*⁺*

Wim Vermeir, Dexia Asset Management, Brussels, *Performance Analysis of Sustainable Equity and Bond Investments*⁺*

◆ COMMISSION III:

Is there an optimal regulation for Asset Management?

Chairmen: **Franco Bruni**, SUERF Council of Management, and Professor of International Monetary Economics, Università Bocconi, Milan
franco.bruni@uni-bocconi.it

Wolfgang Gerke, President, Bayerisches Finanz Zentrum Munich
gerke@bfzev.de

Thursday, 12 June, 2008

Commission Work

Session I and II from 14.00–17.00

Friday, 13 June, 2008

Commission Work

Session III and IV from 9.00–12.45

Session V and VI from 14.30–17.30

Submitted papers may address i. a. the following issues:

- Impact of regulation on AM strategies
- Competition in AM through disclosure, transparency, taxation, accounting, distribution
- Issues in taxation and accounting
- Who should be the regulator? (national vs. international, central banks vs. regulation authorities, lead supervisor solution)
- Investment styles and financial stability
- Harmonization in the EU
- MIFID

Speakers for Commission III:

(List to be completed / + = invited speakers)

Colm Callaly, Head of Legal and Compliance, Pioneer Investments, Dublin, *Unifying the Market and Harmonising the Rules* (working title) ⁺*

René Geskes, Head Legal Affairs, Netherlands Authority for the Financial Markets, Amsterdam, *Regulation and AM: Local Supervision of a Global Industry*⁺*

Donato Masciandaro, Professor of Monetary Economics, Bocconi University, Milan, and **Marc Quintyn**, IMF, *Who and How? Financial Supervision, Asset Management, and the Market View: the Italian Case* (working title)⁺*

Fernando Restoy, Board Member, Comisión Nacional del Mercado de Valores, Madrid, *Challenges for Security Regulators from the Subprime Crisis* (working title)⁺*

Philippe Richard, Former Secretary General of IOSCO, Ville d'Avray⁺*

Andrea Vivoli, Manager of Supervision Department, Financial Intermediation, Banca d'Italia⁺*

The Official Conference Excursion

Saturday, 14th June, 2008 – 14.00 – ca. 22.00



For the afternoon of Saturday, 14th June, 2008 an optional **Official Conference Excursion** will be organized (guided bus-tour to the Chiemsee, boat trip to Herrenchiemsee with guided visit of the castle, closing with a dinner).

Partner Programmes

Thursday, 12th June, 2008 – 14.30 – ca. 17.30



In the afternoon of the 12th June, partners will be invited to attend a classical guided walk in the **historical part of Munich** with “Kaffee und Kuchen”.

In the evening partners may wish to join the Colloquium participants

at the Reception of the State of Bavaria (Staatsempfang) at the Residenz.

Friday, 13th June, 2008, 10.00 – ca. 18.00



On 13th June partners are invited to visit the famous **Schloß Neuschwanstein** (this will be a full day tour with a guided visit to the castle and with lunch).

Detailed information for all three excursions and Registration Forms will be available shortly.

More SUERF Events 2008



OESTERREICHISCHE NATIONALBANK
Eurosystem



SUERF Workshop

Jointly organized with the Oesterreichische Nationalbank and with the Austrian Society for Bank Research (BWG)

Commodities, Energy and Finance

3 March, 2008 , Vienna

Details will be available shortly from the SUERF website www.suerf.org



SUERF Conference
Productivity in the Financial Services Sector

Jointly organized with the Banque Centrale du Luxembourg

11–12 November, 2008 in Luxembourg (1½ day)

Details will be available in due time from the SUERF website www.suerf.org

Report on the 60th East Jour Fixe

*Central and Eastern Europe: Is Economic
Convergence on Track?*

and on the SUERF Annual Lecture by Paul De Grauwe

*Problems and Prospects for Enlargement of
the Eurozone*

The 60th East Jour Fixe on *Central and Eastern Europe: Is Economic Convergence on Track?* took place on June, 22 at the Oesterreichische Nationalbank in Vienna. It was organized as a joint event with this year's SUERF Annual Lecture. Economic convergence has been a long-standing issue in the European and in the global debate – both among policy-makers and in academia – and it certainly is of continuing relevance. In the course of the event the topic was analysed along three dimensions: real, structural and nominal convergence. In the first presentation, **Gábor Oblath**, member of the Monetary Council of the National Bank of Hungary and professor at the Corvinus University Budapest provided an overview on real convergence in Central and Eastern

Europe. Then, **Michael Landesmann**, Director of Research at the Vienna Institute for International Economic Studies and professor at the University of Linz elaborated on the topic competitiveness and structural convergence in Central and Eastern Europe. Finally, **Andrzej Slawinski**, member of the Monetary Policy Council of the National Bank of Poland and professor at the Warsaw School of Economics, gave an analysis on nominal convergence, focusing at the case of Poland. According to the speakers convergence has progressed especially since EU accession in 2004 but there are still some important challenges ahead relating to further structural, institutional and income convergence and also to the introduction of the euro.



In the following **SUERF Annual Lecture**, Professor **Paul De Grauwe**, Katholieke Universiteit Leuven, spoke about *Problems and Prospects for Enlargement of the Eurozone*. Building upon arguments from the theory of Optimal Currency Areas, De Grauwe argued that in terms

of trade integration, many of the New Member States fit better into the euro area than some of the existing Euro Area countries; by contrast, they are subject to more asymmetric shocks. Since the EU-27 does currently not form an OCA, widening of the euro area to 27 Member States would amplify already existing economic diver-

gence within the euro area and thus create tensions within the euro area which cannot be solved by the ECB's single monetary policy. Already among the present group of euro area countries, there are persistent economic imbalances, which, according to De Grauwe, call for monetary union eventually to be supplemented with political union. At the same time, the larger the EU, the more difficult political union will become to achieve. In the vivid ensuing discussion, this rather bleak view was challenged by some, pointing out, for instance, that Germany's current recovery shows that adjustment of the real exchange rate through wages and prices, while being slow, can work effectively over the medium run.

By **Thomas Schreiber** and **Josef Schreiner**,
Oesterreichische Nationalbank

Report on the SUERF and Bank of Finland joint Conference

Financial Markets, Innovation and Growth

by **Morten Balling**
SUERF Council of Management



On 20–21 September 2007, SUERF and Bank of Finland organized a joint conference in the House of the Estates, Helsinki. The theme of the conference was *Financial Markets, Innovation and Growth*. **Catherine Lubochinsky**, President of SUERF, **Sinikka Salo**, Member of the Board, Bank of Finland and **Jouko Vilmunen**, Head of Research, Bank of Finland welcomed the participants.

The first keynote speech was given by **Peter L. Rousseau**, Vanderbilt University. The title was *Financial Development and Economic Growth in Industrialized*

and Emerging Economies. The speaker reviewed studies and methodologies using cross-country, time series and panel studies that establish empirical links from finance to growth in the first place, and he described areas where progress is to be made. He referred to publications by McKinnon (1973), King & Levine (1993), Rousseau & Wachtel (2000) and others. Most empirical studies show strong correlations between financial variables and economic growth. The question is, however, in which direction the causation goes. In order to answer that question, the speaker presented a series of regression analyses, VAR models and GMM estimates for different samples

of countries and for varying data periods. Inflation seems to have an impact on the finance-growth nexus. Finance seems to be related to growth in the cross-section only for sufficiently low-inflation environments. Cross-country regressions with five-year averages of growth for 84 countries from 1960–2004, and then 1960–89 and 1990–2004 separately show weakening. Financial development may be beneficial if not done to excess, meaning that credit booms may lead to lower quality projects, more defaults and a higher incidence of financial crises. The speaker concluded that we have come a long way in documenting the link from finance to growth in the last 15 years. It has, however, become increasingly clear that cross-country regressions emphasize between country variation, rather than within country variation. Institutional and comparative analysis could better answer the question: “How would finance interact with the real sector to support growth?” This requires our future attention.

Ari Hyytinen, University of Jyväskylä and Bank of Finland chaired **Session 1**. **Michael Koetter**, University of Groningen and Deutsche Bundesbank presented the paper *The Quality of Banking and Regional Growth*, co-authored by **Iftekhar Hasan** and **Michael Wedow**. The authors test if output growth in European economic agglomeration regions depends on financial development. They suggest a relative measure of the quality of financial institutions. They use economic efficiency derived from stochastic frontier analysis in order to measure the quality of financial development. Evidence for a positive relation between banking quality and economic growth in regions of 23 member countries of the European Union is presented. Data on financial accounts for approximately 7000 banks active in the EU-25 between 1997 and 2003 are available from Bankscope. The authors conclude that the quality of financial development fosters regional growth significantly. Economic growth in the regions of the EU benefit obviously from higher regional profit efficiency. It is especially the quality of financial services provision in the vein of Schumpeter that spurs economic prosperity in Europe’s relative mature economic regions. The discussant **Cândida Ferreira**, Technical University of Lisbon, observed that according to many empirical studies, financial development may be an important condition for economic growth. The discussant asked if the banks included in the sample could be considered to be representatives of the banking systems in their respec-

tive countries and if they were similar with respect to specialization. An interesting result is that the proxy for the regional quality of financial institutions (profit efficiency) shows that more efficient banks clearly contribute to regional economic growth. The discussant agreed with the authors that the field deserves further attention.

Joaquín Maudos, Ivie and Universidad de València, presented the next paper: *Banking Competition, Financial Dependence and Economic Growth*, co-authored by **Juan Fernández de Guevara**. In the paper, the authors analyze whether ex-ante financial development facilitates access to financing and therefore enhances ex-post growth in the more financially dependent sectors. The approach allows, according to the authors, a robust test of causality by correcting for country and industry characteristics. The authors use a Lerner index of market power to test the impact of banking competition on economic growth. The results indicate that financial development promotes economic growth. They also show that bank monopoly has an inverted-U effect on economic growth, suggesting that market power has its highest effect at intermediate values. The discussant **Laurent Weill**, University of Strasbourg, observed that the measure of external financial dependence used by the authors was a measure of dependence to credit markets. External equity finance was not taken into account. The discussant also asked if the Amadeus Database is the best database for the investigation. The authors might decide to focus the paper on banks and/or test alternative specifications of the model. But, all in all, the discussant concluded that the authors have written a very interesting and clear paper and presented new empirical evidence on the role of financial development and more particularly of banking competition on growth.

Next, **Cilian Jansen Verplanke**, Rabobank, gave an invited speech: *Appetite for Risk: On the Financing of Innovative Firms*. Her point of departure was innovation in the Netherlands. Due to a high level of scientific research and a highly educated population, the current position of the Netherlands is good. Innovation is high on the political agenda. It is important to channel valuable knowledge from universities and colleges of technology to businesses. The Dutch Government prefers to provide support in the form of loan guarantees or government backing rather than subsidies. The majority of Dutch firms aim for a sustainable (and conservative)

growth path. They do not have a finance gap. Substantial economic growth can be attained by motivating a large number of companies with a sustainable growth path to aspire towards a higher growth path. Dutch companies are more restrained and less willing to take risks than US companies. The speaker mentioned different initiatives aimed at increasing economic growth. Companies may be stimulated to locate research oriented employees in so-called “open innovation” campuses. More flexibility on the labour market and in the educational system may be achieved by “social innovation.” Banks can contribute to this process by adapting their lending from risk-avoiding financing to risk-conscious financing and by developing a better understanding of entrepreneurs and their plans. Banks may also establish their own venture capital companies. They should develop a healthy appetite for risk.

Philippe Hartmann, European Central Bank delivered a Presidential Address: *The Role of Financial Markets and Innovation in Productivity and Growth in Europe* on the ECB Occasional Paper co-authored by **Florian Heider**, **Elias Papaioannou** and **Marco Lo Duca**. The authors argue that further financial sector reforms may be a valuable complement to ongoing efforts to reform labour and product markets. The paper analyzes the performance of European capital markets and their contribution to the performance of the European economies. Performance of a financial system has two basic dimensions: its efficiency and its stability. The speaker gave an overview of financial system concepts and their interrelations. The performance of financial systems depends on legal systems, financial regulation and corporate governance. The performance of the economy depends on the performance of the financial system. In order to analyze the efficiency of European financial systems, the speaker presented slides in which the size of capital markets, the enforcement of shareholder rights against self-dealing by corporate insiders, supervisory forbearance discretion and state ownership of banks were compared among 18 European countries. According to the indicators applied, Finland, Sweden and the Netherlands are the front-runners. The paper uses a Schumpeter-inspired measure of financial system efficiency: Speed of inter-sectoral capital reallocation. Plots and regressions document that total capital market size has a positive impact on the speed of inter-sectoral reallocation and consequently on the degree to which the financial system may affect productivity and economic growth. The degree of

investor protection has a positive impact on capital market size. Financial reforms that strengthen investors’ rights, enhance market transparency, fasten resolution of legal disputes, and improve the competition and efficiency of the banking sector may yield substantial productivity gains by increasing the breadth and depth of capital markets.

Session 2 was chaired by **Ulf von Kalckreuth**, Deutsche Bundesbank. **Torsten Santavirta**, Helsinki School of Economics presented the paper: *When do R&D Subsidies Boost Innovation? Revisiting the Inverted-U Shape*, co-authored by **Juha Kilponen**. The authors’ main concern in the paper is whether the effectiveness of R&D subsidies is conditional on the level of product market competition. Schumpeter-inspired theory suggests that R&D subsidies accelerate the rate of innovation at all levels of product market competition, but less so at high degrees of competition. This leads to an inverted-U shaped relation between degree of competition and average rate of innovation. Innovation intensity is measured by patent counts while competition is measured by the industry level Lerner index. R&D subsidies are measured by the direct industrial R&D grants to product development admitted by the national (Finnish) technology agency (TEKES). The empirical findings are in general compatible with an inverted-U shape relationship between patenting activity and degree of competition. The discussant **Nicolas Berman**, University Paris I Panthéon-Sorbonne and Banque de France, found the analysis interesting and clear. The authors apply accepted methodology and most of their coefficients are significant.

Next, **Nicolas Berman**, presented the paper: *Credit Constraints and the Cyclicity of R&D Investment: Evidence from France*, co-authored by **Philippe Aghion**, **Philippe Askenazy**, **Gilbert Cette** and **Laurent Eymard**. Using French firm-level panel data, the authors test the prediction that R&D investments should be more procyclical in firms facing tighter credit constraints. The database has been collected by the Banque de France. They find strong evidence of the role of credit constraints in making the share of R&D investment more procyclical. The effect is asymmetric, only observed during upturns. The R&D investment is lower on average when credit constraints are observed. By preventing the share of R&D investment from being countercyclical, credit constraints magnify the negative

impact of volatility on productivity growth and decrease overall productivity growth. The discussant **Eugenio Proto**, University of Warwick, put a question mark to the use of payment incidents as a proxy for credit constraints. Berman answered that the same approach had been applied by other researchers. He argued that there was an applicable correlation between payment incidents and credit constraints.

Session 3 was chaired by **Wim W. Boonstra**, Rabobank. **Jan Bena**, LSE presented the paper: *Which firms benefit more from Financial Development? co-authored by **Stepán Jurajda***. Financial development seems to help disproportionately those firms in EU 15 that face higher external finance costs or tighter financial constraints. The authors use firms' age or size as a proxy for information asymmetry, which gives rise to external finance costs. They ask whether younger/smaller firms grow faster in financially more developed countries conditional on all country and industry factors. The data sources are Amadeus and the World Bank Financial Structure and Economic Development Database. They find no difference in the effect of financial development by firm size but they do find an inverted-U impact of age difference. Smaller companies do not have unusual growth opportunities that are not realized because of financial markets. The discussant **Sami Torstila**, Helsinki School of Economics, praised the methodology applied. Since only companies with more than 100 employees were included, it might, however, be misleading to write about "small firms."

Laura Vartia, OECD presented the paper: *Regulation of Financial Systems and Economic Growth in OECD Countries: An Empirical Analysis*, published as OECD Economic Study, No. 42 and co-authored by **Alain de Serres**, **Shuji Kobayakawa** and **Torsten Sløk**. The authors use industry-level data from over 20 countries to examine whether industries that rely more heavily on external sources of funds grow more rapidly in countries where regulation allows for stronger competition in markets for banking services and financial instruments. They apply a Bank Regulation and Supervision Database and a Doing Business Database constructed by the World Bank. Overall, the results indicate that financial system regulation has a statistically significant influence on output and productivity growth. More competition-friendly regulation in banking and a stronger legal infrastructure have a favourable impact on output

growth. The discussant **Timo Korkeamäki**, Gonzaga University and Bank of Finland suggested that the authors should analyze low-regulation countries and high-regulation countries separately.



Paul Wachtel, New York University, gave the **Second Keynote Speech: *Tales of the Finance Growth Nexus***. The speaker gave an overview of the

development of growth theory since the 1940s. Early contributions by Harrod, Domar and Solow stressed investment/GDP ratios and technological progress. Later, the role of financial markets and their ability to allocate resources to sectors with growth potential came into focus. Ross Levine established consensus from cross country, time series and panel studies. Regression results regarding the finance effect on growth are, however, dominated by about 30 countries that have highly developed finance sectors. For other countries, the relationship is only measured imprecisely. The speaker compared the long term development in Credit to GDP ratios before, during and after periods of strong growth in a large sample of countries. Growth spurts tend to concur with financial deepening. There is only weak indication of deepening in advance of growth spurts. He concluded that the Finance Growth Nexus is alive and kicking and that research to examine the connections has a long way to go. An important research question is: Which institutions make the nexus happen and how?

Session 4 was chaired by **Már Gudmundsson**, BIS. **Laurent Weill**, University of Strasbourg, presented the paper: *Financial Intermediation and Macroeconomic Efficiency* co-authored by **Yves Kuhry**. The aim of the paper is to investigate the relationship between financial intermediary development and productivity. The authors apply a stochastic frontier approach to estimate efficiency in a panel of 41 countries for the period 1991-1995. The financial system is supposed to produce ex-ante information about possible investments and to provide a better allocation of capital. The system should also monitor firms, exert corporate governance and reduce transaction and information costs. Frontier efficiency methodology implies that each country is compared with the best-practice countries. They find positive coeffi-

cients for all financial intermediary development variables. Finance matters for macroeconomic efficiency. The Private Credit/GDP ratio is the most robust financial intermediary development measure influencing efficiency. The analysis supports policies favouring financial intermediary development. The discussant **Antti Ripatti**, Bank of Finland, remarked that the authors separated capital deepening from capital efficiency. Considering the strongly simplified assumptions, the empirical significance of the impact of the Private Credit/GDP ratio on growth was surprising.

Soeren Bo Nielsen, Copenhagen Business School, presented the paper: *Self Selection and Advice in Venture Capital Finance* co-authored by **Christian Keuschnigg**. Entrepreneurs are people with ideas but most of them lack sufficient capital and managerial experience. Venture capital (VC) firms are supposed to provide both financing and commercial expertise. The authors develop a simple theoretical model of entrepreneurial self-

selection and VC value added. The model includes the success probability, the parameters of the financial contract and the expected quality and surplus outcomes of start-up firms. The model rationalizes a simple form of convertible debt, one of the most widely used financial instruments in VC financing. The discussant **Otto Toivanen**, Helsinki Center of Economic Research, described the paper as very well-written. Screening is, however, not included in the model. In practice, VC companies always look at several projects simultaneously. Therefore inclusion of screening is essential. Soeren Bo Nielsen promised that screening will be included in the next version of the paper.

Jouko Vilmunen, Bank of Finland and **Ernest Gnan**, Oesterreichische Nationalbank and Secretary General of SUERF concluded the conference. On behalf of the organizers, they thanked the speakers, the discussants, the chairmen and all the participants for their contributions to a successful event.

News from the Council of Management

Brief Summary about the General Assembly held on 22nd June 2007 in Vienna

The following Observers to the Council of Management were elected for a three year term starting retroactively on 1 January 2007.

- **Jan Marc Berk**, Head of the Financial Research Department, De Nederlandsche Bank
- **Ernest Gnan**, Senior Adviser and Head Economic Analysis Division, Oesterreichische Nationalbank, and (Acting) Secretary General of SUERF
- **Már Gudmundsson**, Deputy Head of the Monetary and Economic Department, Bank of International Settlements

Additionally, **Willy Friedmann**, Head of the Economics Department, Deutsche Bundesbank, was re elected to the SUERF Council of Management for a further three year term, beginning on 1 January 2008, once his present mandate expires.

Since the last General Assembly in Lisbon, in October 2006, the SUERF Annual Lecture 2006 and 2007 had taken place, and a two day Seminar with the Central

Bank of Cyprus and the OeNB Special East Jour Fixe had been held.

Looking ahead to the remainder of 2007 and the start of 2008, the following events were announced:

A two day SUERF Conference with the Bank of Finland on *Financial Markets, Innovation and Growth* on 20/21 September, 2007 in Helsinki;

A conference *Tracking Financial Behaviour: Where do Macro and Micro Meet?* with Pioneer Global Asset Management on 3 December 2007 in Milan;

In 2008, planning is already at an advanced stage for the 27th SUERF Colloquium on *New Trends in Asset Management – Exploring the Implications*, to be held at the HVB Forum in Munich on 12–14 June 2008, sponsored by HVB, jointly organized with the Bayerisches Finanz Zentrum.

On the publications front, it has continued to be another busy period for SUERF, with three SUERF Studies being

published towards the end of the year and the first Study for 2007 having been published. For the first time we are due to have two books appearing, with the joint publication from the SUERF Conference with the Bank of Finland having appeared in the Spring and with work on the Proceedings of the 26th SUERF Colloquium in Lisbon also at an advanced stage.

The Secretary General reported on behalf of the Treasurer that SUERF remains greatly dependent on revenues from Membership payments and therefore the issues of membership and attracting new members are addressed at every Council Meeting. In 2006 receipts from membership fees stood at approx. € 110,000, with our forecast based on targets for 2007 being just over € 120,000. To date we have managed to attract a number of new Corporate Members and are actively trying to recruit further ones. A substantial number of our Personal Members have payments outstanding – if they pay up we should meet our target for level of membership for them.

The Minutes of the General Assembly will be sent to all Members with the invitation for the next General Assembly to be held in Munich on 13th June 2008.

Words of thanks to leaving Councils and welcome of new Observers



It is with a very real sense of regret and sadness that we have to announce that **John P. Calverley** has decided to step down as a member of the Council of Management. This is because he has relocated to Canada although he will remain as Chief Economist and

Strategist at American Express Bank. His original strong preference and intention was to continue as a member of the Council. However, he has judged that this will not in fact be practical given his other professional commitments and the logistics involved.

John has been a very real personal and professional friend to SUERF and to his colleagues on Council. John joined the Council of Management in 1997 and has been a loyal and active member over the past ten years. He

has given outstanding service in many ways. In addition to his personal input, John has often been instrumental in securing financial support for SUERF from American Express Bank.

John was totally committed to SUERF and its objectives and contributed to its activities in many ways including writing a very successful SUERF Study on emerging stock markets. He was a very active member of Council and we could always rely on his wise counsel and sound advice. He took an active role in SUERF Colloquia planning and administration and has for some time also been a member of the Editorial Board.

John will be greatly missed both by all members of SUERF but most especially by his friends and colleagues on the Council of Management. We have all greatly admired his contributions to the work of SUERF and the Council but most especially with the calm, professional and friendly way he contributed to Council meetings. As with John himself, we all hoped that, despite his re-location to Canada, it would have been possible for him to continue to serve on Council. When he discussed the issue with colleagues we were unanimous in making it clear that we very much wanted him to continue if this would be possible. In the event John has judged that this has proven not to be practical. With customary loyalty and dedication, he judged that if he could not guarantee being able to attend several meetings each year, he would prefer to step down.

John has been an outstanding member of Council and his colleagues, and the SUERF membership, owe him a great deal. Although we all wish he had been able to continue, we respect his judgment that this might prove not to be feasible. He has said that he will remain a strong supporter of SUERF and his colleagues have every confidence in this.

On behalf of all members, we wish John and his wife every success and happiness in their move to Canada and we look forward to welcoming him at future SUERF events.

David T. Llewellyn
SUERF Council of Management



In the summer **Fernando Restoy** left his position as Director of the Monetary and Financial Studies Department at the Banco de España to take up a new position as Board Member of the Spanish National Securities Exchange Commission (CNMV), and decided to stand down

from Council to allow the Banco de España the opportunity to continue its long-standing support for SUERF by nominating a candidate to become a member of the SUERF Council of Management.

Fernando has assured us, however, that he will not completely disappear from SUERF's activities, and hopes to actively participate in future SUERF events, whilst his new institution have decided to become a Corporate Member of SUERF. The SUERF Council of Management would like to extend its thanks to Fernando, who has been a very active member of Council, having been heavily involved in the organisation of the very successful 25th SUERF Colloquium in Madrid in 2004, and wishes him well in his new position and personally.



The SUERF Council of Management is very pleased to announce that **Juan Ayuso** has accepted the SUERF Council of Management's invitation to serve on the Council, joining initially as an Observer.

Juan was born in 1964 in Madrid, and holds a Master in Economics and Finance from CEMFI and a PhD in Economics from the Universidad Complutense de Madrid. He joined the Banco de España in 1990 and was appointed Director of the Monetary and Financial Studies Department in August 2007, having previously been the Head of the Financial Studies Division at the DG Economics, Statistics and Research.

Juan is also a Member of the Monetary Policy Committee of the Eurosystem; Member of the OECD

Committee on Financial Markets; Co-Director of Moneda y Crédito; Co-Editor of Revista de Economía Financiera; Member of the Editorial Board of Investigaciones Económicas. For more details see please his CV under www.suerf.org – Council of Management.



The SUERF Council of Management is also very much pleased that Professor **Beat Bernet** accepted the invitation to become an Observer in the first instance. Beat Bernet is since 1996 full Professor for Banking at

the University of St. Gallen and managing director of the Swiss Institute of Banking and Finance. From 1999 to 2001 he served as dean of the university's Business Administration faculty. He is a board member of stock market listed banks and financial institutions. Beat graduated from the University of Zurich where he also received his Doctoral Degree in Economics.

Previously he was affiliated with Arthur Andersen, Zurich, and with Bank Vontobel, Zurich. Back in 1983 he founded a consulting company, Bernet & Partner, in Zug, which today is regarded as a leading think tank in financial services management in Switzerland. He is also co-owner and chairman of the board of a medium-sized international technology group.

His main research interests focus on 'evolution of financial services markets', 'bank strategic management', and 'bank business models'.

Ernest Gnan, Secretary General

SUERF Council of Management

Catherine Lubochinsky, President
Ernest Gnan, Acting Secretary General

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Franco Bruni

Willy Friedmann
Már Gudmundsson
Ryszard Kokoszczynski
Frank Lierman
David T. Llewellyn
Juergen Pfister
Marc-Olivier Strauss-Kahn

For complete addresses of the Council Members and Curricula vitae see: www.suerf.org

Book Review • Book Review • Book Review



Central Bank Reserve Management: New Trends from Liquidity to Return

Edited by Age F.P. Bakker and Ingmar R.Y. van Herpt

Edward Elgar Publisher, 2007, 272 pp. Hardback, 978 1 84542 957 7 – online discount £ 62.96

Part I: The Size of Central Bank Reserves
Part II: Reserve Management: Return Versus Liquidity
Part III: Implications for Central Bank Balance Sheets References Index

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In 2006 global foreign reserve holdings exceeded US\$ 5 trillion or 10% of world output. Their rapid growth at an annual average rate of 16.4% since the turn of the millennium reflects the so-called global imbalances with high current account deficits in the USA and persistent surpluses in some Asian and oil-exporting countries.

The sustainability of this development and the risks emanating from it are discussed widely in the literature and have become a focus of international economic policy. This book approaches the subject from a central bank's point of view by dealing with the problem of central bank reserve management in a changing economic environment. It collects a comprehensive range of articles by central bankers and financial market practitioners who contribute their experience and expert knowledge to the debate. The extremely informative introductory chapter written by the editors gives an overview of the issues discussed and helps readers to find their way through the variety of interesting articles that follow.

The volume is organised into three parts. The first deals with the optimal size of central bank reserves, considering the costs and benefits of foreign exchange reserves. Partisans of the Bretton Woods II hypothesis argue that foreign reserves in some surplus countries serve as collateral for inward FDI. The principal conclusion of the essays presented in this book, however, is that foreign reserve holdings in Asia now surpass appropriate levels. A special feature of this book is that it brings together perspectives from various countries and institutions. Irrespective of their individual background, all of the authors agree that additional reserve accumulation in many countries is becoming more and more costly but there is no corresponding benefit.

The second part of the book takes the amount of reserves as given and turns to the question of how a central bank should react in the face of growing reserve assets in its balance sheets. The traditional perception that reserves function as a contingency buffer implies that the portfolio must meet the highest standards of safety and

liquidity. This policy, however, is associated with a waiving of higher returns. The consideration that the part of foreign reserves which is not needed for interventions should be invested in higher yielding assets, seems to be straightforward. As Jennifer Johnson-Calari, Roberts Grava and Adam Kobor argue, the diminishing motive of defending the exchange rate also permits a higher diversification of foreign reserve which reduces the currency risk and brings higher risk-adjusted returns.

Hans-Helmut Kotz and Isabel Strauss-Kahn, on the other hand, point to the conflicts that may emerge between higher returns and monetary policy, which is the core business of a central bank. This leads them to advocate a conservative approach that minimises risks – thereby using modern analytical techniques and financial instruments. Given the high opportunity costs resulting from such a strategy, it may be advisable for the Eurosystem and advanced economies with moderate levels of reserves. However, it does not solve the dilemma of central banks that have to deal with “super-size” reserves.

If the exchange rate system is taken as exogenous and a possible influx of foreign reserve assets is not up for discussion, the trade-off between the specific constraints of a central bank and the desire for higher returns may be mitigated by splitting reserves into a (conservatively-managed) liquidity portfolio and a (return-oriented) investment portfolio. The most consistent variant of this strategy is to outsource the investment portfolio to a sovereign wealth fund.

Amy Yip of the Hong Kong Monetary Authority describes in a concise article how the Exchange Fund of Hong Kong, under the aegis of the Hong Kong Monetary Authority, has managed foreign reserves since 1935 in a changing political and economic environment. The case of Hong Kong is extremely interesting since it combines the high quality standards and strict institutional arrangements of a currency board with a highly efficient and market-oriented portfolio management. Other authors describe the experience of economies as different as India, the Czech Republic or the Eurosystem.

Joachim Fels takes the market perspective when he makes clear that, while a broader diversification of official reserves makes sense in principle, this is not the right time for exiting the dollar. An important constraint to the foreign reserve management of central banks is the fact that their market operations have an impact on

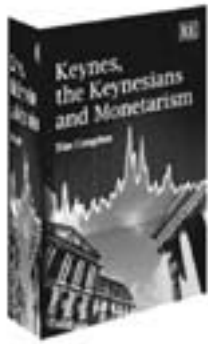
exchange rates and asset prices, not only because of the sheer size of official reserves, but also because of the signals they might send.

A similar aspect is put forth by Robert Litterman who introduces some concepts of the financial literature. He distinguishes between returns of risky assets that exceed the risk-free rate as a remuneration of *market exposure (beta)* and an *active risk exposure (alpha)* that can only be achieved by skilled investment management that outperforms the market. Since *alpha* is a zero-sum game, central banks should limit themselves to a passive portfolio management, which nevertheless would be associated with a substantial increase in returns compared with a traditional administration of foreign reserves.

Part three of the volume comprises contributions that deal with the implications for central bank balance sheets. Even if monetary policy considerations impose only few direct constraints on the balance sheet, the rising demands on asset management necessitate clear and transparent governance rules. Of special importance are a clear profit distribution agreement with the government and adequate capitalisation rules. They are prerequisites for the mitigation of reputation risks when central banks apply modern asset management techniques and invest in complex financial assets. The need for a strong institutional framework is also stressed by Hervé Ferhani who refers to the increase in volatility in central bank balance sheets that results from rapid reserve accumulation and the greater mobility of capital flows.

In summary, this book gives an excellent insight into a subject of high economic and political relevance. The articles are written by experts with extensive experience in theory and practice. They address central bankers, academics, and all those who have some knowledge of economics and are interested in learning about the changing tasks for central banks against the background of increasing capital flexibility and growing worldwide foreign exchange reserves.

**Reviewed by Dr Axel Jochem, Economist,
Deutsche Bundesbank**



Keynes, the Keynesians and Monetarism

By Tim Congdon

Edward Elgar Publisher, Cheltenham, U.K., 2007, 360 pp, Hardback,

978 1 84720 139 3, on-line discount £63.96, also available as an e-book – 978 1 84720 692 3

Professor Tim Congdon is a well-known economist, probably best known as a former head of Lombard Street Research and a member of the

British Shadow Monetary Policy Committee (affiliated with the Institute of Economic Affairs). He retired from Lombard Street Research to devote more time research and writing and this collection of his papers is one of the products of his new occupation. These papers had been originally written between 1975 and 2006, though majority of them were updated and/or revised to make the whole collection a more consistent and smooth reading.

Six parts of the book cover many diverse issues. Firstly, Congdon argues that a great number of British economists calling themselves the Keynesians promoted in the several post-war decades many ideas Keynes himself would rather distance himself from. The major reason for that assessment is the fact that “the British Keynesians of the 1960s and 1970s saw the inflationary process as almost exclusively a question of ‘cost-push’” (p.34) and “Keynes regarded inflation as an excess demand phenomenon” (p.36).

The next part of the book is another exercise in debunking as it denies that Britain had a Keynesian revolution. Congdon states that, between the 1940s and the 1970s, both the conceptual framework of the British macroeconomic policy and its actual conduct were far from the true Keynesian model, though both included some individual components of Keynesian nature. Keynesian revolution is understood here as an active fiscal policy promoting ‘full employment’. Congdon’s argument rests on an outcome of a simple empirical exercise showing that the budget deficit did not vary inversely with the output gap in the period 1948-1974. His conclusion, after studying both data and documents from that period is that “over at least the first two-thirds of the period from 1945 to the mid-1970s, fiscal policy was not Keynesian in the normally understood sense. The trend level of the budget deficit was determined by (...) sustainability of government debt relative (...) to national income (...).

Policy-determined variations of the deficit around this trend were largely motivated by the balance of payments and the state of the pound” (p.88).

Third part of the book is fully devoted to the basic issue of defining monetarism and compares its British and American version. The first essay in this part introduces a novel dimension to the issue, e.g. the broader political context of monetarism. Congdon identifies here some close links between monetarism, liberalism and conservatism. The second one shows some differences between American version of monetarism (as defined by M. Friedman and Th. Mayer) and its British counterpart. The most important distinctive features of the latter were the selection of broad money as the intermediate target of monetary policy; a belief that fiscal policy should be made consistent with monetary policy, and the avoidance of any specific exchange rate objective. Some of them were the natural consequences of various features of the respective economies (independence of the Fed from the Treasury in the US, the UK being more open economy than the US), some were simply idiosyncratic.

Part IV brings back the debate on the 1981 Budget between Tim Congdon and Stephen Nickell complemented nicely with new elements added to this exchange in 2006. Part Five tries to answer the question, whether the remarkable stability of the British economy between 1992 (beginning of the inflation targeting regime) and 2006 can be interpreted as the success of monetarism. Finally, in Part VI (under the apt title How the Economy Works) Congdon presents explicitly his view (implicitly present in the whole book) on the monetary transmission mechanism in which the quantity of money strongly influences asset prices and economic activity.

There are several features of this book I found interesting, informative and notice-worthy. I read with a great interest a history of an evolution of conceptual background to British macroeconomic policies in the post-war decades. It debunks quite a few of old myths and its very informative.¹ Some of these features are of a more general nature. Firstly, quite a few essays from the book I review here show how often there is a big gap between

various labels applied for economists, their doctrines and policies recommended by them and the true substance thereof. The Keynesians promoting ideas Keynes knew nothing about or monetarist policies based on interest rate are only some of possible examples. That requires a thoughtful analysis of past and present policymaking.² Second, many economic controversies have in their root too fuzzy concepts accompanied by the lack of proper facts and data. Congdon-Nickell debate is a very nice example how bringing detailed analysis into debate brings also its participants much closer to each other.

Some essays in this book, mostly from the last part, promote ideas known already from Congdon's publications (i.e. *Money and Asset Prices in Boom and Bust*, London 2005, Institute of Economic Affairs). Congdon subscribes to the active money paradigm, which does not belong to the current mainstream. It may be difficult not to agree with his view that broad money plays some role in the determination of asset prices, however it is difficult for me to agree that changes in broad money are exogenously driven results attributable to central banks policy actions. Of course, if Congdon's claim is simply that we should pay attention to information broad money possibly contains for asset prices and the broader economic activity, then this finds no objections. However, I would strongly oppose the idea of monetary policy tar-

geting specific rates of growth of broad monetary aggregates because of well known reasons belonging now to the standard exposition of macroeconomic textbooks (financial deregulation resulting in the instability of money multiplier, in short).

This criticism notwithstanding, I strongly recommend *Keynes, the Keynesians and Monetarism* to all serious students of history of the British policymaking during last five decades and to all readers (economists and non-economists alike) interested in the interaction between economic ideas and economic policies, economists and policymakers.

References: B. Clift, J. Tomlinson (2007), Credible Keynesianism?: New Labour Macroeconomic Policy and the Political Economy of Coarse Tuning, *British Journal of Political Science*, 37(1), 47-69.

M.J. Oliver (1998), From Anodyne Keynesianism to Delphic Monetarism: Economic policy-making in Britain, 1960-79, *Twentieth Century British History*, 9(1), 139-150.

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¹ Oliver and Pemberton (2004) present a very impressive theoretical explanation of this evolution.

² Oliver (1998) shows also some of these issues in his review of some historical studies, as Clift and Tomlinson (2007) do for the more recent developments in the UK policies.

³ The views expressed in this review are those of the author and should not be interpreted as those of the National Bank of Poland.

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