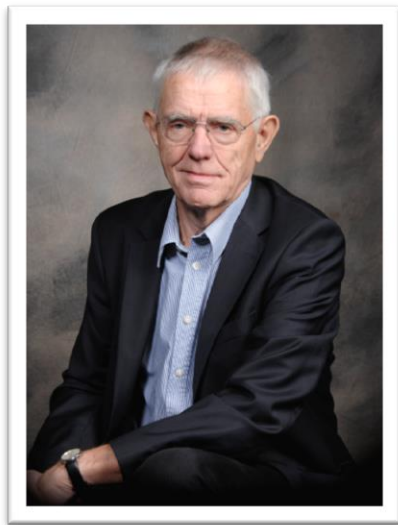


Mind the Gaps

Speech given by Morten Balling, Professor Emeritus, Department of Economics, Aarhus University, on the occasion of receiving the SUERF Honorary Membership Award, at the 33rd SUERF Colloquium, Helsinki, 14 September 2017.



Morten Balling
SUERF and Aarhus University

First of all, I want to thank Urs Birchler and my other colleagues in the SUERF Council of Management for giving me this honour. SUERF has been an essential part of my professional life for about 40 years – in the last 23 years as a Council member. To become an honorary member means a lot to an old economist like me. It has been a great privilege to work with clever people in the Council of Management.

When thinking about what we have been doing in all those years, I came up with the idea that I could refer to the London Underground. Just before you enter a train in the London Underground, you can read a warning on the platform: “Mind the gap”. It means that you should take care before you take the next step. In the context of the SUERF Council of Management, the next step is often the choice of topic for the next event or publication or the choice of speakers to invite. There are a lot of gaps to consider in the financial universe in which SUERF operates. Many of our activities can be interpreted as efforts to understand those gaps and to build bridges across them. At SUERF events, we should often aim at a balance between two sides of a gap.

We should always mind the gap between the thinking of academics and the thinking of financial practitioners. These two constituencies in SUERF's membership share a deep interest in monetary and financial matters, but they look at them from different perspectives. Academics are – as other people – focused on their own career opportunities. Many of them navigate by looking at universities' promotion policy. University deans look at researchers' publication performance, and they consider publication in highly ranked journals as essential. So, academics with university ambitions focus in their choice of topic and research strategy on the scientific quality criteria applied by editors of journals like *Journal of Finance*, *Review of Financial Studies*, *Journal of Financial Economics*, *American Economic Review* and *Econometrica*. Practical relevance is not necessarily a high priority for these editors, but it should be for academic SUERF members. Many academics want to analyze and to construct econometric models, which help them to understand and explain the functioning of financial markets and institutions. Financial practitioners from central banks want to develop monetary policy instruments aiming at inflation targets, exchange rate targets, systemic risk or financial stability. Bank managers in the private sector want to develop efficient business models that allow them to provide financial services to corporate, institutional and retail customers and to give their shareholders an attractive return on equity. Institutional investors are focused on portfolio returns and management in securities markets. Obviously, these groups (SUERF constituencies) can learn from each other. And it is in fact SUERF's *raison d'être* to provide the best possible framework for bridge building over the gaps between them and to facilitate their mutual understanding. Some Council members are especially qualified bridge builders because they have working experience from both sides of the gap. Invitations to outstanding speakers approached through SUERF's personal network and well prepared lists of topics and research questions are crucial for inspiring bridge building discussions of fundamental issues in the monetary and financial universe.

We should in SUERF mind the gap between regulators and financial managers. The Basel recommendations and core principles concerning capital adequacy, liquidity and leverage ratios, supervision and transparency have been on SUERF's agenda again and again. So have EU Directives and Regulations and regulation worldwide inspired by the Basel recommendations. Regulators look at those recommendations as instruments to provide robustness and resilience in the financial sector and ways to reduce systemic risk. Bank managers tend to look at the implied costs of regulation and compliance and to see constraints on capital structure and funding decisions as obstacles to improving return on bank equity. At several SUERF events, efforts have been made to narrow the gap between regulator views and manager views.

We should mind the gap between the views of bond investors and bond issuers. They look at covenants and collateral requirements with different eyes. Bond investors regard such provisions as safeguards that reduce risk, while bond issuers regard them as unwelcome restrictions on financial behavior that may hamper business opportunities. An especially important gap of this kind is relevant in connection with issues of Government debt. We should thus mind the gap between the views of finance ministers in surplus countries and the views of politicians in deficit countries. The EU Stability and

Growth Pact contain limits on debt/GDP ratios and provisions concerning excess deficit procedures, and it is not surprising that there are gaps between the views of for instance German and Greek politicians on such provisions.

Minding the gap between bank depositors and bank shareholders have in recent years been important in discussions at SUERF events about bank resolution models.

Then there is a need to mind the gap between insiders and outsiders in listed companies including listed banks. Several SUERF events have dealt with corporate governance issues. Transparency and disclosure rules have been important elements in bridge building here. Asymmetric information plays an essential role on stock exchanges and in finance in general.

In discussions of bank failures, bail-outs and bail-ins we should mind the gap between taxpayers and bank shareholders. The crucial question to ask is: "Who should carry the risk of losses?" When answering the question, incentives should never be forgotten, when rules are designed. Risk has an important disciplining role. We should mind the gap between people exposed to risk and people protected against risk. If you are exposed to risk, you have an incentive to take care. If you expect to profit from a transaction but can rely on taxpayers to carry possible losses, you may become careless.

In SUERF, we should mind the gap between protectionists and supporters of free trade. A few years ago, it seemed that international trade agreements and repeal of cross-border capital restrictions had ensured the creation of a globalized world with free movements of goods and services, capital and people and with exploitation of comparative advantages to the potential benefit of all. The Brexit referendum in June 2016 and the election of Donald Trump as US President in November 2016 have changed that. Free trade agreements are now given notice to terminate, and plans for building physical and customs walls are made. In 2001, SUERF published a conference volume titled: "Adapting to financial globalization". In the years to come, SUERF may organize a conference and publish a book on "Adapting to European Disintegration" or "Adapting to new international trade and capital restrictions". An old SUERF Council Member like me look at these perspectives with some sadness. It gives me, however, some comfort that I have the strong conviction that SUERF will survive. It is in my view certain that the Council of Management will have to mind several important gaps in the future. I wish them luck. I am confident that they will follow the tradition of dealing with all relevant gaps in an intelligent way.

At the end of the year, I leave the Council because of my high age. I am grateful for my years among my Council colleagues and for my honorary membership. Thank you for extremely interesting discussions. I will miss you, but I will still participate in some SUERF events and may be also contribute on a modest scale to SUERF's publication activity. Let me conclude with special thanks to Dragana, Heidrun and Ernest for your never failing kindness and support during several years.