MONETARY AND FINANCIAL THINKING IN EUROPE

EVIDENCE FROM FOUR DECADES OF SUERF

By Jean-Paul Abraham

Introduction
by David T. Llewellyn

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CIP

Monetary and Financial Thinking in Europe – Evidence from Four Decades of SUERF

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TABLE OF CONTENTS

Introduction (D.T. Llewellyn) 5

A Short Reader's Manual 90

Part 1: A Survey of SUERF Colloquia Publications 1969-2003 (J-P. Abraham) 11

Section 1: An Overall Presentation 13

Section 2: Major Events, Dominant Themes and Outstanding Contributions in Five Distinct Periods 19

Period I: 1969- early 1974: The Demise of the Bretton Woods International Monetary System 19

Period II: Late 1974- early 1979: the Aftermath of Oil Shocks and Bank Failures 21

Period III: The Eighties: Disinflation, Exchange Rate Stabilisation, 'Marketisation' of Banking and Finance 24

Period IV: The Nineties: The Dominance of (unstable) Markets. The New Europe after Berlin and Maastricht. The strenuous but successful Road to EMU 28

Period V: 2000-2003: Adjusting West, Converging East? 37

Section 3: Constants and Change Through Four Decades 51

Constants 51

Change 54

References 67

Part 2: An Anthology of SUERF Colloquia Publications 1969-2003 (J-P. Abraham) 69

SUERF Colloquia and Colloquia Publications 1969-2003 in Figures and Locations 71

Colloquium 1: The Future of the International Monetary System 73

Colloquium 2: Monetary Policy and New Developments in Banking 75

Colloquium 3: Aspects of European Monetary Union 77

Colloquium 4: Multinational Enterprises – Financial and Monetary Aspects 83

Colloquium 5: Floating Exchange Rates – The Lessons of Recent Experience 85

Colloquium 6: The Development of Financial Institutions in Europe 1956-1976 89
Colloquium 7: New Approaches in Monetary Policy 93
Colloquium 8: Europe and the Dollar in the World-Wide Disequilibrium 99
Colloquium 9: Bank Management in a Changing Domestic and International Environment 105
Colloquium 10: International Lending in a Fragile World Economy 111
Colloquium 11: Government Policies and the Working of Financial Systems in Industrialized Countries 117
Colloquium 12: Shifting Frontiers in Financial Markets 123
Colloquium 13: International Monetary and Financial Integration – The European Dimension 129
Colloquium 14: The International Adjustment Process – New Perspectives, Recent Experience and Future Challenges for the Financial System 137
Colloquium 15: Financial Institutions in Europe Under New Competitive Conditions 145
Colloquium 16: Fiscal Policy, Taxation and the Financial System in an Increasingly Integrated Europe 151
Colloquium 17: The New Europe – Evolving Economic and Financial Systems in East and West 159
Colloquium 18: The Competitiveness of Financial Institutions and Centres in Europe 167
Colloquium 19: Risk Management in Volatile Financial Markets 177
Colloquium 20: Corporate Governance, Financial Markets and Global Convergence 187
Colloquium 21: The Euro – A Challenge and Opportunity for Financial Markets 197
Colloquium 22: Adapting to Financial Globalisation 207
Colloquium 23: Technology and Finance Challenges for Financial Markets, Business Strategies and Policy Makers 217
Colloquium 24: Stability and Efficiency of Financial Markets in Central and Eastern Europe 233

SUERF – Société Universitaire Européenne de Recherches Financières 245

SUERF STUDIES 246

INTRODUCTION

by David T Llewellyn, SUERF President

With great foresight, SUERF was founded in 1963 by Professor Pierre Tabatoni (University of Paris) and Jacques Branger (Director General of the Caisse Nationale des Marchés de l'État – CNME). It was founded as a Europe-wide forum with the aim of bringing together professionals from banks and other financial institutions, and from academia, allowing academics and practitioners the opportunity to exchange their views and to interact on common areas of interest. In 1969, central bankers joined to form a third "pillar", being on the one hand a natural enlargement, and on the other hand securing SUERF a sounder financial footing. From the outset it was judged that, through the unique perspectives that the main constituents of SUERF represent, it has the capacity to make significant contributions to research, scholarship and understanding of key issues in public debate about monetary and financial policy, and trends in banking and financial markets in Europe. This was, and remains, the central mission of SUERF. The Mission is to offer a forum for high-quality and informed analyses of key issues in European money and finance.

To mark the 40th anniversary, the Council of Management judged that it would be appropriate and valuable to commission a special anniversary volume. SUERF is a dynamic and evolving institution and has changed markedly over the years, including its name which has recently been modified to *SUERF: The European Money and Finance Forum*. However, the Council decided that it did not want a self-indulgent history of SUERF itself but rather a reflective view of evolving monetary and financial thought as seen through the choice of topics in SUERF Colloquia and the papers presented and published in its Colloquia volumes.

The Council was all too well aware that, given that there have been 24 Colloquia and 22 Colloquia volumes containing 462 individual contributions by close on 500 distinguished authors covering over 8000 pages, this would be a formidable task. Without any hesitation, it was unanimously decided that Jean-Paul Abraham would be the ideal person to undertake this project. Professor Abraham was, in many respects, eminently qualified to undertake the venture and the Council was very pleased that he willingly agreed. Jean-Paul has been a constant in the evolving history of SUERF. He is a distinguished academic and, in his illustrious career, has also been a distinguished European banker. He has therefore represented two of the three main constituents of SUERF. His eminence to undertake the task is also highlighted by the fact that he was a founding member and also a distinguished past-President of SUERF in the period 1994-1997. Over and above that, his dedication to, and support of, SUERF has been exemplary and unsurpassed.

On behalf of the Council of Management, and all members of SUERF, I should like to record deep gratitude to Jean-Paul for undertaking this Herculean task for everyone who has an interest in SUERF and what it stands for. He has produced a fascinating survey. In the process, he has made a formidable contribution which I am confident will be of interest and value to financial practitioners and academics who have an interest in the evolution of monetary thought and practice, and the development of financial institutions and markets. It could not have been done better. We owe Jean-Paul a great deal for what he has produced and the insights he offers in this volume.

The following pages relate solely to SUERF Colloquia and do not include other contributions of SUERF through, for instance, its seminars, annual SUERF lectures, *SUERF Studies* and other publications. SUERF Colloquia (which take place over a period of two and a half days) follow a common format: a series of Keynote Lectures given by distinguished academics and practitioners (including very many Governors of Central Banks), papers presented in three parallel Commissions, and the Marjolin Lecture. In the words of Professor Abraham below: "...the contribution of the Colloquia has been to offer a forum for spreading the information and confronting the views of high-level policy makers with the findings of the research done not only in academia, but also in the research departments of various institutions".

The organisation of the Colloquia present demanding challenges and, on behalf of the Council of Management, I would like to take this opportunity of thanking all those who, over the years, have unstintingly contributed so much behind the scenes to making SUERF Colloquia so very successful. I cannot recall any other association in Europe that, over a period of 40 years, has maintained such a high and continuous standard of informed analysis of European monetary and financial issues. This is surely testimony to the enduring strength and value of SUERF. The constant and powerful support of central banks, financial institutions, and academics demonstrates that SUERF clearly “adds value”. That is what we strive to do. It is gratifying that the support of the constituents demonstrates its enduring value. SUERF is, above all, a “member organisation” which relies on the support and enthusiasm of its members. This support has never failed.

The past forty years have witnessed substantial changes in all aspects of European and international finance with many changes in both the international and domestic architecture and monetary regimes. The “business of banking”, and the operation of financial institutions and markets, have also changed out of all recognition. In reviewing these changes as seen through the contributions to SUERF Colloquia, Jean-Paul has produced a fascinating study which highlights how monetary thought and practice have evolved over almost half a century. He has focussed on the key issues discussed at Colloquia and on how thinking and practice of financial markets and institutions have evolved over the period since the early 1960s. It is also clear from his analysis that it has been the “force of events” rather than changing theory that has shaped the programmes of Colloquia over the years. However, and as Jean-Paul himself notes, “if academic thinking and theorising have seldom played a dominant role in the choice of topics, they strongly continued to highlight the basic issues at stake and to analysing them in a solid analytical framework.” This is one of the major strengths of the association.

We must also be struck by the consistent high quality of the contributions at Colloquia. Looking back, many of the papers have been very prescient and authored by people who have themselves shaped events. Above all, it is interesting to read the different perspectives of the three main constituents of SUERF each of which has always been powerfully represented at each Colloquium.

Over the past forty years there have been enormous changes in the international monetary systems, the role of private markets and institutions, and in European monetary arrangements. Jean-Paul’s volume provides an excellent set of insights into the nature, causes and implications of these changes. The text also creates a strong impression about SUERF and the contribution it has made through its choice of Colloquia topics and the quality of the many papers presented at them. We look forward to this continuing over the next forty years.

Loughborough, July, 2003

A Short Reader's Manual

1. *Part 1, the Survey:* Section 1 is intentionally written in the first person singular *(I, me, my)* because it presents the basic choices made by the author in devising his essay. Section 2 and 3 are written in the first person plural (*we, us, our*), suggesting a more general analysis, except where a strictly personal opinion is expressed (*in my opinion*).

2. *Part 1, Survey*: Being written on the same documentary base as the quotations of Part 2, Section 2 and 3 unavoidably contain some duplications and repetitions. Each of these two sections can be read separately. Readers primarily interested in catching '*l'air du temps*' of a specific period will probably prefer the synchronic approach per period in Section 2. Those focusing on developments through time will be more interested in the diachronic view of Section 3.

3. *Part 2, Anthology ('The SUERF Book of Quotations'):* All the quotations are presented in the language, the spelling and the syntax of the original text, except those referring to the 2003 Tallinn Colloquium, the Colloquium Book for which had not been published at the time of writing. In this instance, the quotations have been drawn from unrevised manuscripts, which sometimes needed some adjusting.

- Some quotations link excerpts from different paragraphs and sometimes even different pages of the same article. Each excerpt is separated from the next one by use of suspension points – "..."

- Titles and functions are those indicated in the relevant Colloquium Book. Consequently, they refer to the title and the functions of the author at the time of the Colloquium. So, for the first quotation from the first SUERF Colloquium (C1, Tilburg 1969) the reference to the author should be understood as: *Robert Russell (at the time of the Colloquium) Assistant Professor of Political Science Wisconsin State University...*

- The page number after each quotation obviously refers to the page number in the Colloquium Book under review.

4. References:

- References to the quotations in the Anthology are indicated as *Q under C1, C2* etc.

- The other references are listed at the end of the Survey Part.

5. Some abbreviations:

abbr. indicates an abbreviation of the original text,
e.g. (exempli gratia), indicates an example given in the original text itself,
ibid. (ibidem) in the same place or text,
i.e. (id est) indicates an explanation added to the original text,
p.m. (pro memoria)

MONETARY AND FINANCIAL THINKING IN EUROPE

EVIDENCE FROM FOUR DECADES OF SUERF

Part 1

A SURVEY OF SUERF COLLOQUIA PUBLICATIONS 1969-2003

"... Non è vero che le idee sono sempre innocenti ..."
(Enzo Biagi, Addio a questi mondi, 2002)

In memory of my best friend ever, Prof. Fernand Nédée (1930-1980),
A driving force of the Paribas Group in Belgium in the late Sixties and in the Seventies,
On the twenty-third anniversary of his untimely death...

Jean-Paul Abraham
President of SUERF 1994-1997
Professor (em.) Universities of Namur and Leuven and College of Europe (Bruges), Former Executive Director Paribas Bank Belgium.
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3rd August 2003

Section 1: An Overall Presentation

"...SUERF is a rather unique institution. Every eighteen months it brings together academics, practitioners and public officials to discuss financial and monetary issues of interest to each of these groups. This is not an easy task. On occasions the three groups can be like ships passing in the night, acknowledging each others' presence at a distance. So it is something of a challenge to bridge their different perspectives on (a) topic in today's financial markets..." (**Andrew D. Crockett**, Keynote Speech, Colloquium 1995 in Thun, Switzerland)

Since its foundation in 1963 SUERF has organised 24 'General' Colloquia at 22 different locations in 16 countries. Although the number of more limited regional conferences has increased in recent years, the 'General' Colloquia have, for several reasons, remained the *core activity* of the organisation. First, because of their *regularity:* a Colloquium has been held about every 18 months, alternatively in spring and autumn, the first one taking place in Tilburg, The Netherlands, in 1969, and number 24 in Tallinn, Estonia, being held in 2003. The regularity of the Colloquia is an impressive symbol of the continuity of SUERF itself over four decades.

Secondly, because of their *careful organisation:* preparation starts about two years in advance with the selection of the subject and the location; a call for papers is sent out in due time; the conference itself combines plenary sessions with keynote addresses and commission work in three (previously four) Commissions. The Colloquium is followed, about one year later, by the publication of the Colloquium Book.

Thirdly and above all, the 'General' Colloquia are a core business of SUERF by their *basic philosophy,* which reflects and justifies the working of SUERF itself as *"...an active network between financial economists, financial practitioners, central bankers and academics for the analysis and mutual understanding of monetary and financial issues..."* (Excerpt from the SUERF Mission Statement)

The present paper aims at analysing this Colloquium activity on the basis of the publications connected with it, and from the specific point of view of the *monetary and financial thought* expressed in them. Up to the spring of 2003, the 24 Colloquia found their written and published expression in 21 Colloquium Books. No Colloquium Book was published after two of the early Colloquia (Tarragona 1970, Strasbourg 1972). Some of the 1970 papers and all of the 1972 papers found their way in brochures published in 1971-1972 in the so-called SUERF Series.

The book of the latest Colloquium under review (Tallinn 2003) is forthcoming and has provisionally been replaced by the mimeo version of the main papers presented at this event. Below, references to the individual colloquia are given by indication of their number as C1, C2 etc.

Thanks to the Archives of the SUERF Secretariat, to the personal library of present and past Council Members and to the library of the National Bank of Belgium, a complete set of these publications has been 'reconstructed' and has been placed at my disposal. This help has been essential in starting the project and is gratefully acknowledged here[1].

Choosing 'monetary and financial thought' as the specific angle of investigation means that the objective of my analysis has not been to provide *l'histoire-bataille* of the 24 Colloquia under review, which would probably have resulted in a tedious 'summary' or even 'a summary of the summaries' already existing in the publications. On the other hand, this paper has not been conceived as an academic monograph of economic thought, which would have been a complete negation of the scope, context and contents of the colloquia. As one of the contributors to the 1977 Colloquium in Wiesbaden observed for the use of monetary targets in the New Monetary Policy of the Seventies (**Warren McClam**, 1977, quoted in the Anthology Part) the choice

[1] I gratefully acknowledge the friendly and efficient help of:

- The SUERF Secretariat in Vienna – in particular of Executive Secretary Beatrix Krones; of several members of the SUERF Council of Management and also of the National Bank of Belgium for digging into their library and archives to assemble a complete set of SUERF Colloquium Books and related publications,
- Morten Balling (Aarhus), Erik Buyst (Leuven), David Llewellyn (Loughborough), Frank Lierman (Leuven-Brussels), Ivo Maes (Brussels-Leuven) and Peter Van Dijcke (Leuven-Brussels) for making comments, suggestions and corrections before, during and after the drafting of the text,
- Emma Vorlat (Leuven), and Neil Foster (Vienna) for revising and correcting the rather rawish English text of a non-native writer,
- Michael Bailey (Vienna) for editing the final version and monitoring the printing process.

All the remaining errors are mine.

JPA

of the dominant themes and the title of a colloquium have been influenced more by the *"force of events"* than by academic theories. The presentations and discussions at the sessions are reactions to important events (e.g. the breakdown of the Bretton Woods system) or major shifts in policies and in financial activity (e.g. deregulation or globalisation). These reactions are partly embedded in academic thinking but also in the analyses of bank economists and in the field experience of the practitioners from both the public and the private financial sector, from central and the commercial bankers.

Therefore it is, in my opinion, essential to try to capture *l'air du temps,* the general mood, the particular focus of a given colloquium by analysing the written contributions, confronting them with the current thinking and practice at that time. In this respect the keynote addresses, the General Reports (up to the mid-1990s), the Marjolin Lectures afterwards, and also the introduction and the conclusions of the individual papers are of particular interest, not only for *what* – the content, but also for *how* – the way in which – something has been said or written.

This explains why my analysis has been built on a documentary base of *quotations* from the papers presented at the several colloquia. From these quotations I have derived, in a *synchronic* approach, a characterisation of *l'air du temps* and of the dominant issues in a given period. In the recapitulation at the end I have taken a *diachronic* view, following the main developments through time.

With the above considerations in mind, the reader will easily understand the *structure* of the present contribution. The first part, the **Survey,** presents, after this *overall presentation*, a characterization of the main issues in five distinct periods, marked out by major events or major shifts:

- *The demise of the Bretton Woods monetary system* at the end of the Sixties and the beginning of the Seventies,

- *The first oil shock (October 1973) and the Bankhaus Herstatt Crash (June 1974),*

- *The shift to monetarism and deregulation in US policy and the constitution of the European Monetary System* at the end of the Seventies,

- *The breakthrough of market-led globalisation and the road to European Monetary Union* starting in the early Nineties,

- *The Millennium Turn* in 2000-2003.

Under the title “Constants and Change Through Four Decades”, a final section recapitulates the main trends and evaluates them in the light of current literature.

The second part of my contribution, the **Anthology,** constitutes the SUERF ‘Book of Quotations’ excerpted from the several Colloquium publications. These quotations are expected to help the reader in feeling *l’air du temps* and the developments through time.

I have made the selection and the ordering of the quotations based on three criteria:

– The *chronology* of the colloquia, with one section per colloquium, starting at C1, in 1969 and ending at C24 in 2003;

– The *specific focus* of my analysis: exploring monetary and financial thinking about basic issues, thereby excluding (outdated) statistics, methodological problems, techniques, and also purely descriptive information;

– Rather strict *space limitations:* the more extended coverage for the recent colloquia undoubtedly results from an implicit actualisation process (with a rather high subjective actualisation coefficient!), favouring issues and texts that are more than mere ‘historical monuments’ and remain relevant for present discussions and policies. However, this extension also derives from the *increased density* of the contributions in the more recent Colloquium Books. Since the mid-Nineties these publications no longer present all the written contributions of the colloquia but only a selection of those, which are, rightly or wrongly, considered as the most significant ones by an *ad hoc* committee. These texts frequently incorporate the ‘technical progress’ made in economic analysis through the four decades under review. More space was needed to adjust to this improvement in quality and technicality.

The two parts of the present contribution, ***Survey*** and ***Anthology***, are linked to each other in a closely interactive way. As already mentioned, the quotations of the Anthology have been collected to constitute the documentary base for the Survey. But they have been selected and ordered, having in mind some *a priori* impressions about characteristic periods and issues to be analysed in the Survey.

Hopefully, the complete text, with its two parts, will provide a fair picture of the way in which monetary and financial thinking has penetrated the core activity of SUERF in the four decades since its constitution, and will be useful as a source of inspiration for future times.

Section 2: Major Events, Dominant Themes and Outstanding Contributions in Five Distinct Periods

Period I: 1969- early 1974: The Demise of the Bretton Woods International Monetary System

Four Colloquia:

C1: Tilburg, April 1969: The future of the International Monetary System
C2: Tarragona, October 1970: Monetary Policy and New Developments in Banking
C3: Strasbourg, January 1972: Aspects of European Monetary Union
C4: Nottingham, April 1973: Multinational Enterprises – Financial and Monetary Aspects

The opening address by **Louis Camu**, the highly esteemed President of the Banque de Bruxelles (Quoted in the Anthology under C3, in short: **Q under C3**) shows how much the events around the breakdown of the quarter-of-a century old international monetary system impacted on thinking and reactions at that time. The Strasbourg Colloquium was held six months after the Nixon Declaration of inconvertibility (into gold) of the US dollar (15 August 1971) and only a few weeks after the Smithsonian Conference (18 December 1971). There the computers 'produced' a substantial devaluation of the dollar in a completely new grid of exchange rate parities, which, however, did not resist the pressures of the markets in the months thereafter. In his typical Latin style, Louis Camu spoke of the death of the monetary structure of the world and, using a phrasing by Sartre, urged the audience to look at this historical event '*avec des yeux réinventés*'. He announced (wrongly) that the persistent creation of liquidity through the deficits of the US balance of payments financed by the rest of the world had come to an end.

This gives a tragicomical connotation to most of the contributions to C1, the Tilburg Colloquium in 1969, where the future of the international monetary had completely been analysed as a *reform within* the existing system and not as its breakdown. Reading the papers and the position statements of the stars of that time (cf. the Q under C1 in the Anthology) one feels like listening to the orchestra on the Titanic, stoically performing while the ship was sinking.

What, in my opinion, should be remembered of that future which never materialized, is the brilliant paper by **Robert W. Russell**, a then, presumably young, Assistant Professor at Wisconsin State University, who analysed the pressures on the existing system and the proposals of reform considering five variables: freedom of international economic transactions, alterability of exchange rates, internationally accepted monetary reserves, autonomous mechanisms for adjustment and foreign holding of key national currencies (especially US dollar and British Pound Sterling). He concluded that the most fundamental and promising changes would be to make exchange rates somewhat (sic) more flexible and to activate the Special Drawing Rights IMF arrangement for managed growth in world monetary reserves (Q under C1).

From what precedes, we can safely derive that *macroeconomic issues in international monetary relations* dominated the SUERF Colloquia scene in this period. The collapse of the Bretton Woods system spurred efforts to add a specific monetary dimension to European integration. The debacle of the Werner Plan (1971) was a major incentive at the Strasbourg Colloquium for searching for new ways towards Economic and Monetary Union. By its timing, by the quality of the contributors and contributions and by the intensity of the discussions, this meeting may be considered an early landmark in the history of the SUERF Colloquia.

From the point of view of economic thought, the paper presented at this meeting by **Prof. Fabrizio Onida**, from the University of Milano, still deserves attention, because it criticises a mere theoretical architecture of EMU derived from the literature on the optimum currency area, and also an over-emphasis on exchange rate stability in the sense of irreversible parity pegging (Q under C3). His position on the latter issue is typical of Italian thinking in the early Seventies.

The focus on international monetary relations in this period dwarfs, at least for an *ex post* observer, the significance of the Tarragona (1970) and the Nottingham Colloquia (Spring 1973). What is left of the former is a rather academic survey of the various theories of monetary policy (Q under C2) and a Swiss paper on the working and the pros and cons of the Eurocurrency market (ibid). The latter meeting (Q under C4) focused on the working of multinational enterprises, especially in their relations and frequent tensions with national state policies, a theme which is now a current issue in the analyses of emerging market economies and which has also been revived at the 2003 Tallinn colloquium, as far as the impact of foreign banks in Central and Baltic Europe is concerned.

Finally, two particular points may be added to complete the picture of the SUERF Colloquia in this period:

The problems about the entry of the United Kingdom into the EEC (1973): At the Strasbourg meeting, Continentals expressed suspicion about 'the historical ballast' linked with the reserve currency function of the sterling. On the contrary, the British emphasised that the 'marriage' was not one between a debt-ridden Britain and a reserve-rich Community and that '*the bride, in fact, brings a fine dowry':* the international relations of London as a top financial centre (Q under C3).

The SUERF attention to the problems of the countries of Central and Eastern Europe, which were still integrated in the Comecon system under Soviet dominance. This concern was expressed from the very first Colloquium in Tilburg on, where two academics from Czechoslovakia presented a paper and participated in an exchange of views on the future of the international system (Q under C1). Afterwards, the association of academics and financial professionals from that region became a tradition in the series of Colloquia and even a major concern after the fall of the Berlin Wall in 1989.

Period II: Late 1974- early 1979: the Aftermath of Oil Shocks and Bank Failures

Four colloquia:

C5: Venice, October 1974: Floating exchange rates – The lessons from experience
C6: Brussels, April 1976: The Development of Financial Institutions 1956-1976
C7: Wiesbaden, September 1977: New Approaches in Monetary Policy
C8: Basle, May 1979: Europe and the Dollar in the World-Wide Disequilibrium

The quinquennium after the first oil shock (October 1973) and the Herstatt Bank Crash (June 1974) was a period of *disarray and search for new monetary anchors.*

International monetary relations remained at the forefront of several colloquia, as shown by the inconclusive Venice discussion on the experience of floating exchange rates and the colourful controversies in Basle about what has been called in the Anthology: *The stormy relations in growing interdependence* (between Europe and the United States).

From the quotations under C5 we can derive that the initial interest and trust in floating exchange rate regimes as an instrument of adjustment of international payments and as a tool for insulating domestic monetary policy from external pressures had significantly weakened. In the opinion of several authors, (i) no system of exchange rates – either floating or fixed – could work well under the pressure of the enormous oil deficits (**Francis Forte**, Q under C5), (ii) no new theoretical breakthrough had been achieved in the fixed versus floating debate (**Governor Carli**, ibid), and (iii) empirical conclusions were difficult to draw because recent experience was not about a system of generalised 'clean' (i.e. pure) floating or not even of managed floating, but about a variety of different, sometimes hybrid, systems (**Francis Forte and E. Merigo**, ibid).

Meanwhile, the after-effects of the collapse of the Bretton Woods system and of the first oil shock had intensified what Irving S. Friedman has called *The World-Wide Inflation Disaster* (**Friedman** 1974), with two-digit inflation rates in many countries. Therefore, the focus in the Colloquia shifted, at least partly, from international to *overall monetary policy*, domestic and international. The monetarist paradigm according to which inflation was a monetary phenomenon that should be counteracted by restrictive quantitative control of the money supply, no longer remained a subject of academic debate. It penetrated the research departments of financial institutions and even the boardroom of some central banks, especially, although in a pragmatic way, that of the Bundesbank.

This constituted the background of the impressive 1977 Wiesbaden Colloquium, which I consider as the archetype of what a good SUERF Colloquium should be:

- an extensive academic input by **Jacques Sijben** on the theoretical foundations of monetary policy from a monetarist point of view;

- a well-structured exposé by **Helmut Schlesinger**, at that time Member of the Directorate of the Bundesbank, on the philosophy and the implementation of German monetary policy with its quantitative targets and its control of the money creation process;

- an international survey of targets and techniques in Western Europe by **Warren McClam**;

- contributions not only from individual officials of central banks, but also from research departments as such (including those of the Bank of England, the Banca d'Italia and the Banco de España);

- analyses of the international aspects of monetary policy and their coordination by **Theo Peeters** and **Niels Thygesen** (cf. Q under C7).

Evidently, the pressure of generalized inflation was also felt at the level of *markets and individual institutions.* At the Brussels 1976 Colloquium, a sharp divergence of views arose about the issue of indexation of financial instruments, a process brilliantly advocated by **Roland Vaubel**. In retrospect, the upshot of the discussion was that, if indexed financial tools may protect individual firms and persons against inflation, they also help to institutionalise inflation and to weaken the incentive to suppress inflationary pressures (Q under C6).

On the other hand, the Herstatt Bank crash and other bank failures and losses contributed to attract the attention not only to the immediate effects of bank 'accidents' but even more to the (in)adequacy of liquidity and solvency in the financial sector, and to the need to improve national banking supervision and international coordination of national supervision. In the formulation, at the Colloquium, by **G. Blunden**, Executive Director of the Bank of England and Chairman of the new Committee on Banking Regulation and Supervisory Practices of the Group of Ten: "*(The failures, etc.) served as a catalyst for much rethinking of traditional attitudes both within individual banks and within supervisory authorities...*" (Q under C6)

Finally, by way of a transition to the next period, it should be mentioned that the 1979 Basle Colloquium was held at a moment that the European Monetary System (EMS) had already been launched (March 1979). At the Colloquium, one of the Founding Fathers of this system, **Jacques van Ypersele** motivated and described EMS referring to the progress to be made in overall European integration and growth, and in overall exchange rate stabilisation (Q under C8).

Participants in the discussion focused on the relations with the dollar. Europeans recognised, some of them with regret, that the dollar was inescapable, '*incontournable*' in international monetary relations, but that some of its functions (e.g. those of international monetary reserve) should be shared with European currencies in a context of multilateral interdependence and cooperation (ibid).

Anglo-Saxon scepticism, especially on the EMS approach, was not absent (**Ralph C. Bryant**, Brookings Institution: *Exchange rate stability can result from, but cannot by itself engender, an integrated Europe*) (ibid). This heralded many discussions in the Eighties and Nineties.

Period III: The Eighties: Disinflation, Exchange Rate Stabilisation, 'Marketisation' of Banking and Finance

Seven Colloquia:

C9: Helsingør, October 1980: Bank Management in a Changing Domestic and International Environment
C10: Vienna, April 1982: International Lending in a Fragile World Economy
C11: Madrid, October 1983: Government Policies and the Working of Financial Systems in Industrialized Countries
C12: Cambridge, March 1985: Shifting Frontiers in Financial Markets
C13: Luxembourg, October 1986: International Monetary and Financial Integration – The European Dimension
C14: Helsinki, May 1988: The International Adjustment Process, New Perspectives, Recent Experience and Future Challenges for the Financial System
C15: Nice, October 1989: Financial Institutions in Europe Under New Competitive Conditions.

In many respects the experience of the Eighties, as reflected in the collection of the seven Colloquia Books of the decade, can be divided into two subperiods or phases, linked to one another by some common factors. In the current literature, the dividing line is often traced to the middle of the decade and the Plaza Accord of September 1985. This instigated an attempt to stabilise exchange rates worldwide through multilateral, mostly tripolar, policy coordination. As this effort met only with partial and temporary success and, in addition, exclusively refers to international monetary policy, we prefer the distinction made by **Michael Artis** (Q under C13). In his paper he opposed '*the global post-1979 episode*' in which the theme of '*putting one's own house in order*' had been dominant, and '*the issue of the day*' (in 1986), which was, rather than inflation, '*employment*'. However, we will generalise 'the issue of the day' into a '*search for new, market-led growth.*

The 'global post-1979 episode' has been essentially an exercise in disinflation, led by the harsh but efficient US monetary policy à la Volcker. Together with the after-effects of the second oil shock, this policy brought the world economy to the brink of a generalised financial crisis. Nevertheless, it finally succeeded in reducing inflationary pressures.

The concern for a major financial crisis was apparent at the Vienna Colloquium of April 1982 (C10) and, eventually, materialized later that year in the so-called Mexican crisis, which shocked the financial system worldwide. At that time volatility (of exchange and interest rates), fragility and risk became keywords in many papers (Q under C10).

International bankers were accused of reckless profiteering from the recycling of the oil surpluses and Eurocurrency markets were considered as mysterious mechanisms with multiplier effects, which hampered the conduct of monetary policy.

However, **Rainer Gut**, the President of Crédit Suisse, replied in a sharply formulated paper (Q ibid) that the international banking system, by financing the payments deficits after the oil shocks, filled, *almost against its will* (sic*),* the gap created by government hesitations and cuts in development aid. On his side, **David Llewellyn** blew up the 'mystery' of the Eurodollar market by pointing out that this market posed no threat to the conduct of monetary policy if this policy did not rely on non-market and control mechanisms and did not influence the competitive position of the domestic sector vis-à-vis the Euro-sector (Q ibid).

This marks the Vienna Colloquium as a memorable event, with outstanding papers by authors such as **Alexander Swoboda**, **Luigi Spaventa** and **David Llewellyn**.

Pessimism about the prospects of banking and the future of bankers had already been expressed, in terms of *to be or not to be* at the Helsingør Colloquium (C9) on bank management (1980).

The reactions at several colloquia to the post-1979 episode frequently evoked the *crowding out* of the private sector as a result of the priority to be given to the financing of huge government deficits.

Already at Helsingør, the Bocconi team (**Franco Bruni**, **Mario Monti** and **Angelo Porta**) had concluded that when deficits are no longer financed by the creation of monetary base (which was one of the main objectives of monetarist anti-inflation policy) and banks are compelled to pursue lending to the public sector by direct or indirect portfolio constraints, these constraints must be regarded as disguised taxes levied on banks. They may be partly or completely shifted by them to other agents in a kind of transmission mechanism of fiscal policy (Q under C9).

Crowding out became the 'star' at C11 in Madrid in 1983, which focused on the explosion of budget deficits in a period of stagflation. The general tune of the Colloquium was set by an acting President and a former President of an important central bank: **Alvarez Rendueles** of the Banco de España and **Ottmar Emminger** of the Bundesbank, the latter proposing a '*law of government retrenchment'* instead of the Wagner law of increasing government expenditures. Meanwhile, inflation rates had diminished and several speakers were wondering and tried to explain why real interest rates remained so high (Q under C11).

On the whole, the Colloquia during the 'post-1979 episode' reflected all the difficulties of a period of '*remise en ordre',* which, at critical moments, required harsh crisis management and raised the well-known question: *why are these hardships necessary?* Only later, at the Helsinki Colloquium in 1988, was the resulting success of this crisis management fully recognised (Q under C14).

In the second half of the Eighties, the general mood at the Colloquia became more cheerful and forward-looking. This appears from a series of positive indications collected from the Colloquia Books of that period:

– The experience of the first years of EMS got a positive evaluation as far as the intra-EMS exchange rate stabilisation was concerned (**Jean-Jacques Rey** and **Jan Michielsen**). This experience was considered as a regional counterpart to the international disinflation effort, combining the function of a counter-inflation framework with that of stabilizing intra-EMS real exchange rates (**Michael Artis**, Q under C13, 1986).

- Liberalisation of capital movements got under way as an extension of EMS and as part of the Europe 1992 project aiming at the Single Market of goods and services. **Rey** and **Michielsen** suggested a '*Werner Plan revisited'* (ibid).

- The success of the disinflation effort and of intra-EMS exchange rate stabilisation improved the prospects of tripolar policy cooperation between the US, Japan and the EEC and even, on a larger scale at the 1988 Helsinki Colloquium (C14), those for an international global adjustment process. This worldwide adjustment would involve tackling the US payments imbalances and financing developing countries, which had suffered an 'involuntary' adjustment after the Mexican crisis (with remarkable papers by **Christian de Boissieu** (Q under C13), **Sergio Siglienti** and **Robert Pringle** (Q under C14)). However, the optimism for global adjustment through policy cooperation weakened after the failure of the Louvre Accord in 1987 and had practically disappeared by the end of the decade. This evolution rendered obsolete a significant part of the literature on policy cooperation, which had been developed at that time, for example, concerning the concept and the technicalities of target zones for exchange rates.

What finally seems to be the most important development in the Eighties from the point of view of economic thought is implied in the title of the 1985 Cambridge Colloquium: *Shifting Frontiers in Financial Markets.* At that meeting, the late **Tadeusz Rybczynski** (Q under C12) distinguished two dimensions in these shifts: the extension of *external frontiers* of financial activity (i.e. 'globalisation') and the removal of *internal* frontiers between financial activities and between various types of institutions (i.e. 'desegmentation' or 'despecialisation'), resulting from a greater reliance on market forces, which in turn pointed to deregulation (**Governor Robin Leigh Pemberton**, ibid).

The transition from a government-led system of markets and institutions to a market-led one, the '*marketisation of banking and finance'* (**Jan Koning**, ibid) did not take place at once, but spanned the whole decade, linking the two subperiods and most of the colloquia of the decade.

Neither did the process occur at the same pace everywhere. In the mid-Eighties it still differentiated the US and the UK from most countries of Continental Europe. But in the second half of the decade the process accelerated and generalised, so that at the last colloquium of the Eighties

(C15, Nice 1989) **Alfred Steinherr** was able to introduce his presentation by the question: "*Why does it all happen now? ... What happens now is both a quantitative and a qualitative jump with deregulation proceeding in many countries at a sharp accelerated pace, capital controls being reduced in many parts of the globe, innovation becoming a driving force and finance rapidly internationalising. It is the simultaneous occurrence of these factors in many parts of the globe, at a rapid pace, which is the new phenomenon. I think there are two major forces at work, reinforcing each other. One is the increasing internationalization of the non-financial sector. The other is that existing regulations were largely set up for needs of the past and therefore not well suited for present needs...*" **Rainer S. Masera** spoke in the same sense, mentioning the '*ossification*' of regulatory frameworks over an almost fifty-year span (Q under C15).

All this explains why I consider the second half of the Eighties as a period of search for a new market-led growth. Some authors, such as **David Llewellyn** at C 13, that is before the Europe 1992 project and the full EMU move of the Nineties, estimated that, in this search, the European dimension was swamped by factors operating at the global level and was '*irrelevant or at least of second-order for international financial integration*'. The subsequent developments, especially in the Nineties, will show that the interaction between the global and the European dimension still remains a significant feature of financial life in Europe (Q under C13).

Period IV: The Nineties: The Dominance of (unstable) Markets. The New Europe after Berlin and Maastricht. The strenuous but successful Road to EMU.

Six Colloquia:

C16: Lisbon, May 1991: Fiscal Policy, Taxation and the Financial System in an Increasingly Integrated Europe
C17: Berlin, October 1992: The New Europe: Evolving Economic and Financial Systems in East and West
C18: Dublin, May 1994: The Competitiveness of Financial Institutions and Centres in Europe
C19: Thun, October 1995: Risk Management in Volatile Financial Markets

C20: Budapest, May 1997: Corporate Governance, Financial Markets and Global Convergence
C21: Frankfurt, October 1998: The euro: A Challenge and Opportunity for Financial Markets

The list of topics and even the length of the titles of the colloquia in the Nineties point to an increasing variety, from the macro level, over the markets, down to the management and governance of individual financial firms, and vice versa. Besides the impact of changes in the organisation (more joint initiatives with other institutions, extension of the list of authors and contributions as a result of regular calls for papers, attracting young talent, new topics and new ideas), this diversity reflects the way in which the financial system works at present, and is also progressively extended to Central, Baltic and Eastern Europe: a mix of evolving government policy, regulation and supervision, intense and globalised market activity in unstable conditions, and the competitive struggle of financial institutions.

Three main determinants may be mentioned:

– The '*force of major events',* particularly the Fall of the Berlin Wall (1989) and the signature of the Maastricht Treaty (1991-1992), which created a 'New Europe' involved, at the same time, in two transitions:
  in the East, towards a privatised market economy, a two-tier bank system and a progressive and as yet uncompleted integration into an enlarged European Union;
  in the West, towards full EMU and a single currency through a process in three stages.

– *The dominance of markets,* characterised by globalisation, intense competition and widespread financial risk, which, all three, exerted increasing pressure on the management and the governance of individual financial firms.

– *The launching of the euro*, as the rather exuberant end of the journey on the road to EMU, creating a framework with new challenges and new expectations.

● ***The Dominance of Markets***

This aspect closely links up with the experience of 'marketisation' of banking and finance in the 1980s. However, as reflected in the colloquia of the decade, particularly in the Dublin 1994 (C18) and the 1995 Thun (C19) meetings, this is not a mere 'continuation' but a '*continuing acceleration*' with an emphasis on specific points, old and new:

– *Shift to Capital Markets*: Much attention was given to the shift from traditional intermediation by banks towards finance through capital markets, which also involved the intervention of non-bank intermediaries, such as securities houses. **David Llewellyn** held that, as a consequence of this shift, banking may exhibit some characteristics of a '*declining industry*', whose comparative advantages in its traditional business and its protection by regulation had been eroded (Q under C17). On the contrary, **Rainer Masera** considered the phenomenon as a diversification of the forms of intermediation, in which banks were able to maintain a significant role, if they achieved economies of scale and scope in the production of financial services through appropriate operational and organisational strategies (Q under C18).

– *Competitive Environment:* A review in Dublin of the reactions of banks and financial centres to the new environment after deregulation pointed to *varying* national banking strategies but often *analogous* pressures of competition for more efficiency, more profitability and a reduction of risks through diversification in large commercial banks (ibid).

  From the academic side, **Jacques Sijben** introduced, in an impressive paper, asymmetric information, adverse selection and moral hazard as determinants of market imperfections. In a downturn of the cycle these imperfections may contribute to financial crises. He stressed the need for stable government policies and an institutional environment that encourages diversification of risks (ibid).

– *Risk, Risk Management and Financial Fragility:* these were the keywords at the 1995 Thun meeting. In an in-depth analysis of risk, **Andrew Crockett** distinguished diversifiable risk, which can be hedged or diversified away, and non-diversifiable risk, which requires a prudential capital cushion on the part of individual institutions in a framework of capital adequacy requirements of the Basle type. Official support should be available in the event of truly unforeseen shocks of major proportions (Q under C19).

  Martin Hellwig linked up with some of the considerations expressed above, by explaining the impact on financial fragility of interest and exchange risks and of the correlation between them. He related them to the erosion of margins in traditional banking and to the reduced ability of banks to rely on oligopoly rents to withstand shocks (ibid).

– *Volatility, Bubbles, Crises*. **Charles Goodhart** argued that the perception of worsening risk, though fashionable, had been much exaggerated, "*... It would not surprise me if, by the year 2010, we looked back at the decades of the 1980s and 1990s as being (periods) of general stability and relatively little structural change...*" (Q under C19). In his paper, **Crockett** (implicitly) replied that, although *average* volatility may not have risen, the risk of large short-term but potentially disruptive price movements may indeed have increased (ibidem).

  It appeared, anyway, that the frequency of such recent disruptions on various financial markets had induced several economists in international organisations to explore the determinants and the specific aspects of these crises. In their findings, **Claudio Borio** and **Robert McAuley** at the BIS and **Philip Davis** at the European Central Bank attributed the outburst of the crises to the own dynamics of the market(s) involved, more than to fundamental economic and financial factors (ibid). The (implicit) conclusion from these studies was, in my opinion, that such crises could not be handled merely with the traditional instruments of monetary policy and that a new dimension had to be added to the objectives of public policy: *financial* stability, besides and as a complement to *monetary* stability.

  From the point of view of economic thought these ideas were, at that time, discussed in many academic and policymaking circles. In this sense they were not new. However, as usual, the contribution of the Colloquia has been to offer a forum for spreading the information and confronting the views of high-level policy makers with the findings of the research done not only in academia, but also in the research departments of various institutions.

- ***Transition Economics: The East: Stabilisation, Institution Building, Convergence still far away.***

By the '*force of events*', the Colloquia got involved in *Transition Economics*. This involvement was new, certainly as far as Central and Eastern Europe were concerned. By definition, the subject implies 'transitional' elements such as interim reports on various experiments, many of which will not have durable results. Some of them are illustrated in the Anthology in order to reflect *l'air du temps*. They will be omitted in the present survey, which focuses on the more lasting elements in the development of economic thought.

That Transition Economics will penetrate the issues and problems inherited from previous periods was already apparent at the first Colloquium of the decade: C16 at Lisbon, in May 1991, where the dominant theme referred to the saving-investment relation. As underlined by **Mervyn King** (Q under C16) the fall in the aggregate saving rate was marked and general in the 1980s: roughly 6 percentage points in all the major countries. Hence the concern that savings would be insufficient to cover the investment and financing needs of the Nineties. Several participants were sceptical about the effectiveness of tax incentives to increase aggregate savings and insisted on further reduction of public budget deficits, i.e. government dissaving. However, from the German side, no doubt was left about increased public transfers and expenditures induced by German economic and monetary unification. **Hans-Peter Fröhlich** astutely added that this situation was exactly what had been internationally expected from and asked of Germany in the Eighties (Q ibid).

At that Colloquium the transition from 1989 to the start of "*self-sustained growth on market principles*" in the East, was optimistically estimated at 6-7 years by **Conrad Reuss** (ibid). This optimism did not stand the test of hard experience, which was reflected in the subsequent meetings. An overview of the basic statements made from the 1992 Berlin Colloquium (C17) on, provides the following picture:

– In Berlin, both policymakers and professional economists emphasised the complexity and the difficulties of economic reform in the East. **Governor Hans Tietmeyer** stated that there was no unique blueprint or 'royal road' to successful reform. And Associate IMF Director **Manuel Guitián** added that the challenge was "*to extract from an increasingly obsolete body of expertise and from the still-to-be applicable body of knowledge insights that can help the reform along in an orderly fashion ...*" (Q under C17).

– In Berlin, as well as in Lisbon, opinions and statement generally stuck to '*the middle of the road'* between what was called the Anglo-American model of going 'cold turkey' into a free market system (**Roy C. Smith** and **Ingo Walter**) and gradualism without time path or limit. Much emphasis was put on the imperative of '*institution building'* (**Helen Junz**) or '*the* *infrastructure of laws and institutions'* (**Smith** and **Walter**) which should accompany stabilisation. In this context participants in Berlin discussed the pros and cons for the East, of different systems of corporate ownership, on the basis of a paper by **Colin Mayer** distinguishing the *insider* systems of corporate ownership, as in most Continental European Countries and in Japan and the *outsider* systems, as in the US and the UK (Q ibid).

– *Convergence* between East and West was the leitmotiv of the 1997 Budapest Colloquium (C20), which focused on corporate governance. In his introductory presentation, **Morten Balling** stated that in all parts of Europe – East and West – one can find countries which are moving towards governance systems in which financial markets can be expected to play a stronger disciplining role on corporate managers and where one can also find cases of privatisation, allowing tougher monitoring of managers (Q under C20). In fact, most papers dealt with corporate governance problems in the West (e.g. the respective role of the large shareholder(s), of the banks and, most of all, of institutional investors as stakeholders in corporations) quoting aspects which were not immediately applicable to the East, at least at that time. This clearly appeared from the comparison of these papers with the case study on the Czech Republic and Poland, presented by **Tito Boeri** and **Giancarlo Perasso** (Q under C20). Afterwards, the convergence issue gained momentum, when a significant number of Central and Baltic Europe countries applied for entry into the enlarged European Union. One had to wait for the 2003 Colloquium in Tallinn (C24) to assess the progress made in the six years after the Budapest event (cf. the next period).

- ***Transition Economics: The West*: *The Bumpy Road to EMU.***

The first years of the Nineties corresponded, in the EEC, to the last phase of the Single Market Project and the start of the journey in three stages towards full Economic and Monetary Union. It was a period of turbulences and uncertainty, marked by the EMS exchange rate crisis of 1992-1993 and by the political difficulties to get the Treaty of Maastricht ratified in some countries, events which were all echoed in the SUERF Colloquia.

Speaking at the 1991 Lisbon colloquium, **Jean-Jacques Rey** compared these years to a mountain hike where '*climbing starts only when one has walked a long time already'* (Q under C16). The climbing was towards further progress in convergence, which meant catching up for some countries, consolidation for others. There was a need to manage currencies within the EMS, to eliminate out-of-line country performances when they were inconsistent with adherence to EMU, and to remedy a number of difficult-to-identify rigidities, which ran the risk of putting the country concerned at a competitive disadvantage when EMU was implemented (ibid).

In the background stood the fact – highlighted by **Axel Weber** in his Marjolin-Prize winning paper and exemplified by the sterilisation of interventions within the EMS – that "*neither the Bundesbank nor the central banks in the remaining EMS were prepared to give up some monetary autonomy for the sake of exchange stability*" (Q under C19).

The problem boils down to what **Robert Raymond** said at the end of his Marjolin Lecture at the Thun Colloquium: "*...If the target can easily be determined, difficulties are in the transition... The challenge is to find the optimal path between some flexibility which would be compatible with the variety of individual situations and a smoothly organised transition...*" (Q ibid).

However, three years before, at the Berlin Colloquium, **Governor Tietmeyer** had defended the EMS, as an important stopover and also a test on the road to EMU (Q under C 17).

But, from the point of view of economic thought, the most remarkable development was what **Tommaso Padoa-Schioppa** wrote in his 1994 book 'The Road to Monetary Union in Europe' and what **Niels Thygesen** recalled in his masterly survey of '*Twenty Five Years of European Monetary Unification*' at the Frankfurt Colloquium in 1998 (C 21): "*that the utopian perspective of full currency union was confirmed as a realistic option by the 1992-1993 crises in the EMS. With the degree of capital mobility achieved at the end of the 1880s, fixed -but-adjustable exchanges rates might have become impossible to maintain...*" (Q under C21). Despite the hesitations of some central bankers and the staunch opposition of many academics, which was also felt at the SUERF Colloquia, this would, in the second half of the decade, become the safer way to full EMU, including the Single Currency.

On this road, the policymakers got the support of top practitioners in the financial world. At the SUERF Colloquia, **Graham Bishop** promoted the idea and sketched, in several papers, the prospects of a large European market for savings, for bonds, for pension funds, in an integrated area with a single currency (Q under C17 and C21).

- ***The launching of the euro***

Symbolically, the 21st Colloquium was held in Frankfurt, the city chosen as the seat of the European Central Bank. It was held about six months after the final decision to introduce the single currency and less than three months before the effective launching of the euro. Europe was resisting the East Asian crisis, which induced **Governor Tietmeyer** to say, in his opening address, that the euro had passed its first acid test, since it proved that the markets had accepted the transition to monetary union as '*irreversible*' and regarded the euro as a *safe haven (*Q under C21). Dresdner Bank Director **Ernst-Moritz Lipp** joined this statement in a more cautious way: "*...The euro has passed its first critical test before it comes into existence but the experiences of the Asian tiger states have shown that every trust must be earned ex post ...*" (Q ibid).

These statements explain why most papers and the discussions reflected some exuberance on the prospective structural effects of the introduction of the euro and of the single monetary policy connected with it. **Olivier De Bandt** phrased a rather general expectation that the final impact of EMU would be to increase the competitiveness of banks in the Single Currency area and to favour the emergence of some large Europe-based global banking groups, while, at the same time, smaller institutions may develop profitable niches (Q ibid). **Rudi Vander Vennet** estimated that the continued expansion of financial conglomerates and universal banks in Europe, partly as a response to EMU, would lead to a more efficient financial system (Q ibid).

In the field of portfolio management and corporate finance, government bond markets would be more integrated and yields closely correlated. Non-government borrowers would increasingly borrow directly from investors by issuing debt securities rather than borrowing from banks, leading to a US-style corporate bond market. The national bias in equity and fixed income investments would diminish and funds would be increasingly managed against Euro-wide benchmarks, possibly involving some reallocation of existing investments. Equity markets would grow, as more companies go public and more investors seek to invest funds in equity markets. In addition to these general trends, Goldman Sachs banker **Martin Brooks** estimated that cross-border flows resulting from the re-balancing of portfolios may be skewed towards large-cap stocks (Q ibid).

The launching of the euro was an opportunity to discuss a possible lender-of-last resort function for the European Central Bank (**Allessandro Prati** and

Garry Schinasi), the streamlining of the balance sheets of the central banks in the euro area and the disposal of their excess foreign reserves (**Daniel Gros** and **Franziska Schobert**) (all Q ibid).

However, the optimism was not unlimited. **Michael Artis** had conducted a clustering exercise on 18 countries, the result of which was, as expected, that in Europe three groups could be distinguished: a cluster around Germany, a 'Northern periphery' and a 'Southern periphery'. A single monetary policy could probably not always fit all ... Policies to substitute for the loss of independent monetary policies in some countries should be considered.

The most qualifying opinions related to the external role of the euro. **Robert McCauley** did not see an immediate prospect for the euro's use outside Central Europe and the Mediterranean. **John Arrowsmith**, **Ray Barrell** and **Christopher Taylor** pointed to the worry of many economists that, if and when the euro develops into a global currency, it will prove to be at least as unstable as the dollar and the yen had been. Returning to the views of the latter half of the Eighties they suggested '*despite the fairly discouraging omens*', a revival of global co-operation, to minimise fluctuations between the key currencies in a tripolar, or more probably bipolar, post-EMU world.

The most impressive and most balanced contribution of the Colloquium was undoubtedly the already mentioned survey of twenty-five years of European unification in the Marjolin Lecture by **Niels Thygesen**. Using his previous work on the subject and updating it, he analysed the current state of monetary union in the light of five evolving ambitions, constituting a logical sequence:

– reducing, then eliminating nominal exchange rate fluctuations,
– reducing, then eliminating inflation,
– developing rules for non-monetary policies, then scope for coordinating them without undermining the rules,
– developing a potential role in the international monetary system, then adjusting it to the realities of the day,
– developing a European profile in financial regulation.

His assessment was that only the first three, or rather two and a half, of these ambitions had been fulfilled at the start of full EMU and the launching of the euro.

This brilliant survey confirms my personal opinion that the whole professional work of **Niels Thygesen**, including this paper, has been and still is a keystone for building and extending economic and monetary union in Europe.

Many readers will consider most other contributions as examples of daydreaming or wishful thinking. At least, they should view them as expressing the expectations created by the successful end of the difficult journey towards EMU, and as a reference for future developments.

Period V: 2000-2003: Adjusting West, Converging East?

Three Colloquia:

C22: Vienna, April 2000: Adapting to Financial Globalisation
C23: Brussels, October 2001: Technology and Finance, Challenges for Financial Markets, Business Strategies and Policy Makers
C24: Tallinn, June 2003: Stability and Efficiency of Financial Markets in Central and Eastern Europe

This is too short a period to be analysed in the same way as the previous ones. Yet, in these three years from the Vienna to the Tallinn Colloquium major events occurred, two of which are particularly relevant for our subject. Firstly, the reversal of the world's financial markets 'from bull to bear' from Q2 2000 on. The effect of this downturn was exacerbated by the events of September 11th (2001) and by the implications of the Iraq war in early 2003. The threat of general deflation also became manifest in 2003. Secondly, the agreement reached on 11-12 December 2002 in Copenhagen on the enlargement of the European Union (EU), by which 10 countries, 8 of them from Central and Baltic Europe, were invited to join the EU by May 2004. The latter event directly inspired the dominant themes chosen for the 2003 Tallinn Colloquium; the former reduced the exuberance, which characterized the late Nineties and was apparent at the Frankfurt Colloquium of 1998.

One may imagine analysing the developments in both West and East under two common labels: *efficiency* in a competitive environment at the level of markets and institutions, *stability* at the macro-level of systems and public policies. However, such a procedure would soon appear artificial because each label relates to, at least partly, different contents in each region:

– *In the West*: meeting the challenges of globalisation and technology at the micro- and meso-level; at the macro-level, facing financial instability and systemic risk.

– *In the East*: searching for bank efficiency in different countries and/of different types of banks; discussing the role of foreign banks (friends or foes?) on the one side, macro-implications of accession to the EU-integration and convergence towards EU stability-oriented policies, on the other.

– It is nevertheless striking that the three Colloquia under review were opened or concluded by top central bankers who, in their addresses, focused on the same topic:

  Financial stability and the role of central banks in this respect:

  – **Governor Liebscher** in Vienna: "*One outgrowth for us central bankers, is that in addition to our concern with price stability, our acknowledged home turf, we must increasingly also be concerned with the stability of the financial system both regionally and globally...*" (Q under C22)

  – **Governor Quaden** in Brussels: "*The monitoring of financial stability may certainly not be considered as a by-product or a mere extension of the traditional monetary stability objective of central banks. The two functions are closely related but distinct. In other words, the monetary stability and financial stability wings belong to the same bird.*"(Q under C23)

  – **Governor Vahur Kraft** in Tallinn: "*Directly or indirectly, the primary goal of most central banks is price stability...(But) monetary transmission cannot be efficient if a weak financial system distorts interest signals by increasing margins, or if financial markets have ceased to function for the reason that some of the participants do not trust other players...*" (Q under C24)

Most penetrating was the analysis of **Andrew Crockett** in Vienna: "... *(The) large asset price swings are ... a palpable manifestation of the increased financial instability experienced around the world since at least the 1980s ... Just as policy makers appeared to be emerging victorious from one exhausting battle, that against inflation, another equally challenging front* *was opening up. Lower inflation, it appeared, had not by itself yielded the peace dividend of a more stable environment ... Financial globalisation has transformed geography with significant implications for the character of instability. Globalisation has heightened the significance of 'common factors' in the genesis and unfolding financial distress. It has done so by extending and tightening financial linkages across institutions, markets and countries ... In addition, globalisation has heightened the significance of size asymmetries, between the main industrial countries, on the one hand, and emerging market economies, on the other, that is, between core and periphery ... The search for a solution ... can be seen as a search for adequate anchors in the monetary and financial spheres...*" (Q under C22)

In this context, **Philip Davis**, continuing his studies of financial crises, drew the lessons from US financial history for the European euro-area. He concluded that US history shows that in a large and diverse monetary area with segmented local banking markets, regional crises can pose a major challenge to policymakers, while the existence of a large monetary area means that there will inevitably be international transmission of shocks generated within it. He suggested that, while European financial instability has traditionally been of a pattern of bank failures following loan and trading losses, the likely securitisation of euro-area markets may lead to crises of a type more characteristic of the US, i.e. associated with price volatility in asset markets following shifts in expectations or with the collapse of market liquidity and issuance. Too-big-to fail problems can arise in a large monetary zone in the same way as in a small state with a concentrated banking sector. Finally, real estate lending booms and rising corporate leverage are warning signs of financial instability (Q under C22).

How to cope with financial fragility? As usual, capital adequacy stood first on the list. Reflecting upon the issues behind the proposals of the Basle Committee, Swedish financial supervisor **Claes Norgren** sketched the requirements of a new capital adequacy framework, better adapted to current conditions and taking into account a bank's ability to identify its various risks and to cope with them in its internal policy. His slogan was: *8 % is not the full answer!* (Q ibid)

Kenneth Kuttner and **Adam Posen**, from the Federal Reserve Bank of New York and the Institute for International Economics respectively, defended the case for reducing the exchange rate volatility between the three key currencies by rendering monetary policies more transparent. They shared Rogoff's view that the problem of the 'G3 exchange rate volatility' would and should not go away so long as financial markets' microstructure is its source. But they guessed that 20-30 % of that volatility could be removed by more transparency in the monetary policies. This would be significant for emerging markets and international businesses and improve, without economic cost, the political legitimacy of these policies. (Q ibidem)

For the emerging markets, **Enrique Aberola-Ila** and **Luis Molina Sanches** stated that the worldwide upsurge of financial flows had eased the reform process in several emerging economies, by providing the much needed inflow of capital but had increased their vulnerability at the same time. Countries that had been perceived to have weak economic and financial fundamentals suffered from swift reversals in the inflows of capital, which put the process of reform at stake.

They observed that fixed exchange regimes, against theoretical expectations, had only attained limited macroeconomic stability in emerging markets, as compared to countries with flexible exchange rate regimes. In contrast, a special type of exchange rate arrangement with stronger legal and institutional constraints, the currency board, had shown more strength in the financial turmoil and was recommended by the authors, because, if it can gain the support of economic and social forces (an important qualification, in my opinion) it can be identified '*with a deep institutional change, which transforms the way economic policy operates*' (Q ibid). This discussion was continued at the 2003 Tallinn Colloquium.

How interesting these analyses of financial instability problems and of the ways to cope with them, may be from the viewpoint of economic and financial thought, they should not convey the impression that the Vienna and Brussels meetings were primarily exercises in doom and gloom, a traditional pastime of many macroeconomists and public regulators.

In Brussels (C23) **Charles Goodhart** warned, in a very appropriate Marjolin Lecture, against determining regulation based on the current deviation of the economy from 'fundamental disequilibrium "*... since we only get to know what that actually was after the event, and usually many years after the event ...*" Neither can we hope to predict the really big adverse shocks, since these are almost by definition unpredictable, "*all we can do is model the aftershocks*" (Q under C23).

This leads to a dilemma illustrating the 'inevitable' conflict between the micro- and the macro-level concerns in the operation of financial regulation: "*In the* *event of a serious adverse crisis, financial intermediaries are individually more fragile, but in aggregate you want them to be more expansionary. By the same token during an expansionary boom, individual banks are stronger, but in aggregate you would wish them to be more cautious ...*" In short, he urged the regulators "*to make strenuous efforts to lengthen the horizon over which regulating metrics and decisions are made.*" (extensive Q under C23)

Eventually, the contributions focusing on *markets and institutions* displayed rather positive reactions to the challenges of globalisation and technology.

In Vienna, this was apparent in the following three topics for example (several quotations under C22):

– *The emergent Euroland banking system:* **Tommaso Padoa-Schioppa** assessed that one and a half years after the launch of the euro, signs that a single Euroland banking system was emerging, were rather strong in wholesale and capital market activities. On the other hand, they were lacking in localised retail banking and in cross-border M&A, just as in other mature financial systems, such as the US one. On the contrary, the obstacles in the fields of technology and infrastructure were less justified and asked for policy action.

– *Financial consolidation:* **Jacques de Larosière** and **Eric Barthalon** summarised the rationale for cross-border M&A in one paradox: *too many large national banks, no big European bank!* The discussion on cross-border financial consolidation was very lively. There was widespread agreement on the need for a strong domestic stronghold for entering the Pan-European market.

– *Efficiency:* As a bank economist, **Peter Van Dijcke** stated, in his Marjolin-Prize winning contribution, that increased competition, ongoing consolidation, continuing pressure for the reduction of existing excess capacity and shrinking profitability in the European banking industry had put efficiency high on the agenda of most banks. His findings on the cost-to-income ratio, considered as a proxy for bank (in)efficiency, seem to confirm that changing scale and scope only have a limited impact on this ratio. He derives that banks can improve their overall cost efficiency to a greater extent, if they emulate the banking industry's best practice, thereby increasing their managerial and technical efficiency (reducing so-called X-inefficiency) rather than by size (scale economies) or diversification (scope economies).

The Brussels Colloquium 2001

The impressive list of papers collected for the 2001 Brussels Colloquium (C23) – many of them entering into great detail and technicality – shows at length the widespread and, for many experts, even the overriding impact of technology in the financial world: in banks and other financial intermediaries, in financial markets, at stock exchanges and other trading systems, in payment networks, etc. This raises the issue of whether, in this and other ways, technology creates a '*new economy*' in society. In the Anthology part of the present paper, an extensive number of quotations try to give some idea of this impact, as reflected in the Colloquium Book, which, however, comprises only a selection of the best and most representative contributions.

It is not possible to go, in this Survey, into all the aspects suggested by those quotations. I prefer to agglomerate some of them around two general issues. Using the formulation of two contributors, I will successively deal with the *Shift of paradigm* issue raised by **David Llewellyn** for banking, which can also be extended to other institutions and markets, and the *New economy: reality or mirage* issue raised by **Antje Stobbe**, which can also be extended to other particular aspects.

David Llewellyn's thesis is presented in the framework of the so-called '*New Economics of Banking*'. Technology is a dominant driver in the combination of pressures, which change all aspects of banking in a fundamental, not incremental way. In this shift, some banking markets (rather than necessarily the banking industry) have become more contestable, in that entry and exit barriers have been reducing in significance. Scale has become less of an entry barrier to the extent that, while technology has increased the economies of scale in processing, many processes can be subcontracted. Scale economies tend to be in bank processes rather than in banks *per se*, which means that, if processes can be subcontracted, economies of scale can be secured by firms of varying size. If the external (sub)contracts are managed efficiently, the existence of economies of scale does not mean that only large banks can be competitive and survive (and, in my opinion, that the banking sector is no longer a 'declining industry' which was an important issue in the Nineties (cf. period IV)).

Papers by other contributors indicate that technology penetrates in other ways and at a different speed in different countries and, as exemplified by Spanish banking, in different types of banks of the same country. The same applies to markets. **Helen Allen**, **John Hawkins** and **Setsuya Sato**, of the Bank of

England, and **Hans Degryse** and **Mark Van Achter** in their Marjolin Prize winning paper on Alternative Trading Systems, pointed to the contrasting development patterns of equity markets in the US and in Europe. Whereas the US equity market has been characterised by a proliferation of alternative electronic trading systems (e.g. ECNs) alongside relatively few traditional exchanges, Europe has been notable for the absence of separate systems, with electronic trading incorporated *within* its many traditional exchanges.

This turns **Llewellyn**'s thesis into a shift with many faces, speeds and limits. In my opinion, this qualifies, but does not necessarily invalidate his view.

The '*New Economy'* issue raised more objections against attributing to technology an overriding impact on the economy and society as a whole. In her paper **Antje Stobbe** was outspoken. So far, the new economy is more mirage than reality. Even in the US there seem to be no clear signs of spillover effects from increased ICT (Information and Telecommunication Technology) investment on the efficiency of the economic process In Europe, most studies show capital deepening with respect to ICT, with increased demand for high-skilled labour and reduction of demand for unskilled labour, but evidence on Total Factor Productivity (TFP) growth was, in her opinion, rather disappointing. **Johan Van Gompel** suggested that the rapid growth of productivity in the US after 1995 might have been a cyclical phenomenon, and not a shift of a more lasting nature.

For most of the non-believers, technology is just one of the numerous factors, albeit an important one, that influences financial and global activity. This explains the answers to two, implicitly or explicitly formulated questions:

*Does **geography** not matter any more* according to **O'Brien**'s work on networks? It still does, was the answer of most participants and authors. "*We find no evidence for the thesis that technology has eliminated the importance of geography, as predicted by the* '*Geography doesn't Matter' hypothesis*." (**Iman Van Lelyveld** and **Marieke Donker**, both from the Nederlandsche Bank) *"Spatial proximity has not been completely substituted by virtual proximity on the net. It does not make traders footloose"* (**Vivien Lo** and **Michael Grote**). *"It does not destroy the value of home equity markets, especially for small and mid-caps"* (**Olivier Lefebvre**).

*Does **history** not matter any more?* It still does, said **Gottfried Leibbrandt** from McKinsey, for payments systems. The network nature of many payments (especially the prime-mover advantage emphasised in **Allen** *et al*.)

causes historical differences to persist in the short or even the medium term, rather than to disappear.

But non-believers can become moderate believers when technology is considered in conjunction with other factors within an appropriate framework and when it is promoted by public policies. For **Siegfried Utzig**, from the Bundesverband Deutscher Banken, the new economy has its own laws and requires more flexibility from market participants. This highlights the responsibility of economic policymakers to create a framework within which market forces can freely interact and develop. Also **Van Gompel** urged that institutional and legislative obstacles be eliminated. In addition, the governments in the EMU should make extra efforts in support of commercially oriented R&D and, because ICT applications are 'knowledge products *par excellence*', in strengthening ICT knowledge and skill among the population.

The Tallinn Colloquium 2003

The Tallinn 2003 Colloquium may duly be characterised as '*the event with the right topic at the right time and at the right place'*. The development of the financial sector in Central and Eastern Europe and its integration into the EU and later on into the EMU (in short CEE), has become a high priority in many countries in that region (cf. **Governor Vahur Kraft**, Q under C24). It will be a major issue in the post-accession years for unlocking the benefits of the Single Financial Market (cf. **Luigi Passamonti**, ibidem).

It was the right time to assess what has already been realised in the various transition economics and, even more what has still to be realised on the road to full integration in the coming years, in accordance with the sequence:

Transition → convergence → accession → full EU membership → full EMU membership.

And Tallinn was the right place because Estonia, in the East, *has been among the frontrunners in understanding the opportunities and the risks of the internationalisation process* in the financial sector (**Mart Sörg et al.,** ibidem). This small country may be considered a successful country on the road map we have just drawn.

No wonder, that under these circumstances a very large number of contributions had been collected. Fourteen papers were presented on the subtopic of the impact of foreign banks in CEE countries alone. Many of the empirical cases discussed were not monographs on one single country but included comparative research on several ones. Remarkably, a number of the high quality papers also did not originate from the West or from international organisations, but from researchers working in CEE countries themselves. Compared to the presentations at the 1997 Budapest Colloquium, progress in techniques and analysis was impressive and points to a large convergence in economic and financial research between East and West. Estonia was also a frontrunner in this respect, in the context of the cooperation between SUERF and the (central) Bank of Estonia.

In the framework of this survey three aspects should be highlighted on the basis of the papers that have been selected for the Colloquium Book:

– *the integration process*, the present and prospective positions on the road map transition → convergence → accession → full EU membership → full EMU membership,

– *the role and the performance* of the financial sector in transition and accession economies,

– *the quest for financial stability in* these countries.

As far as the first aspect is concerned, the obvious assessment may be summarised in one sentence, namely: Much has been done in the last ten years, but even more has still to be done in the coming years. **Luigi Passamonti** was most explicit on the accomplishments of the past, **Maxwell Watson** on the gap that still remains and the challenges to be faced in the period ahead (for both, Q under C24). In Watson's terms: "*Little more than a decade after transition began, the progress that has been made in strengthening the efficiency of the financial sector is impressive – but it gives no grounds for complacency in terms of the path ahead…*

By EU standards, financial depth typically remains fairly modest – leaving a considerable way to go to ensure that the financial sector functions efficiently and is competitive in the settings of the EU market in financial services..." (ibidem) However, **Passamonti** estimates that if the benefits of the Single Financial Market can be unlocked, '*it is quite possible that the new member states may become the main beneficiaries of the EU Financial Sector Plan'* (ibidem).

As mentioned before, Estonia was considered a success country on the road map, not only by the Estonian authors (**Lelo Liive**, **Mart Sörg et al**., Q under C24), who were rightfully proud of the performance of their home country but also by authors with a rather critical approach, as e.g. **Maxwell Watson**: '*...Estonia...by the late 1990s (had) achieved success through a strictly rule-based framework (currency board, balanced budget), a major banking clean-up in the late 1990s – triggered by the Asian and Russian crisis, and absolute openness to foreign capital'* (ibidem).

With regard to the second aspect, *the role and the performance of the financial sector in the transition and accession economies,* the growth potential of the sector was, in general, evaluated in rather optimistic terms. In his keynote address **Herman Agneessens** stated that the CEE financial sector would profit, on the one hand, from general economic growth in the transition economies which would be higher than in the existing EU-15 and, on the other hand, from a specific financial catch-up effect, due to the initial lower level of development of the sector and supported by a high degree of foreign involvement. However, as **Fink et al**. pointed out, initial evidence indicated that the growth-enhancing potential did not so much lie in financial sector *size* but rather in financial sector *efficiency* (Q under C24).

In several papers attempts were made to measure bank efficiency in countries of Central and Baltic Europe. Results did not allow definite conclusions to be drawn, because of differences in countries and periods considered, and also in sampling and estimation techniques. This is not surprising when one remembers that even the extensive (Western) literature on measurement of economies of scale and scope has remained quite inconclusive.

Some studies (e.g **Tuuli Koivu,** Q under C24) point to the reduction of the margin between deposit and lending rates as an indicator of increasing efficiency of banks, accelerating economic growth. The impression conveyed by several papers (e.g. **Mariana Tomova et al.**) is that efficiency is (slowly) increasing with reduced dispersion among countries and that it is convergent towards EU standards. Nevertheless, the gap between efficiency levels remains large and the overall picture is still unclear.

Much more consensus resulted from the extensive discussion of papers and views about the role and performance of *foreign banks* in Central and Baltic Europe. As an innovation at SUERF Colloquia, a banker's panel of high representatives from 5 banks 'from the West', but with substantial involvement 'in the East', concluded the exchange of views. The consensus was reflected in a statement by **Governor Kraft** (Q under C24): *"Foreign capital has had a positive impact on the financial sector, increasing competition and making it possible to import management culture and professional skills. It is noticeable that no proof of significant negative effects related to the foreign banks entry has been found. It seems that the foreign banks' credit policies have been less sensitive in local economic downturns and the entrance of foreign banks has not imported instability in any form..."* This consensus is supported by the conclusion of several contributions on various CEE economies, in particular by the orally presented evidence on the dynamics of foreign ownership in Hungary, one of the countries where foreign banks penetrated early (**Giovanni Majnoni et al.**): higher profitability of foreign banks resulted not from lending policies different from those of domestic banks, not from higher intermediation margins, which were in fact decreasing over time, but from product innovation and a better screening and monitoring procedure of the loan applicants.

However, a sharply dissenting view was expressed in the paper by **Christopher Green et al.** based upon an extensive investigation of the economies of scale and scope in 273 foreign and domestic banks located in nine different countries for the period 1995-1999. The paper contested the widespread belief that foreign banks were more efficient than their domestic counterparts. In each of the nine countries under review foreign banks were not more efficient than the average bank. *"... The results suggest that foreign bank ownership (rather than domestic ownership) is not a significant factor in reducing the banks' total costs ..."* (Q under C24)

Anyway, as will be argued in Section Three of the Survey, the evidence about foreign banks in Central and Baltic Europe adds a distinct dimension to the current worldwide debate on the impact of international capital flows on economic and financial growth.

The *quest for financial stability* in CEE countries, as expressed in the contributions to the Tallinn Colloquium, has clearly been inspired by the multiple financial crises which have occurred in Central and Baltic Europe since the beginning of the Nineties (cf. infra, the statement by **Governor Kraft**). The focus has been put on the prevention of currency and banking crises and on the combination of both. The frequency, the sudden occurrence and the intensity of these crises explain the emphasis laid on the need for adequate information and early warning mechanisms for the policy-makers, as well as for many other market participants. It is also characteristic, that in this concern about prevention much attention is devoted to factors of an institutional nature, beyond mere economic indicators. And finally, this concern for prevention is no longer limited to general statements but is increasingly being adapted to local conditions and expressed in technical models, two of which were presented at the Colloquium (cf. **Franz Schardax** and **Dirk Effenberger**, Q under C24).

In their Marjolin Prize-winning contribution, **Alicia García-Herrero** and **Pedro del Rio**, from the Banco de España, concentrated on the *banking crises* over the years 1970-1999 for 79 countries, of which 20 were transition economies. They tried to relate, at least statistically, the likelihood of such crises to the central bank objectives, to the monetary strategy followed and also, but to a lesser extent to other factors of regulatory and supervisory nature.

The general outcome is that the likelihood of banking crises is, other things given, reduced in countries and conditions where central bank objectives focus on price stability. However, this conclusion does not seem to hold for transition economies, where monetary policy strategy with exchange rate targeting appears to be the preferred option in terms of financial stability. Partly in contradiction with other investigations, this finding would support the choice of relatively fixed exchange regimes. Finally, locating regulatory and supervisory responsibilities at the central bank appears to be the solution to be preferred in all cases where factors of this kind are introduced into the analysis.

On the other hand, in the early warning models presented for signalling *currency* crises, **Dirk Effenberger** claimed that adding institutional factors to mere economic indicators improves the forecasting quality of the model. One interesting result of his investigation qualifies the preference of **García-Herrero** and **del Rio** for fixed exchange regimes and links up with the observations of **Aberola-Ila** and **Molina Sanches** at the Vienna meeting. For transition economies, 'hard' fixed exchange rate regimes such as the currency board, but not conventional adjustable pegs or crawling pegs reduce the vulnerability of transition economies for *currency crises.* (Compare relevant Q under C22 and C24). Obviously, this relates to the problem of credibility in so-called fixed exchange rate systems, as described in **De Grauwe** (2000): "*The fragility of a fixed exchange rate system has everything to do with credibility...When the authorities of a country announce that they will fix the exchange rate they are making a promise: they pledge to keep the exchange rate fixed today and in the future. The problem with any promise, however, is that doubts may arise as to whether it will be kept. In other words, all* *promises lead to problems of credibility"* (p. 97). In transition economies, fixed exchange rates seem to be only credible in the hard framework of a currency board and not in other fixed exchange rate systems.

All in all, the SUERF Colloquia of Vienna and Brussels showed that the Millennium Turn had reduced the rather exuberant euro and 'new economy' expectations of the late Nineties. However, they did not replace the hype of that period by an equal wave of euro and ICT pessimism. In other words, in the West, *l'air du temps was 'less exuberant, but reasonable and not negative'*. On the other hand, the Tallinn Colloquium, by stressing the potential of the financial sector in Central and Baltic Europe, added a new dimension to the analysis of growth and integration in Europe, which forces us to face new challenges, but also opens new prospects.

Section 3: Constants and Change Through Four Decades

In this final section we no longer discuss developments period per period. Taking a diachronic view instead of a synchronic one, we recapitulate our findings and conclusions by trying to describe the main trends in the whole period under review, distinguishing three constant aspects on the one hand, and on the other, change (i.e. developments through time) in three main areas of interest for SUERF.

This leads to the following structure:

Constants: - the 'force of events'
- mainstream thinking
- interaction between macro- and micro-factors

Change: - monetary and financial policy
- European monetary integration
- markets and institutions

Constants

When considering the '*force of events*' as a permanent feature of the SUERF Colloquia, we link up with the overall presentation in section 1. Events and major shifts, not theories, have constantly determined the main topic and the dominant themes of the meetings. Some of them, such as the oil shocks and the fall of the Berlin Wall were primarily political, but had far-reaching monetary and financial implications; others, such as deregulation, globalisation, EMU, originated in the sphere of economics and economic policy, but occurred in a well-defined political context. Although the intensity of the impact may have been different from case to case, no major issues seem to have been neglected, at least as far as they were considered relevant for the financial community in Europe. This qualification is important. It shows why events in the developing world and in the emerging markets have attracted much attention only when they had a significant impact on the European financial sector, particularly when they threatened to lead to an international financial crisis (cf. the credit crisis in the early Eighties and the East Asian crisis in the second half of the Nineties). On the other hand, this aspect of relevance explains the continuing emphasis on progress in European monetary integration, which is so characteristic of the history of the colloquia in the four decades under review.

However, if academic thinking and theorising have seldom played a dominant role in the choice of topics, they strongly contributed to highlighting the basic issues at stake and to analysing them in a solid analytical framework.

As already mentioned, the contributions of **Jacques Sijben** on monetarist economic policy and on market imperfections (Q under C7 and C18), those of **Niels Thygesen** and **Michael Artis** on European monetary integration (Q under C13 and C21), those of **David Llewellyn** on the New Economics of Banking (Q under C17 and C23), those of **Charles Goodhart** on risk and risk management (Q under C23) are examples of in-depth analysis, which shaped the intellectual profile of several colloquia. Would it not be advisable to have at each Colloquium, a keynote paper or a Marjolin lecture systematically analysing the main themes of the meeting from the point of view of current academic thinking and literature? Such a contribution would be an excellent counterpart to the keynote speech of outstanding policymakers, such as **Andrew Crockett** at C19 in 1995 and at C22 in 2000, and outstanding practioners, such as **Herman Agneessens** at C24 in 2003.

Mainstream thinking is a second rather permanent feature of the Colloquia. Obviously, it derives from the composition of the SUERF constituency: central bankers, commercial bankers, academics in banking and finance. It appears in several aspects. First, the opinions expressed in the papers and the discussions generally refrain from extremes and out-of-line novelties. They often express a kind of consensual wisdom. At the Wiesbaden Colloquium in 1977 the proposal, in the so-called academic '*All Saints Manifesto*', of a parallel European currency and a European central bank as independent as the judicial system and separated from the national treasuries, with monetary authorities '*appointed or* elected for long periods of time, if not for life...' was flatly rejected and even ridiculed (Q under C7). In Lisbon in 1991, and in Berlin in 1992, the views about the transition to a market economy in Central and Eastern Europe held, as already mentioned in section 2, the middle of the road between going 'cold turkey' into the free market system and a gradualism without time path and limit (Q under C16 and C17). Another aspect of SUERF thinking is that the Colloquia *grosso modo* followed the general mainstream change from Keynesian active demand management policies based on fine tuning through a combination of fiscal and monetary policies, towards a more monetarist and supply-oriented medium-term approach, allowing for a greater impact of market forces (as analysed by Ivo Maes, 2002). In this context the Wiesbaden 1977 meeting was a landmark for monetary policy and the Cambridge 1985 Colloquium one for market forces, shifting existing frontiers. However, the general trend did not exclude differences of speed and national peculiarities. In this respect, the differences between the mainstream Anglo-Saxon and mainstream Continental approach remained significant, particularly for France.

On the whole, systematic dissenters from mainstream thinking have not been numerous. Within the existing framework, **Charles Goodhart**, who likes to call himself a contrarian, contested the higher volatility of financial markets and also criticised regulatory decisions based on current deviations from a fundamental disequilibrium, about which we do not know very much at the moment of the decision (Q in C19 and C23). At the 2003 Tallinn Colloquium, **Christopher J. Green, Victor Murinde** and **Ivaylo Nikolov** contested the widespread belief that foreign banks in Central and Eastern Europe were more efficient than their domestic counterparts.

In a more radical way, **Dominique Strauss-Kahn**, at that time Professor at the Paris I University and later a very able Minister of Finance in France, opposed, at the 1983 Madrid Colloquium, the current drive to reduce and even suppress public deficits because, in his opinion, it hampered the state in two of its initial missions: stabilisation of the business cycle and the macro-economic allocation of resources (Q under C11).

In general, such reactions against mainstream thinking and 'consensual' wisdom were rather rare. Anyway, it is typical, that what has been defined and contested by **Stiglitz** (2002) and other 'global' dissenters, as the three pillars of the so-called Washington Consensus – fiscal austerity, privatisation and market liberalisation – have been topics approached in a positive way at the SUERF Colloquia. Maybe, more dissenting voices may prevent the SUERF *consensual* wisdom from turning into a *conventional* one.

From the very beginning, the third constant feature – *the interaction between macro- and micro factors* – has been built in the Colloquia by alternating meetings on macro-economic topics with others that were more closely related to developments in the financial markets and in the management of banks and other financial institutions. As *l'air du temps* does not generally change overnight, osmosis of ideas and percolation of opinions have frequently occurred.

Conflicts between micro-decisions of financial operators and macro regulatory orientations have not been eschewed. Already in Brussels in 1976, **Jack Revell** stated that "*there must always be some conflict between competition and regulation* ..." (Q under C6). In Vienna in 1982, when an international financial crisis was threatening, **W.P. Cooke**, who afterwards became famous through the 'Cooke's coefficients' of capital adequacy, stated the supervisor's dilemma as follows, "*On the one hand, the supervisory authorities have the responsibility for restraining banks from overreaching themselves and exceeding the prudent limits of lending, but on the other it is clear that to restrict the recycling capacity of the banking system...might precipitate the very crisis which the prudential regime is designed to avoid*..." (Q under C10) This raises the issue tackled by **Michel Tison** at the Tallinn Colloquium whether the prudential supervisor should be regulatorily immune against claims from private parties contesting decisions taken in the context of regulation and supervision (Q under C24).

However, emphasizing the interaction between macro- and micro- does not mean that this interaction has remained unchanged in the whole period under review. As will be shown infra, when considering changes at the level of markets and institutions, macro-economic aspects and factors predominated until about the mid-Eighties. Afterwards, problems were often related to the dynamics proper of the financial sector itself. They sometimes even induced macro-developments and decisions, while, before that time, causation usually went the reverse way.

Change

Monetary and financial policy

Linking up the quotations in the Anthology and the period analysis of section 2 of the present Survey invites the reader to an impressive journey into the world of monetary and financial policy, covering four decades and 24 SUERF Colloquia.

As already mentioned several times, the beginning of the period under review, exemplified by the 1969 Tilburg and the 1972 Strasbourg meetings, was dominated by international monetary problems, associated with the demise and final breakdown of the Bretton Woods system. From this debacle two main issues and strands of thought emerged:

- The issue of the exchange rate regime. How to replace the adjustable peg system of Bretton Woods by a less rigid, more flexible one?
- The anchorage issue, after the US dollar had, also formally, become inconvertible into gold. How to replace or redefine the role of the US currency as the anchor of the system and as the major reserve currency?

The exchange rate issue was the main topic of the 1974 Venice Colloquium (C5) and was also discussed on the sidelines of the 1977 Wiesbaden meeting (C7). The anchorage issue was dealt with, in a first immediate reaction at the 1972 Strasbourg meeting (C3) and then, after much trial and error during the whole decade of the Seventies, at the 1979 Basle meeting (C8).

In the field of exchange rates, the fixed-float debate entered on a large scale in practical policy-making. Would floating or at least managed floating become a (semi-) automatic instrument of adjusting external disequilibria and even a way to insulate the domestic economy and national policy from external shocks? At the beginning of the Seventies, these ideas were quite attractive not only among academics but also among policy advisers and policy makers, especially in countries, such as Italy, where external disequilibria were associated with structural differences in the propensity to inflate (**Magnifico**, 1972). These expectations soon proved to be illusions, as testified by the discussions in Venice. Floating rates were not a panacea, particularly in the economic disarray after the first oil shock. The real world had become a rather chaotic conglomerate of adjustable pegs, managed floating and more or less 'clean' floating. In Wiesbaden (Q under C7) **Theo Peeters** emphasized that an open economy (especially in Europe) is open, no matter what his exchange rate regime is. Governments can use exchange rates as policy instruments, even, as in the Thirties, for practising beggar-thy-neighbour policies through competitive devaluations. Hence, the need for policy coordination.

As such coordination did not occur because of benign neglect or, at least, did not prevent large swings in the exchange rates of the major currencies; the need for exchange rate stabilisation was increasingly felt in Europe. This led to the creation of the European Monetary System, which was presented at the Basle Colloquium by one of its Founding Fathers (Q under C8).

The anchorage issue and the changing role of the dollar after the breakdown of the Bretton Woods system was an aspect that struck the European policymakers and market operators of that time even more than the exchange rate issue. Impressed by the Nixon Declaration of inconvertibility of the dollar, **Louis**

Camu announced in Strasbourg, as already mentioned, that the persistent creation of liquidity through the deficits of the US and financed by the rest of the world had come to an end. He was proved wrong, the mechanism survived. The dollar remained the (unstable) anchor of the *de facto* system, which emerged from the ruins of Bretton Woods. This led, during the whole decade, to stormy relations between the dollar and the key European currencies.

In this context, the papers and discussions at the Basle meeting, held under the suggestive title: *Europe and the Dollar in the World-Wide Disequilibrium* offer a very representative picture of the situation at the end of the Seventies. Three points may be mentioned:

– Interdependence had increased. Developments in the Seventies had limited the ability of the US to determine its own economic fate independently. Even high-ranking officials recognised at the colloquium that the US could no longer afford to ignore feedback effects from the rest of the world. (**Daniel H. Brill** and **Edwin M. Truman** (Q under C8)).

– The 'worldwide disequilibrium' was considered, in Keynesian terms, to be rooted in the deficiency of savings in the US, which had maintained relatively high levels of growth and investment, the opposite being the case for Germany and Japan. This deficiency was mainly financed through official capital flows which inflated the reserves of the surplus countries (**Jacques Artus**, ibid). Autonomous private capital flows were not forthcoming on a stable and continuous basis from the surplus countries because the inward-looking capital markets of Germany and Japan did not generate sufficient long-term capital outflows. This was considered to lead to the absurd situation that countries in deficit had been borrowing in the well-developed capital market of the country with the largest deficit of all: the United States (**Tom de Vries**, ibid). However, reserve diversification and exchange rate flexibility would feed on each other to reduce the gap between actual and desired dollar holdings (**Sergio Siglienti**, ibid). No mention was made of the entrepot function of the London financial centre.

– In this context the US dollar was still considered inescapable, 'incontournable' as transaction and intervention currency, but was expected to gradually lose its other reserve functions.

The reader will observe that some considerations mentioned above, for example, concerning the insufficiency of US net savings, remain of relevance for present times.

Meanwhile, monetary policy was being revolutionised to face the challenge of worldwide inflation. Post-war macro-economic stabilisation policy based on Keynesian analysis had not been successful in curbing the inflationary process (**Jacques Sijben**, Q under C7). After more than a decade of mere academic debate, monetarism penetrated the boardrooms of policymaking organisations. In the Seventies, monetarism was discussed at the 1970 Colloquium in Tarragona (C2) and, most of all, at the already often quoted 1977 meeting in Wiesbaden (C7).

In Tarragona, it was only analysed in the framework of a rather academic survey of various theories of monetary policy and with the prudent caveat: '*recognizing the importance of the monetary supply is not equivalent to centring stabilisation policy exclusively on the management of the quantity of money ... Fiscal and monetary policies should be used in coordination and much discretion was preferred to* '*any rigid rule though it will not be free from errors*' (**L.A. Rojo**, Q under C2).

The Radcliffe Report was clearly not forgotten and the coordination recommendations reminded us of the Fleming-Mundell model.

Seven years later in Wiesbaden, the – not unanimous – message was that the inflationary process was essentially a monetary phenomenon that cannot come into effect unless the monetary authorities provide the required 'monetary fuel' (**Jacques Sijben**, Q under C7). In this way control of the money supply, based on the hypothesis of a stable demand for money and a strong and systematic correlation between money supply and economic activity, became the new paradigm. The strategy of the Bundesbank, which, in a pragmatic way, followed this quantitative approach, became a reference for friends and foes alike.

As a logical consequence, policy coordination and exchange rate stabilisation should in the first place be a matter of coordination of money supply policies and not of exchange rate surveillance and intervention rules (**Theo Peeters**, ibid). However, not everybody was prepared to push that far the Copernican change, the causation going from money supply to exchange rates, instead of the other way round. **Niels Thygesen** stated that, without the focus on some declared objectives for exchange rates, clear guidelines for monetary policy coordination were not feasible (ibid). Obviously the idea of the European Monetary System was in the air.

Monetarism found its most extreme application in the new US monetary policy, initiated at the end of the Seventies under the leadership of Federal

Reserve President Volcker. Together with the impact of the second oil shock, this had two consequences, which were analysed at two different Colloquia: in Vienna in 1982 (C10) and in Madrid in 1983 (C11):

– In the industrialised countries, particularly in Europe, it reinforced the effect of *stagflation*, inducing large government *budget deficits*, whose financing put heavy pressure on central banks to allow monetary expansion, in contradiction with monetarist rules. In Madrid, former Bundesbank **President Emminger** strongly opposed the idea that high public deficits would inevitably lead to an over-expansive monetary policy and advocated a law of government retrenchment.

– Worldwide, it fuelled the threat of an international financial crisis, followed by a collapse of the real economy which went '*beyond the usual gloom associated with every recessionary or stabilisation phase.'* (**Alexander Swoboda** in Vienna (Q under C10)).

In the meantime, deregulation was progressing, leading to the '*marketisation*' of banking and finance. Financial innovations generated shocks, which tended to destabilise the money demand function and seriously complicated the use of monetary targets (**Jan Koning** and **Niels Thygesen** at the 1985 Cambridge Colloquium, Q under C12). In some countries inflation targeting replaced mere control of the money supply. Exchange rates and interest rates came again to the forefront.

When in the second half of the Eighties, inflation rates had been reduced and intra-EMS exchange rate stabilisation had scored its first results, time seemed to have come for renewed efforts of international cooperation and even for initiating a global adjustment process (cf. the 1988 Helsinki Colloquium, Q under C14). As mentioned in section 2, these efforts did not survive the failure of the Louvre Accord in 1987, while the fall of the Berlin Wall and the signature of the Maastricht Treaty directed the attention to new perspectives.

Most of all, the *increasing dominance of globalised market developments* forced both theorists and policymakers to re-examine the scope and methods of monetary and financial policy in a context of despecialised banking and free capital movements. How to cope with increased competition, volatility, risk and financial fragility?

Empirical studies (Q under C18 and C19), both in public and private institutions, had brought out that an increasing number of tensions and crises had to be related, not to fundamental macroeconomic and financial factors but to the dynamics of markets themselves.

As a consequence financial stability had to be promoted and secured in its own way, besides monetary stability: by market discipline, by private management or public intervention?

The response to this new challenge is still not clear-cut, as testified by the important addresses of **Andrew Crockett** at the 1995 Thun (C19) and the 2000 Vienna (C22) meetings. Additionally, a new accent in the discussion came, at the 2003 Tallinn Colloquium, from the sensitivity for crises in the transition and accession countries, which had experienced frequent, sudden and intense currency and banking crises since the beginning of the Nineties.

There are limits to market discipline, but which? "*From the experience of the last three years I would argue that a number of institutions seriously overestimated the ability to hedge and diversify market and credit risk.*" (**Andrew Crockett**, Q under C19).

How to define capital adequacy requirements in a more refined way than by the blunt 8% rule of the original Basle Accord? (**Claes Norgren**, Q under C22).

How to organise official support in the event of truly unforeseen shocks of major proportions without creating moral hazard problems? (**Andrew Crockett**, Q under C19).

It appears that in a market-led economic and financial world, public policy in general and central banking in particular becomes more complex and less obvious in their objectives and methods, especially as far as financial stability is concerned. At the 2001 Brussels Colloquium **Governor Quaden** spoke of present central banking as a bird with two wings: monetary and financial stability (Q under C23). At present, the monetary wing seems to be much stronger than the financial one, which often covers only defensive capital requirements and more or less pathetic appeals for more transparency and disclosure. Is it not difficult to fly with two uneven wings?

European Monetary Integration

From the beginning, European monetary integration has been an area of special interest for SUERF. Few private associations can display such a record of permanent attention to the subject during four decades. Economic and Monetary Union (EMU) has provided the subject matter and the title of three colloquia: Strasbourg 1972 (C3), Luxembourg 1986 (C13) and Frankfurt 1998 (C21). It was a major theme at several other meetings: Basle 1979 (C8), Nice 1989 (C15), Lisbon 1991 (C16), Berlin 1992 (C17) and Tallinn 2003 (C24) and it received secondary attention at several other ones.

If one neglects hesitations and temporary setbacks, the development through time of this topic in the period under review can be summarised in a very straightforward way:

- *from the failure of the Werner Plan, towards exchange stabilisation in the European Monetary System (EMS) from the late Seventies on.*
- *to reach full EMU with a single currency in three stages during the Nineties*.
- *to be enlarged, with some delay, to countries of Central and Baltic Europe, after their accession to the European Union, from 2004 on.*

In this process, the pressure of external factors, from both policy (cf. supra) and private origin (cf. infra) has been important. The failure of the first comprehensive programme of EMU, the Werner Plan, was determined in a significant way by the breakdown of the Bretton Woods system, on which it implicitly relied (**Gros** and **Thygesen**, 1992). It was discussed in these terms at the Strasbourg meeting.

The setting up of the EMS, presented at the Basle meeting, aimed at exchange rate stabilisation after the large swings and the stormy relations between Europe and the dollar in the second half of the Seventies. We should remember the rather military approach used by Lord Jenkins, President of the European Commission, when he spoke in April 1978 in the European Parliament of "*a fundamental asymmetry about the United States having withdrawn from the responsibilities of Bretton Woods, while dollars, like legions without a central command* (sic), *continued to dominate the currency transactions of the world.*" (quoted in **Abraham** and **Lemineur-Toumson**, 1981).

Most importantly, the final decision to go beyond the adjustable peg solution of the EMS towards full EMU with a single currency was significantly determined by the assessment, after the 1992-1993 EMS crisis, that in a world of deregulated markets and free capital movements mere internal exchange rate stability was no longer sustainable (**Niels Thygesen**, Q under C21).

Amidst these external pressures, the European dimension did not disappear, although at certain moments it was questioned in the wake of increasing globalisation and intensifying technological progress. (**David Llewellyn**, Q under C13 and C15) Ultimately, these pressures stimulated new thinking and new initiatives.

Also in the SUERF Colloquia, the EMU topic developed its own profile in several ways:

– *As an important component of overall economic integration in its political context*. At the Basle Colloquium, the creation of the EMS was motivated on the basis that unstable exchange rate conditions had adverse effects on economic integration in Europe and had replaced old customs barriers in their negative effects on growth (**Jacques van Ypersele**, Q under C8). In Nice, monetary union was presented as the logical extension of the single market of goods and services (**Philippe Lagayette**, Q under C15). In Tallinn, the potential benefits of the single European financial market for the accession countries from the East were strongly underlined (**Passamonti**, Q under C24) but, at the same time, due attention went to the imperative of putting the 'old' EU back on a path of sustainable and no longer decreasing economic growth (**André Sapir** in his oral presentation at C24).

– *With its solid institutional arrangements*: single monetary policy and independent central bank (**Hans Tietmeyer**, Q under C21).

– *With its logic of a gradual deepening* of the integration process (**Rey and Michielsen**, Q under C13).

– *With its basic issues and tensions* (cf. **Ivo Maes**, 2002):

  – The permanent tension between the logic of integration, which requires deepening, and the fear of losing much national sovereignty: "*Une des difficultés de l'actuelle négociation (of the Maastricht Treaty and its implementation) est qu'elle prend souvent l'allure d'une défense excessive des symboles nationaux. Chaque pays a ses valeurs et ses préférences en matière économique et monétaire. Lorsqu'elles sont brandies comme des drapeaux sur un champ de bataille, elles en deviennent des symboles.*" (**Giovanni Ravasio**, Q under C16).

  – The tension between the 'monetarists' (in the 'European', not in the 'theorist' jargon), who want to use the monetary issue as a catalyst for

EMU, and the 'economists', who consider money as the 'coronation' of successful coordination of economic policy of the member states: "*...Exchange rate stability must be viewed as the outcome of a process of policy coordination and convergence in Europe and not vice versa...*" **(Axel Weber**, Q under C19).

  - The tension between centralisation and decentralisation of economic policy, the implementation of the subsidiarity principle, the '*one size fits all'* problem in the single monetary policy (**Michael Artis**, Q under C21).

- *With its doubts and temporary setbacks*: the disarray of the Seventies, the gloom of the early Eighties, the impact of market-induced turbulence in the early Nineties and again after the Millennium Turn...

- *With its protagonists and its euro-sceptics*, who often did not line up along the classical dividing line: Continental versus Anglo-Saxon (cf. the brilliant protagonists **Michael Artis** and **Graham Bishop** in the UK, versus the rather sceptical German academics).

At the 1998 Frankfurt colloquium, the already decided and soon to be launched euro made for some exuberance, which is not characteristic of SUERF Colloquia. However, the enthusiastic idea that a new era had already been initiated, was somewhat tempered by the final assessment of **Niels Thygesen** (Q under C21), that only two-and a-half of the five initial ambitions for EMU had already been fulfilled. As far as the external impact of the eurozone on the international monetary system and the development of a European profile in financial regulation are concerned, deepening is still lacking. Together with the enlargement problem towards the United Kingdom, Scandinavia and the accession countries of Central and Eastern Europe, this makes for a tremendous assignment... and a subject matter for future SUERF Colloquia.

Markets and Institutions

As already suggested in section 2, the developments through time at the meso- and the micro-level can be summarised by breaking down the four decades under review in two periods, the dividing line being placed somewhere at the mid-Eighties, at about the time when SUERF discussed 'Shifting Frontiers' in Cambridge (C12 in 1985). In the first period, the focus had been put on the impact of macro-evolutions and of government policy on the functioning of markets and on the management of banks and other financial institutions. In this macro – and government – led time the main issues for markets and banks was to meet the challenges induced by these external factors.

In the second period, the specific dynamics of the financial sector itself came to the forefront as a consequence of deregulation. Sometimes it became dominant, having macro-economic implications of volatility and financial risk. The attention went – though not exclusively – towards internal issues of the financial sector or to internalising external developments by adequate management.

In both periods specific features and topics appeared in various ways.

Among the most significant ones in the macro – or government – led period, may be mentioned:

– At the 1974 Nottingham Colloquium (C4), the effects of internationalisation on the business sector and, more specifically, the functioning of multinational enterprises in their relations and conflicts with domestic firms and government policies;

– At the 1976 meeting in Brussels (C6), meeting the challenge of worldwide inflation, among others by indexation of financial instruments;

– At the same meeting, deriving the lessons for liquidity and solvency of financial institutions from the failure of Herstatt Bankhaus, which occurred in the period of super-inflation and volatile exchange rates after the first oil shock;

– At the 1980 Helsingør Colloquium (C9), focusing on bank management in difficult times, illustrated by these quite typical quotations: "*The time had come for a topic of more direct concern to individual bank managements, (facing) major new challenges: the rise in energy prices, high rates of inflation, balance of payments disequilibria, fast-growing indebtedness of lesser developed countries, rapid structural change in industrial economies and growing intervention by governments.*" (Preface to the Colloquium Book). "*Nous sommes ici au pays de Hamlet et la question fondamentale (du colloque) ne devrait-elle pas se formuler: Pourra-t-on continuer à être banquier dans les année 1980?*" (**Pierre Ledoux**, Q under C9).

These quotations hint at a growing discontent of banks about government policies and huge public deficits, whose financing crowded out private credit activity to business and individuals.

– The crowding-out theme towered in the 1983 Madrid meeting (C11) where it was called ‘the star’ of the colloquium. But, as mentioned in section 2, resistance of top bankers was also noticed at the 1982 Vienna meeting (C10), when the role of international banks in the recycling of the oil-surpluses was explicitly questioned and criticized.

When, under the impact of deregulation and liberalisation of capital movements, the ‘frontiers’ were shifted to market-led developments, new specific features appeared:

– Financial intermediation and innovations in conditions, mainly determined by market forces (**Jan Koning** in Cambridge (C12 in 1985), **David Llewellyn** in Luxembourg (C13 in 1986) and in Nice (C15 in 1989), **Rainer Masera** in Dublin (C18 in 1994)).

– Competition and competitiveness, market imperfections and vulnerability in a large spectrum of countries and financial centres (C18 in 1994 in Dublin);

– Volatility, risk management and corporate governance in financial institutions and other firms and by public authorities (C19 in Thun in 1995 and C20 in Budapest in 1997);

– Internalisation of the effects of globalisation and technology (C22 in Vienna in 2000 and C23 in Brussels in 2001).

The 1998 Frankfurt Colloquium (C21) and the Tallinn Colloquium (C24) constitute exceptions to the classification followed in the preceding lists. The implications of the introduction of the euro, and also of the EU enlargement towards the East, for the financial sector of the accession countries were discussed in a ‘government-led’ way of previous times. However, the presentations included many more details related to financial markets and bank management. This reflects the impact of that major ‘public innovation’ on market operators and their expectations.

Anyhow, it is quite typical that in recent times more and more papers and presentations at the SUERF Colloquia are given by professionals, daily involved in market operations. This trend reflects the general interest in management problems at various levels. It may also explain the widening gap between the statements by policymakers and their staff on the one hand, and the contributions of market operators and of the young academics following these operations, on the other hand. The latter emphasize the technicalities of the issues and the cases they are working on. Implicitly, they accept volatility and bubbles as a fact of life and they seek how to live with it and to profit from it. Public authorities, on the contrary, focus on the vulnerability and fragility of the present market-led and globalised financial system. These divergent conceptions are quite fundamental but can be reconciled at SUERF Colloquia. At the Tallinn Colloquium for instance, the gap between practitioners and policymakers was reduced by the contributions of practitioners, also from the private financial sector. They searched to develop and improve quite technical early warning models signalling the threat of currency and banking crises in transition economies. Obviously, this osmosis of macro issues and micro techniques should be promoted in future colloquia. It highlights SUERF's role and mission in providing a forum and a network, where professionals, academics, central bankers and other policy makers meet and work together for better mutual understanding and for stimulating research and analysis of basic issues and driving forces in the financial world.

Intentionally, this Survey ends with a suggestion that is inspired by the conclusion of **Peter Oppenheimer** at the end of the 1988 Helsinki Colloquium:

"The solutions of one quinquennium or one decade or one generation turn into the problems of the next. Happily so, in order that the world's economists and bankers may go on conferring ..."

Indeed, to the SUERF Colloquia may be applied what **Martin Fase**, a dedicated former member of the SUERF Council of Management, said about monetary economics in his impressive farewell address on his retirement from the University of Amsterdam (28 November 2002) (our translation from Dutch): **"This monetary landscape somewhat resembles a flower garden: a blooming flowerbed at one place wilts with the passage of time and season. However, it almost imperceptibly reproduces itself in no less splendid flowers somewhere else in the garden. So, the original splendour sinks into oblivion ..." May the Survey and the Anthology of this Jubilee contribution help to revive the forgotten blossoms, highlight the present ones and, most of all, allow the future ones to turn into splendid flowers ...**

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[2] Excluding quotations in the Anthology of Part 2

Part 2

AN ANTHOLOGY OF SUERF COLLOQUIA PUBLICATIONS 1969-2003

"***Anthology**: from anthos flower + logia, logeia collecting ...: a usually representative collection of selected literary pieces or passages...also:* ***something felt to resemble such a collection*** *(his performance was an ~ of hilarity)*" (Webster's International Dictionary).

"...Competition for Markets and Turf
In finance can get pretty Rough
But to see a real fight
Where everyone's right
Attend a Colloquium of SUERF ..."

(An attempted limerick by Richard O'Brien at the end of the General Report, Colloquium 1994 in Dublin)

SUERF Colloquia and Colloquia Publications 1969-2003 in Figures and Locations

Number of Colloquia	24
Of which in:	
Germany (Wiesbaden 1977, Berlin 1992, Frankfurt 1998)	3
Spain (Tarragona 1970, Madrid 1983)	2
France (Strasbourg 1972, Nice 1989)	2
The United Kingdom (Nottingham 1973, Cambridge 1985)	2
Belgium (Brussels 1976, 2001)	2
Switzerland (Basle 1979,Thun 1995)	2
Austria (Vienna 1982, 2000)	2
The Netherlands (Tilburg 1969)	1
Italy (Venice 1974)	1
Denmark (Helsingør 1980)	1
Luxembourg (1986)	1
Finland (Helsinki 1988)	1
Portugal (Lisbon 1991)	1
Ireland (Dublin 1994)	1
Hungary (Budapest 1997)	1
Estonia (Tallinn 2003)	1

Colloquia Publications

Number of **Colloquia Books***	**22**
Number of Colloquia-related brochures in the **SUERF Series****	**10**
Total Number of **Contributions***	**462**
Total Number of different **Authors (**approx.)	**477**
Total Number of **Pages*** (**approx.)	**8275**

* 21 published Colloquium Books and the forthcoming volume on the 2003 Tallinn Colloquium

** in the absence of an overall Colloquium Book for the Colloquia of Tarragona (1970) and Strasbourg (1972).

*** Includes an estimate of 350 pages for the 2003 Tallinn Colloquium Book

Colloquium 1: The Future of the International Monetary System

Tilburg, April 1969
Joint initiative of John F. Kennedy Institute and SUERF
President of SUERF and Co-Chairman of the Colloquium: Hans W.J. Bosman

Colloquium Book:
Editors: H.W.J. Bosman and F.A.M. Alting von Geusau
Authors: Paul Bareau, Edward M. Bernstein, Irving S. Friedman, Milton Gilbert, Emile Van Lennep, Javier Márquez, J. Petrivalský, Robert W. Russell, L. Veltruský
Publishers: A.W. Sijthoff, Leyden and Heath Lexington Books, Lexington Mass, 1970, 180 pp.

– *On the state of the international monetary system at the end of the Sixties:*
"Considerable freedom for economic transactions, resistance to changes in exchange rates, the slow growth of acceptable monetary reserves, the neglect of failures of automatic mechanisms for adjustment and the disputes over permissible foreign accumulation of dollars and sterling – all these together – constitute the structure of the international monetary system today and that structure is designed (perhaps unintentionally) to place maximum stress upon the willingness of nations to keep their economies closely in line with price and cost trends in other major nations" (**Robert Russell**, Assistant Professor of Political Science, Wisconsin State University, pp. 78-79)[3].

– *On gold as a major reserve asset:*
"It has also become increasingly noticeable that nations are now regarding gold as the least liquid of their reserve assets, with the result that when they begin to run deficits, their first thought is to preserve their gold stock." (**Emile Van Lennep**, Treasurer General of the Netherlands, afterwards Secretary General of OECD, p. 20).

[3] It should be recalled that the title and the functions of the author refer to those existing at the time of the Colloquium, as mentioned in the Colloquium Book. cf. the Short Reader's Manual, in Part 1.

“It seems to me ... that the problem of gold is the key question with regard to the future of the monetary system. If gold is to perform its normal role in the system, action must be taken to assure an adequate regular inflow of gold to monetary reserves. If not, the monetary authorities must reach a workable arrangement for the full management of gold in the composition of reserves, probably with the implication that gold must be a generally inactive reserve asset.” (**Milton Gilbert**, Economic Advisor and Head of the Monetary and Economic Department of the BIS, p. 70-71)

– *On the Special Drawing Rights as a new reserve asset:*
“The early activation of the Special Drawing Rights is necessary precisely because there can no longer be a substantial increase in gold reserves and there should no longer be a substantial increase in foreign exchange reserves.” (**Edward M. Bernstein**, Director Research and Statistics Department of the IMF p. 109)

– *On the reform of the international monetary system:*
“The most fundamental and promising structural changes would be to make exchange rates somewhat more flexible than at present and to activate the SDR arrangement for managed growth in world monetary reserves.” (**Robert W. Russell**, p. 94)

– *On the developing countries:*
“I also take the position that the international monetary game should not be an even one, that the industrial heavyweights should, by common agreement, give a handicap to the developing featherweights.” (**Javier Marquez**, Director, Centro de Estudios Latin-americanos, Mexico, p. 119-120)

– *On the socialist countries:*
“In our view the Comecon and world monetary systems will continue to develop differently for some time to come. In view of the conditions prevailing within Comecon it is useful for that system to be directly or indirectly supported by the gold base, whereas on a world scale, measures should be taken towards the demonetisation of gold.” (**Ladislav Veltruský** and **Jiri Petrivalský**, High School of Economics, Prague, p. 161)

Colloquium 2: Monetary Policy and New Developments in Banking

Tarragona, October 1970.
President of SUERF and Chairman of the Colloquium: Hans W.J. Bosman

No Colloquium Book
Two papers in SUERF SERIES nº 1 & 2
Authors: L.A. Rojo, F.E. Aschinger
Publisher: SUERF, 1971 (16 + 15 pp.)

– *An eclectic view on stabilisation policy:*
"Recognizing the importance of the monetary supply is not equivalent to centring the stabilization policy exclusively on the management of the quantity of money." (SUERF Series nº 1, p. 14)

"Fiscal and monetary policies are ... two different instruments that used in coordination offer the components of a short term stabilisation economic policy..." (p. 13)

"Discretional action based on the best available information will probably work better than any rigid rule though it will not be free from errors." (p. 16)
(**L.A. Rojo**, Professor at the University of Madrid)

– *On the impact and the control of the Eurocurrency Market:*
"Individual countries cannot fully insulate themselves from the influences of the Euromarket without adopting a comprehensive foreign exchange control system. The Euromarket, which is of great service to the world economy, should not be viewed solely from a protectionist angle. On the contrary, every occasion should be seized to bring the Euromarket into play in support of national monetary policy.

On the other hand, the Euromoney market should not serve as a safety valve for escaping national monetary policy ...

Hectic fluctuation of the Euromarket and the resulting disrupting effects are frequently a result of economic policies in the main currency countries. It is up to these countries, the USA in particular, to make allowances for the Euromarket by adopting policies of domestic economic stability and appropriate credit policy procedures...

International endeavour to control the Euromarket should principally be aimed at offsetting the flow of hot money in times of monetary crises." (**F.E. Aschinger**, Economic Adviser, Swiss Bank Corporation, Zurich, SUERF Series nº 2, p. 14-15)

Colloquium 3: Aspects of European Monetary Union

Strasbourg, January 1972
President of SUERF and Chairman of the Coloquium: Hans W.J. Bosman.

No Colloquium Book
9 papers in 8 issues of the SUERF SERIES nº 3 through 10.
Authors: Paul Bareau, F. Boyer de la Giroday, Louis Camu, F. Cassell, August Leeman, Francesco Masera, John E. Nash, Fabrizio Onido, Herbert Weise.
Publisher: SUERF, 1972 (30 + 23 + 12 + 19 + 11 + 35 + 43 + 27 pp.)

– *On the breakdown of the Bretton Woods system:*
"Le principal évènement qui a marqué cette année est sans doute celui dont nos avons pris connaissance le 16 Août dernier (i.e. The Nixon Declaration of the inconvertibility of the dollar, 15 08 1971). Ce jour là, nous avons appris qu'une structure monétaire du monde avait vécu et s'il faut regarder cet événement, qu'il me soit permis de citer Sartre, 'avec des yeux réinventés'.

Depuis des années, les systèmes monétaires occidentaux ont vécu dans le climat entretenu par une source de création de liquidités qui était le déficit persistant de la balance des paiements des Etats-Unis et sa multiplication par la création d'eurodollars...

Cette source de création de liquidités ... et son financement pratiquement illimité par le reste du monde ont pris fin ..." (**Louis Camu**, President of the Banque de Bruxelles, in the opening address, SUERF Series nº 3, p. 2)

– *On the impact on European Monetary Cooperation, particularly on the Werner Plan:*
"The breakdown in monetary cohesion between EEC countries reflected substantial divergencies of their cost and price structures; but the basic causes went still deeper and are to be found not only in the lack of structural or institutional machinery for achieving the required cohesion, but in doubts as to whether, even if this machinery existed, the national governments would have the will and ability to carry through the necessary adjustments in their domestic monetary, fiscal and other relevant policies." (**Paul Bareau**, Economic Adviser

to the International Publishing Corporation Limited, London, author of the final report of the Colloquium, SUERF Series nº 3, p. 17)

"...Any choice of an "optimum" solution makes no sense unless at the same time we understand what the "optimum" path is which leads to that solution. Or else we fall into the temptation, which has long beset economists, of amusing ourselves with more or less refined descriptions of a world which we still do not know how to get into. This is, in my opinion the major logical flaw in the Werner philosophy and more generally in the attempt to derive, straight from the theory of interregional payments a set of consistent criteria for unifying the present national currency areas into larger currency domains." (**Fabrizio Onida**, Professor of international Economics at the University of Milano, in a discussion of the theory and policy of optimum currency areas and their implications for the European Monetary Union, SUERF Series nº 9, p. 25)

– *Economists versus 'monetarists' in shaping EMU:*
"One of the basic issues before the colloquium was the clash between those who hold that monetary union can only be achieved and maintained when economic and virtually complete political union have already been secured and those who regard monetary union as one of the means and as providing part of the discipline required to achieve complete economic union. Is monetary union one of the foundation stones of economic union, or is it the final coping stone of the arch?" (**Paul Bareau**, cf. supra, p. 17)

"The only serious argument in favor of a European currency area preceding a complete economic and political unification is perhaps the pressing need for a new international asset and official intervention currency alternative to the dollar." (**F. Onida**, cf. supra, p. 29)

– *Fixed or adjustable exchange rates within EMU:*
"The crucial question thus becomes: to what extent are the major advantages which a EMU is expected to bring about (a faster process of economic integration through institutional and policy harmonization; a more efficient mechanism of financing and adjustment of externally disequilibria, which implies a more equitable distribution of the burden of adjustment as among deficit and surplus regions; a decisive step towards a more international monetary system) more likely to follow from a mix of policy cooperation plus parity adjustments rather than from Werner's prescription of policy cooperation plus irreversible parity pegging? ..." (**F. Onida**, cf. supra, p. 31-32)

"There is a prima facie evidence that, for European countries characterised by a smaller economic size and/or a greater weight of regional and structural imbalances relative to their partner countries, joining a common currency area under present conditions is likely to sharpen rather than help to solve the problem of the current asymmetries in the burden of adjustment ... Even aside from national interests the formation of a European currency area starting from unalterably fixed parities does not seem to be a necessary nor a sufficient condition for improving the efficiency of our present international monetary system through a forced reduction of the dollar monopoly position. (ibid, p. 31)

"...I am led to conclude that in the present situation a plan for intra-EEC adjustable parities coupled with a common set of controls upon intra and extra-community transfers, bank deposits is the most reasonable alternative." (ibid, p. 34)

– *Diverging views on a common European currency:*
"The views expressed on the need for a common European currency ranged from the support for full and even immediate union ... to complete rejection of the need for such project." (**P. Bareau**, op. cit., p. 20)

"Si les pays européens entendent préserver leurs chances d'union – dans l'indépendance – ils doivent tenter de se dégager de l'emprise du dollar. A défaut d'une action qu'il faudrait immédiatement mettre en oeuvre sous peine d'en voir disparaître la possibilité même, le choix qui leur est offert aujourd'hui se situe entre les deux termes de l'alternative suivante: la prolongation des perturbations actuelles qui risquerait de faire disparaître la Communauté elle-même, ou la consécration de l'étalon dollar universel.

Dans la mesure où l'on considère ces évolutions comme également indésirables, on peut se demander, et l'on s'est demandé de divers côtés, s'il ne serait pas possible de faire naître d'une action commune, un instrument monétaire commun, qui tendrait à remplacer le dollar dans autant de fonctions possibles au fur et à mesure des progrès de la construction économique et monétaire." (**F. Boyer de la Giroday**, Director of Monetary Affairs at the European Commission, SUERF Series nº 10, p. 18-19)

"If the common currency is to have an operational meaning, rather than being a symbol, and to work without creating tension and a clash of interest among member countries, it cannot be a *prius* but only a *posterius* of economic and political integration of the Community countries." (**Francesco Masera**, Economic Adviser of the Banca d'Italia, SUERF Series nº 6, p. 5)

– *The role of sterling after Britain's entry into the EEC:*
A British view: "The marriage" that has now been arranged is not one between a debt-ridden Britain and a reserve-rich Community – a match of our liabilities and their assets. The bride, in fact, brings a fine dowry. London might become in effect a giant financial intermediary, taking in short term funds from other parts of the Community and transmuting them into longer-term loans and direct investments. The question is whether the main vehicle currency for those transactions would be sterling or (Euro-) dollars or a 'common' EEC currency. I do not foresee Britain's membership of the Community having a dramatic effect on the international role of sterling ... The forces reshaping sterling's role are in the main global ones, and they seem unlikely to be fundamentally changed by Britain's accession to the Community ... My guess ... is that the dollar will continue to serve as the dominant currency in international finance and hence I would not expect sterling to enjoy (or suffer) a grand resurgence within an enlarged EEC." (**Francis Cassell**, Senior Economic Adviser, The Treasury, London, SUERF Series nº 5, pp. 5, 10, 11)

A Continental view: "It appears quite natural that substantial scruples are arising with regard to the integrative capacity of a currency that brings such a world-wide network of connections and financial ties as dowry for entry into the European 'matrimony'... It is necessary in the interest of the European partner countries, as well as in the self-interest of Britain, to fundamentally adapt and streamline the role of sterling and to relieve it of the burdens and risks which no longer stand in a commensurate relation with the present international economic capacity of the country. This applies especially to the reserve currency function with all its implications ... Once the 'historical ballast' is discharged and the British economy gains a new platform through the monetary and economic cooperation with the European partner countries, a certain regeneration of the international scope and efficiency of sterling is quite within the reach of future development." (**Herbert Weise**, Institut für Weltwirtschaft, Kiel, SUERF Series nº 8, pp. 19, 29)

– *On the future of Financial Centres in a European Monetary Union:*
A Continental view: "La notion de 'centre financier' est en train de perdre une grande partie de sa signification géographique bien définie. Le développement des techniques et moyens de communication a contribué dans une mesure considérable à l'estompement de cette conception...L'union monétaire placera le développement des centres financiers sous un jour tout

autre que ce n'était généralement le cas jusqu'à présent. En effet, lorsqu'on soupèse les chances de développement, l'on parle souvent des entraves nationales qui se situent essentiellement sur le plan monétaire. Leur suppression favorisera ... les fusions et d'autres formes de coopération qui, jointes au développement des moyens de communication, réduiront l'importance locale de Paris, d'Amsterdam Bruxelles, etc par rapport à un marché non régional qui s'appuiera plutôt sur le développement institutionnel que sur les avantages locaux..." (**Auguste Leeman**, Professor at the Catholic University of Leuven and Executive Director of Kredietbank, Brussels, SUERF Series nº 7, p. 6, 11)

A British view: "At least part of the reason for different modes of development (of financial centres) is the difference between financial centres which have traditionally been national and 'inward' looking and financial centres which have been international and 'outward' looking ... Liberalization of international payments combined with the growth of the Eurodollar market gave an enormous stimulus to the only financial centre capable of taking advantage of these developments, namely the City of London ... Many practitioners in the City have long felt that the internationalism and 'outward' looking orientation of the financial centre in London could actually find itself reduced or hamstrung by European legislation on many international transactions (e.g. international insurance) and by the possible dangers of a powerful central bureaucracy with little experience of or sympathy for international markets ... All (this) refers to preoccupations which have, in a very real sense, been overtaken by events ... Today and in the future, whatever happens to the larger international issues, the main difference between the members of the EEC (including the U.K.) are differences of institutional and legal structure. Progress in such matters as a European company law, uniform European savings and investment institutions and patterns, uniform investment requirements and policies of insurance companies and pension funds, uniform reporting and accounting practices of public companies etc. etc. are likely to be far more important in determining the final shape of financial markets and methods of intermediation than any spectacular currency or monetary initiatives.

The fact that these institutional and legal factors are deeply rooted in diverse historical, sociological and political backgrounds is a measure of the problems of future integration, and of reasonable forecasting of the future." (**John E. Nash**, Executive Director, Samuel Montagu and Co, Ltd, London, SUERF Series nº 4, pp. 4, 15, 17, 23)

Colloquium 4: Multinational Enterprises – Financial and Monetary Aspects

Nottingham, April 1973
President of SUERF and Chairman of the Colloquium: Hans Bosman

Colloquium Book:
Editors: J.G.S. Wilson and C.F. Scheffer
Authors: Lord O'Brien, G.Y. Bertin, F.H. Brittenden, John H. Dunning, Jack Hendley, J. Koning, A.J.W.S. Leonard, Nils Lundgren, W.A.P. Manser, John Mellors, Sylvain Plasschaert, Sidney E. Rolfe, Sieghardt Rometsch, Edward Thielemans, Patrice de la Vallée, Donald W. Vollmer.
Publisher: A.W. Sijthoff, Leyden, 1974, xi, 241 pp.

– *On the threefold dimension of the multinational company (MNC):*
"(The MNC) is actually active in three dimensions. First of all, the national dimension of the parent company, whence it extends its activities over the world and which takes decisions on the strategically important points and determines the arrangement of the whole. In the second place, the dimension of the foreign countries, which is fragmented by political, economic and sociological boundaries and which is occupied by the MNC via its local establishments. And lastly, the MNC's own specific dimension, created by itself via its internal organisation and structure.

This threefold dimension gives the MNC a greater independence vis-à-vis its environment and thence offers it possibilities which are not available, or at least are available to a lesser extent, to the national enterprise." (**Edward Thielemans**, Director, Kredietbank NV, Brussels, p. 23)

– *On MNC versus nation state:*
"A traditional frame of reference in discussing MNCs has been the conflict between the objectives of those enterprises as part of the international economic system, attempting to allocate resources optimally without reference to national borders, and the needs of the national states. Traditionally, those who place the higher priority on the legitimacy of the objectives of the nation states have seen MNC as a threat to sovereignty while

those who place a higher priority on international economic rationality see the nation state as a residual barrier ... MNCs improve the international allocation of resources, while the institutional arrangements under which the modern world exists tend to make them contribute to international instability. The task at hand is to concentrate on developing both national and international policies and institutions to cope with the stability problem rather than sacrifice real growth by interventions to restrict international firms ... It was suggested that many features of the markets in which multinational enterprises operated such as tax differentials, privileged access to finance and the like, were forms of market imperfection arising out of government action ...” (**Sidney E. Rolfe**, Professor at the Center for International Studies, MIT, Massachusetts, USA, in the general report on the Colloquium, p. 222)

“The commercial interests of a MNC may not coincide with the national interest of a country where it operates; and further work remains to be done on how best such conflicts of interest can be reconciled, so as to preserve national objectives without necessarily killing the goose that lays the golden eggs.” (**Lord O’Brien**, Governor of the Bank of England, p. 11)

“Domestic management policies (are) more difficult to achieve the greater the openness of the economy. But because MNCs (are) so much more involved in international transactions than national firms and that a substantial part of these (are) intra-group; because they (are) among the world’s largest and most powerful financial institutions; and because they (operate) in a world comprised of sovereign states each with different fiscal, monetary and exchange policies designed to meet its own particular objectives, the clash between such firms and national governments (are) the more dramatically expressed.” (**John H. Dunning**, Professor of Economics, University of Reading, p. 183)

Colloquium 5: Floating Exchange Rates – The Lessons of Recent Experience

Venice, October 1974.
President of SUERF and Chairman of the Colloquium: J.S.G. Wilson

Colloquium Book:
Editors: H. Fournier and J.E. Wadsworth
Authors: G. Carli, A.W. Clements, F. Forte, H. Glesjer, N. Kagami, J. van der Linden, R.S. Masera, E. Merigo, G. Pelli, M. Rist, R.W. Russell, H.P. Schär, P. van Veen, T. Yoshino
Publisher: A.W. Sijthoff, Leyden, 1976, xi, 229 pp.

– *On the state of the debate:*
"In recent years no major theoretical breakthrough has been achieved regarding the fixed-versus floating-rate debate. Rather, there has been a consolidation of the respective arguments in favour of the two regimes formulated essentially on the basis of empirical considerations concerning the following fundamental points: (a) the stabilizing or destabilizing nature of speculation; (b) obstacles to trade and foreign investment deriving from exchange-rate uncertainties; (c) the degree of anti-inflationary discipline imposed by the two regimes; (d) the negative consequence of temporary fluctuations of the exchange rate around the trend." (**G. Carli**, Governor of the Banca d'Italia, in the opening address to the Colloquium, pp. 3-5)

– *Findings according to the elasticity approach:*
"... We have stressed: (1) the complex reaction of export and import prices to a movement in exchange rates: we found generally a relatively small deterioration in the terms of trade for manufactured goods in the very early quarters after the depreciation and some further subsequent worsening; (2) the need to disaggregate the balance of currents accounts. The impact of, say, a depreciation will vary even in sign between the various components; (3) the high elasticities in the medium-run but low ones in the short-run; (4) the quite low supply elasticities in the medium-run, especially for raw materials ... Some of those findings explain the slow adjustment of current payments to changes in exchange rates." (**Herbert Glesjer**, Professor at the University of Brussels, p. 45-46)

– *Conclusions starting from the monetary approach to the balance of payments:*

"... It is misleading to argue that free exchange rates automatically eliminate external payments problems and hence that the policy-makers can direct fiscal and monetary tools towards any desired internal objective. Flexible exchange rates per se need not be unstable but if they make for instability and variability of rates of domestic money creation in the various countries, then they will indeed prove unstable. Such effects will be the more pronounced if the home economy is highly open and integrated with foreign economies. In these conditions the integration of the network of the world market might suffer with a consequent generalised loss in welfare. This suggests that a case can be made to establish, wherever possible, large currency blocks, floating against each other and characterised by stable rules of internal monetary growth." (**R.S. Masera**, Economist at the BIS, Basle, p. 55, 65)

– *On the impact of the oil shock:*

"...If flexible exchange rates are more suitable for conditions where the balance of payments is a small fraction of aggregate domestic product, while fixed rates are better employed in conditions where it is a large part, one has to point out that neither system of exchange can work well with the present enormous oil deficits." (**Francis Forte**, Professor and Vice-President Ente Nazionale Idrocarburi, Rome, general rapporteur of the Colloquium, p. 221)

– *How to assess the experience of flexible rates?*

"Flexible rates came into operation in a period of great disturbances which were to a large extent, provoked by the previous experience of fixed exchange rates where frequent adjustments were rendered difficult by the fact that such changes were regarded as a traumatic experience. I would say that floating has not been 'clean' ... (The) previous disequilibrium situation was largely due to the excess of the money supply in various countries, a situation that proponents of flexible exchange systems do not suppose, particularly as they believe that a country may try to insulate itself by way of flexibility ..." (**F. Forte** ibid, p. 221-222)

"... If one wants to judge the present system's performance one must not forget that it is not a generalized system of floating, or even of managed floating ... Currencies in the 'snake' cannot be said to belong to a system of managed floating rates, but to a system of adjustable pegs, since they are committed to a fixed relationship between them. Managed fluctuations may not differ significantly from adjustable pegs ..." (ibid, p. 222)

"... A tendency persists, under flexible exchange rates to reason in terms similar to those employed under fixed rates: i.e. to consider rates behaviour mostly as 'one way' and therefore to believe that if a currency has been devalued, it is likely to suffer further devaluations and that if a currency has been revalued, it is likely to be involved in further revaluations. This kind of attitude may be destabilizing." (ibid, p. 224)

– *Towards a hybrid system?*
"Il semble donc que le monde devra se contenter d'un système hybride où les taux de change resteront flottants mais où les interventions des autorités seront nombreuses. Un tel système devra permettre aux autorités d'un pays de céder devant des fortes pressions sur leur monnaie tout en résistant à des variations de taux qui leur paraîtront trop fortes ou mal dirigées." (**E. Mérigo**, Adviser at the Ministry of Finance, Madrid, p. 174)

Colloquium 6: The Development of Financial Institutions in Europe 1956-1976

Brussels, April 1976
President of SUERF and Chairman of the Colloquium: Raymond Bertrand

Colloquium Book
Editors: J.E. Wadsworth, J.G.S. Wilson and H Fournier
Authors: J.- P. Abraham, G. Blunden, D.C. Bourdon, G. Carli, J.- H. David, D. Deguen, A. Delvaux, W. Eizenga, H. Fournier, H. Haschek, R. Hutton, J. le Brun, P. Lemoine, M. Monti, T. Padoa-Schioppa, E.F. Paltzer, R. Pecchioli, J. Revell,, C.J. Rijnvos, L.A. Rojo, J.R. Sargent, H. Soldner, K.-J. Steffen, U. Steuber, R.Vaubel, H.Wienold.
Publisher: A.W. Sijthoff, Leyden, 1977, xii, 357 pp.

– *Setting the stage:*
“Nous avons retenu trois grands axes de réflexion. Le premier concerne les forces macro-économiques qui déterminent fondamentalement l’activité bancaire et financière, le second s’attache aux problèmes relatifs à la diffusion internationale de cette activité. Le dernier regroupe les questions liées au contrôle de celle-ci ... (a) macro-économiquement, ce qui nous préoccupe maintenant, en premier lieu, n’est plus l’organisation du recyclage des soldes pétroliers mais la répercussion sur l’activité financière du grand mouvement d’inflation au niveau mondial et national; (b) internationalement, l’avenir des Euro-marchés n’est plus en question mais plutôt les formes selon lesquelles le mouvement d’internationalisation des activités bancaires sera consolidé ainsi que les modalités de financement des besoins des pays en voie de développement (c) enfin, du point de vue contrôle, l’attention s’est déplacée de la prévention ad hoc d’accidents bancaires et d’aide immédiate en cas de difficultés, à la mise au point de mesures plus générales garantissant la liquidité et la solvabilité bancaires. En d’autres termes, autorités et financiers, sont, souvent en étroite concertation, à la recherche d’un niveau de réglementation qui garantisse une exposition aux risques compatible avec le fonctionnement d’un système financier, où il y a, à la fois, concurrence, innovation, liberté et d’autre part protection de l’épargnant, répartition des risques, responsabilité publique en matière monétaire et financière ...”

(**J.-P. Abraham**, Professor at the University Faculties of Namur and at the College of Europe, Bruges; and Adviser to Paribank Belgium, in the general report of the Colloquium, pp. 249-251 and in the English translation, pp. 3-5)

– *On stagflation and crowding out*
"The great question of 1976: will the recovery which is now in prospect be frustrated because the private sector, as its need for funds increases, be 'crowded out' of financial markets by the irreducible appetite of deficit-spending governments? The potential danger which is foreseen is quite distinct from the sort of competition for real resources which may occur when productive capacity is at full stretch and involves 'overheating' ... The problem identified as 'crowding out' is not one of over-employment of real resources, but is seen as operating through financial markets at an earlier stage of recovery with the effect of preventing the full employment of real resources being reached at all." (**J.R. Sargent**, Group Economic Adviser Midland Bank Ltd. Group, pp. 35-36)

– *On financial structures at times of inflation*
"In Italy, external financing is on a vast scale and this applies especially to indirect financing. Among financial intermediaries the credit institutions, and especially the banking system, have a dominant role. Hence the enormous scope for the tools available to the monetary authorities and the opportunities for effective manoeuvre. It is these structural factors especially, plus the traditional shortcomings of fiscal policy that explain why economic policy in Italy is mainly a matter of monetary policy." (**Guido Carli, Mario Monti** and **Tommaso Padoa-Schioppa**, respectively (1) former Governor of the Banca d'Italia and President of Ente Einaudi, (2) Professor at the University of Torino and at the University Bocconi, Milano; and (3) Adviser in the Banca d'Italia, p. 33)

"As a result of the process of continually rising prices, the solvency ratios of the commercial banks and the savings banks have deteriorated over the past ten years... From an appreciation of the valuable function that profits and common equity fulfil in the Dutch economy, will be readily understood how urgent the need is for a recovery in earnings and with it the necessary improvement in solvency." (**W. Eizenga**, Professor of Economics at the University of Leyden, pp. 77-78, 79)

"Inflation is a gigantic redistribution in favour of owners of tangible assets and at the expense of owners of financial assets... The rate of inflation will have a decisive influence on how life assurance develops in the future and assurers will be well advised to do all they can to add to their range of instruments for preserving the real purchasing power of the benefits they offer.” (**K.-J. Steffen, H. Wienold** and **H. Soldner**, Vereinigte Versicherungsgruppe, München, p. 99, 110)

“Vingt-cinq années de croissance économique rapide, accompagnée de taux d’inflation élevés avaient en effet diminué les risques de défaillance des emprunteurs et altéré le sens du risque dans la profession bancaire... En rappelant aux banquiers qu’il existait encore des risques, les évènements de 1973 et de 1974 auront stoppé une évolution dangereuse des structures financières occidentales, sans que l’on puisse dire aujourd’hui si les conditions d’arbitrage ‘sécurité-rentabilité’ seront maintenant durablement modifiées au profit de la sécurité.” (**Daniel Deguen** and **Jacques-Henry David**, respectively, Caisse Nationale des Marchés de l’Etat and Inspection des Finances Paris, pp. 326-327)

– *Divergent views on indexation of financial instruments:*
“... Indexation should be a positive sum game for borrowers and lenders taken together: indexation eliminates the purchasing-power for savers and investors; indexation eliminates the risk for intermediaries in that, as a result of inflation, interest rates on their current, shorter-term liabilities may rise faster than interest rates on their old, longer-term assets... In view of these important advantages which indexation offers to both borrowers and lenders, it seems difficult to understand why in recent years so little use has been made of financial indexation (and floating interest-rate agreements) in the industrialised countries.” (**Roland Vaubel**, Institut für Weltwirtschaft, University of Kiel, pp. 128-129)

“Financial indexation cannot be regarded as *the* solution to the problems raised by rapid inflation. At best, it may represent a palliative likely to produce positive results in given circumstances but at the cost of introducing further distortions and rigidities in the present economic and financial structures.” (**Rinaldo Pecchioli**, OECD, Paris, p. 153)

– *On regulation and supervision*
“There must always be some conflict between competition and regulation. The only completely safe financial system consists of a monopoly institution whose liabilities are guaranteed by the government. The idea of competition presupposes that some institutions will go on the wall or be swallowed up by more powerful competitors, and this process of failure or difficulty creates risk and uncertainty in the financial system. It is only natural that the

authorities, faced with the need to tighten up the safety regulations for the financial system after a period in which a number of institutions, mostly small, have got into difficulties, should look to the large institutions as the models of probity and strength... The authorities in all countries seem to be operating under the slogan of 'big is beautiful' ... However the safety of the larger institutions derives as much from the fact that everybody knows that the authorities would never let them fail as from their inherent strength.

The essential feature of an effective system of prudential regulation is that it should concentrate on the risk exposure of individual institutions, and this cannot be done by detailed regulation." (**Jack Revell**, Professor, University College of North Wales, Bangor, p. 211-213)

"The failures of one or two banks and the well-known series of serious losses incurred by a number of others as a result of imprudent or unauthorised transactions in foreign exchange, which shook the banking system during 1974 with such unsettling effects on confidence and which in every case had effects which crossed frontiers, served as a catalyst for much rethinking of traditional attitudes both within individual banks and within supervisory authorities..." (**G. Blunden**, Executive Director, Bank of England, Chairman of the Committee on Banking Regulations and Supervisory Practices of the Group of Ten, p. 195)

– *On international harmonisation of banking regulations*
C'est avec beaucoup de pragmatisme, qu'il faut aborder et conduire l'oeuvre d'harmonisation des legislations bancaires. Les efforts déployés dans le passé et actuellement montrent la difficulté technique de rapprocher des systèmes nationaux hérités d'histoires économiques et financières et d'institutions politiques et administratives toujours spécifiques. Aucun modèle bancaire ne s'impose avec évidence pour tous les Etats de la Communauté, à court et moyen terme du moins. Par ailleurs, ce n'est pas du jour au lendemain que les systèmes de contrôle pourraient être unifiés de manière suffisamment étroite pour que l'harmonisation des régimes ait un sens positif, spécialement du point de vue de la protection des épargnants. (**Jean Le Brun**, Professor in the Université Catholique de Louvain, Adviser Bank Commission, Brussels p. 357)

Colloquium 7: New Approaches in Monetary Policy

Wiesbaden, September 1977.
President of SUERF and Chairman of the Colloquium: Raymond Bertrand

Colloquium Book
Editors: J.E.Wadsworth and François Léonard de Juvigny
Authors: Carlo D'Adda, Reino Airikkala, Nino Andreatta, Andrew Bain, Jacques Baudewijns, Horst Bockelmann, Hans W.J. Bosman, Cesare Caranza, Paul Coulbois, Jacques-Henri David, Herman J. Dudler, Economic Intelligence Department Bank of England, Research Department Banco de España, Einar Forsbak, Leif Hansen, Banking Department Central Bank of Ireland, Warren D. McClam, Tommaso Padoa-Schioppa, Ralf Pauli, Peter Pauly, Jacques Pecha, Theo Peeters, Kurt Schiltknecht, Helmut Schlesinger, Jacques J. Sijben, Niels Thygesen, Martin N.C. Thomann, Uwe Westphal, Manfred Wilms.
Publishers: Sijthoff and Noordhoff, Alphen aan den Rijn, The Netherlands, 1979, xiv, 390 pp.

– *In a nutshell...*
"... It became clear that the views of the monetarists had gained acceptance -at any rate in part – over a wide field, especially during years when gathering inflation made less effective the customary remedies such as restrictive measures by way of interest rates, money market conditions and banking activity. Nevertheless, such views were far from being accepted in their entirety. Central banks generally, while agreeing with the importance of paying attention to monetary aggregates, stressed the need, in practice, for employing additional means of regulation and expressed doubts as to the effectiveness of simply controlling the money stock when, for example, inflation was being imported. Among academic writers, also, were some holding similar opinions ... Discussions covered such fields as using the most appropriate among the various monetary aggregates available and the means of regulation." (**John E. Wadsworth**, Honorary Editor-in-Chief of SUERF, pp. ix-x)

"The use of monetary targets has in practice been influenced more by the force of events than by the new monetarism..." (**Warren D. McClam**, Deputy Manager, BIS, Basle. p. 70)

– *Academic monetarist views on the theoretical foundations...*
"(The emphasis on the theoretical foundations of monetary policy) is closely related to the fact that the post-war macro-economic stabilisation policy, based on the Keynesian analysis, has not been successful in curbing the inflationary process during the past decade ... We cannot endorse the philosophy of 'learning to live with inflation" ... In this way habituation to the inflation phenomenon becomes an independent driving force in the inflationary process. In the long-run a return to sound and stable monetary relations will become more difficult costly and painful ... The permanent and increasing inflation of recent years in the Western-world is caused in essence by a continuous and even an accelerating growth of the money supply in relation to the growth of real production. The inflationary process is essentially a monetary phenomenon which cannot come into effect unless the monetary authorities provide the required 'monetary fuel' ... A policy of gradually reducing the monetary growth rate as to become commensurate with the real growth rate of the economy, may contribute to an elimination of the destabilizing impact of inflationary expectations. Wage negotiations and price-setting by firms should not be determined by the rate of inflation in the recent past, but rather by the lower rate of inflation which will be allowed by monetary authorities in the near future." (**Jacques J. Sijben**, Economist at the University of Tilburg, pp. 13, 37)

"The rational expectation hypothesis implies that economic units are aware of the effects of an excessive expansion of the money stock. They anticipate the inflationary impact of such a policy. As a result, an excessive monetary policy does not stimulate the growth of real variables in the economy, not even in the short run. It leads only to inflation. Therefore, given rational expectations, a monetary policy using quantitative target variables, and adjusting the growth rate of these variables to the long-run expansion path of real economic activity, seems to be the most appropriate monetary policy in our present situation." (**Manfred Willms**, Professor of Economics, Christian-Albrechts-University of Kiel, p. 63)

– *The Bundesbank as the reference for practical monetary policy?*
"The Bundesbank has decided to use primarily a quantitative target ... The movement of the money stock serves as an indicator of the effects of the central bank's measures on economic activity. On this point we are guided less than we used to be by interest rates, changes in interest rates are not only the outcome of monetary actions, they may also be the result of market determinants or of a mixture of both ... Not very long ago, for instance, one commentator charged us with 'hindering a policy which is modern in

conception by using outdated instruments'. For him the 'monetarist' slant of our policy is evidently not pronounced enough. Other observers fear precisely the opposite, namely that there is too much 'monetarism' in our approach; in their view we pay too little attention to current cyclical requirements ... The compromise – at bottom a pragmatic one – between steadying the monetary developments and an anti-cyclical orientation is evident from the practical policies pursued by the Bundesbank since 1975 ...

Money creation processes in the banking system can start in a variety of ways, and without any action by the central bank. This does not mean, however, that the central bank is powerless to influence the bank's money creation ... (The) demand for central bank money is the connecting link between the central bank's money creation and the money creation of the banking system. This is the point at which the central bank must exploit its monopoly of central bank money, by setting the conditions – if necessary, harshly – on which it is prepared to satisfy the banks' demand for central bank money once it has arisen... You may well come to the conclusion that the practical formulation and the preconditions for the success of any monetary policy depend in a large measure on the political and institutional conditions prevailing in a country. I am sure that our experience of controlling the central bank money stock cannot be transferred without difficulty to other countries; conversely, we are always initially assailed by doubt if people who fail to appreciate the institutional differences from other central bank systems recommend us to use these systems' instruments... This does not mean that we do not examine them to see how far they can be used..." (**Helmut Schlesinger**, Member of the Directorate of the Deutsche Bundesbank, Frankfurt/Main, pp. 7, 8, 9, 10, 11)

"La première ('vérité'), c'est que la crédibilité et donc l'efficacité de toute intervention monétaire dépend d'abord des structures bancaires et financières du pays où elle est appliquée. Condamnée par exemple à soutenir des établissements fragiles dont la mise en liquidation pourrait être à l'origine d'une crise bancaire, la Banque centrale ne peut avoir en France la même autorité sur les banques que son homologue allemande qui trouve en face d'elle des interlocuteurs à la fois plus homogènes et moins dépendants de ses interventions. La seconde ('vérité'), c'est qu'en agissant sur le comportement des banques et sur la disponibilité du crédit, les autorités monétaires déplacent tous les éléments de l'équilibre économique national suscitant par là une multiplicité de réactions émanant de tous les agents économiques et, de ce fait, difficile à prévoir. C'est pourquoi la politique monétaire est du domaine du contingent. Adjuvant indispensable à la régulation de la conjoncture, elle ne peut à elle seule tenir lieu de politique économique." (**Jacques-Henri**

David, Inspecteur des Finances, Ministère de l'Economie et des Finances, Paris, p. 289)

"The central bank getting the same independence as the courts and separate from national treasuries! (Reference to the All Saints Manifesto of November 1975: we must give the monetary authorities the same independence from political control and the same responsibility to the rule of law we have accorded the judicial system. It follows that the new institution or institutions should be removed from the jurisdiction of treasuries, and monetary authorities should be appointed or elected for long periods of time if not for life...). It must be a wonderful dream for monetarists, and for central bankers; a dream that in all probability will never come true in this way. But that the maintenance of the value of money would be greatly facilitated by a high degree of independence of the central bank is a thesis which I would like to support, and which I base, both on theoretical considerations and on the experiences of the Federal Republic of Germany." (**Hans W.J. Bosman**, Professor of Money and Banking, University of Tilburg and Secretary General of SUERF, p. 261)

– *Monetary policy in open economies and its coordination, particularly in the EEC*

"Floating rates provide incomplete insulation from real external disturbances. An open economy is open, no matter what its exchange rate regime (is). But flexible exchanges do, however, permit different long-term rates of inflation. Mussa has drawn further attention to the fact that since exchange rate changes have real effects, at least in the short run, this makes such changes a concern of government policy. It even implies that governments can use exchange rates as policy instruments. The possibility has been recognized for some time as the experience of the thirties has demonstrated. But as is well known policy conflicts are bound to arise if everyone wants to devalue vis-à-vis everyone else The potential for policy conflicts, therefore, remains under a managed flexible exchange rate system and consequently also the need for policy coordination... Policy coordination and stability of exchange rates are in the first place matters of coordination of money supply policies, and not of exchange rate surveillance and intervention rules..." (**Theo Peeters**, Professor, Centre for Economic Studies, Catholic University of Leuven, pp. 199-200)

"There is an inbred scepticism in most European central banks and Treasuries towards the quantification of economic policy effects for the purpose of national public debate or exchanges in international meetings, even when the historical experiences appear fairly well based in econometric work and in general accord with the views of policy-makers themselves. To some extent this scepticism is well-founded in the present state of knowledge on private investment, consumption, imports and other economic variables; but it is also a convenient protection against a better informed, though mechanical, interpretation of national policies by outsiders such as international colleagues ...

I would like to argue that there is a strong need for adopting an integrated approach at the EC-level to the coordination of national exchange-rate and monetary policies. In particular, it would appear that, without the focus on some declared objectives for exchange rates, clear guidelines for monetary policy coordination are not feasible..." (**Niels Thygesen**, Professor, Institute of Economics, University of Copenhagen, pp. 209, 214)

Colloquium 8: Europe and the Dollar in the World-Wide Disequilibrium

Basle, May 1979.
President of SUERF and Chairman of the Colloquium: Raymond Bertrand

Colloquium Book
Editors: J.R. Sargent, assisted by R. Bertrand, J.S. Wilson and T.M. Rybczynski
Authors: M. van den Adel, J. Artus, H. Bourguinat, D. Brill, R. Bryant, F. Deming, M. Gérard, H. Glesjer, P. Languetin, R. Larre, C. Lutz, P. Oppenheimer, H.-E. Scharrer, S. Siglienti, E. Truman, T. de Vries, J. van Ypersele de Strihou.
Publishers: Sijthoff and Noordhoff, Alphen aan den Rijn, The Netherlands, Rockville, Maryland, U.S.A, 1981, xii, 348 pp.

– *Stormy Relations in growing interdependence:*
"L'Europe entretient en toutes circonstances avec le Dollar des relations privilégiées mais orageuses ... Si ces relations ne sont pas faciles en toutes circonstances, elles sont plus mal-aisées encore en temps de crise. Les liens entre le Dollar et l'Europe sont alors resserrés- au point même parfois d'être tendus- et la crise fait apparaître plus clairement l'ambiguìté fondamentale de la relation entre les deux parties. Les pays européens se tournent vers les Etats-Unis tantôt pour demander leur aide, tantôt pour rejeter sur eux la responsabilité des difficultés et, plus généralement, pour les deux à la fois ... A première vue, cette attitude des Européens a de quoi surprendre, car on peut trouver étonnant que ces pays adressent – en même temps – leurs requêtes et leurs reproches aux Etats Unis .On peut cependant lui trouver certaines justifications, car il n'est pas excessif de prétendre que, si le Dollar aide l'Europe à surmonter des crises, il contribue aussi, dans une certaine mesure, à les aggraver." (**René Larre**, General Manager, BIS, Basle, p. 3, 4)

"In the evolution of the post-war world economic order, a number of developments have increasingly limited the ability of the U.S. to determine independently its own economic fate, or to determine single-handedly the course of the global economy. The relatively faster rise in other countries' output, the reduction in the U.S. share of world trade, the rising share of foreign trade in U.S. output, the emergence of strong competitors able to employ contemporary technology but retaining comparative advantages, the inception of floating exchange rates, the development – still in its early stages – of alternative reserve assets, all tie U.S more closely into the world economy. At the same time, these developments require that more of the burden of global economic stabilization be shared by other countries, in both the financial and nonfinancial spheres of cooperation...” (**Daniel H. Brill**, Assistant Secretary of the U.S. Treasury for Economic Policy, p. 26-27)

“It follows from recent experience that unattractive consequences can result for the U.S economy and for the international financial system from independent, national decisions on macro-economic policies in an increasingly interdependent world economy. The United States can no longer, if it ever could, afford to ignore so-called feedback effects from the rest of the world. Especially in an environment in which exchanges rates can and do fluctuate, if the U.S. economy expands significantly more rapidly than the economies of other industrial countries, it appears that the United States becomes not only a ‘locomotive’ but also a ‘sink’ – attracting the output of other countries, enlarging its trade deficit, and in the extreme case causing an excessive depreciation of the Dollar.” (**Edwin M. Truman**, Director, Division of International Finance, Board of Governors of the Federal Reserve System, p. 57)

– *Divergent trends in saving and investment as an explanation of persisting balance of payments disequilibria. A neo-Keynesian approach:*

“The sharp increase of the divergence (in current account experience) is in part a result of the difference between cyclical phases in the United States and the other two major countries (i.e. Japan and Germany) For the main, however, the longer-run divergence reflects structural developments that are affecting the rates of investment and saving in those countries. In the United States, the secular growth and the level of investment have been relatively well maintained. The overall rate of saving of the private sector and the government, on the other hand, has declined. The two surplus countries, by contrast, have experienced gradual reductions in the secular rates of growth during the 1970s. These reductions in growth rates have been accompanied by cuts in investment that have not been matched by reduced saving. The deficiency of savings in the United States was made good through capital inflows. Similarly, the excess of savings in the two other countries was transferred abroad in the form of capital outflows. These capital flows were not private capital flows but official capital flows recorded ‘below the line’. This transfer mechanism, which took the form of a large and continuous increase in the amount of U.S. liabilities to the German and Japanese central banks was costly to Germany and Japan, since the real rates of return on German and Japanese investments have tended to be negative over the past five years. Further it may not be sustainable in the long run... The divergence gives rise to external adjustment difficulties and places heavy pressures on exchange rates. While the maintenance of exchange flexibility will be needed to move gradually to a more sustainable pattern of current account balances, it may not be desirable to place the whole burden of adjustment on exchange rates. The adjustment process would, in particular, benefit from demand-management and other measures that bear more directly on saving or investment." (**Jacques R. Artus**, staff member of the IMF, p. 63, 64, 87)

– *Private capital movements as the 'villains'?:*
"The private capital flows that are needed ... are not forthcoming on a stable and continuous basis. The United States have maintained a propensity to export rather than import private capital, in particular direct investments. The financial markets of the two surplus countries, on the other hand, may not yet be sufficiently developed to allow a smooth transfer abroad in the form of private capital flows of the excess savings generated at home. The lack of well-developed markets for foreign bonds is particular constraining in this respect. Pressures on exchange markets have tended to be substantial and practically all of the transfer of saving has taken place 'below the line' (i.e. as official compensatory capital flows)." (**J. Artus**, ibid, p. 87)

"... One important element is the very uneven development of capital markets in industrial countries. For instance, the situation in the German and Japanese capital markets has prevented the generation of long-term capital outflows on a scale and in a form that would not only have formed an adequate counterpart of the large current account surpluses of these two countries of the past few years... but which would also have made a precious contribution to providing scarce capital resources to countries in dire need of them. Another consequence... has been the absurd situation that countries in deficit have been borrowing in the well-developed capital market of the country with the largest deficit of all: the United States.

... Free (short-term) capital movements contribute significantly to economic instability, both internationally and through their effects on the individual domestic economies – under a par value as well as under exchange flexibility. It is far from obvious that the industrial countries can live in a tolerable fashion with this instability, or that they should be willing to accept the cost connected with the vast hot money movements of today and tomorrow."

(**Tom de Vries**, Alternate Executive Director of the IMF and Visiting Professor at John Hopkins University, Baltimore, pp. 123, 126)

"International capital movements, especially on today's scale, do indeed have the capacity to make an impact on exchange markets. These movements are, however, not an autonomous creation of the Euromarkets nor are these markets the only conduit ... Capital movements have not been the cause but a symptom of instability." (**Matthijs van den Adel**, Centrale Rabobank, The Netherlands, p. 147)

– *On the* '*incontournable" inescapable Dollar:*
"Le dollar américain avec sa variabilité au jour le jour considérable, ses aller et retour à court terme très sensibles et ses fluctuations à long terme plus impressionnantes encore, ne saurait revendiquer (l') attribut de résilience-stabilité. Mais, inversement de par son champ d'utilisation, il demeure – et de très loin – la première monnaie mondiale. Il ne peut donc dans ces conditions être question de lui ôter sa fonction de monnaie 'véhicule' ou celle de réserve de valeurs; cela, au demeurant, pour une raison très simple: il n'a pas actuellement de substitut réellement crédible. *Une chose et de constater qu'il n'est plus qu'une monnaie de second best, une autre de lui trouver un remplaçant: il n'en a point*!" (in italics in the original text) (**Henri Bourguinat**, Directeur du Laboratoire d'Analyse et de Recherches Economiques, Faculté des Sciences Economiques, Université de Bordeaux, p. 259)

"The Dollar will still be the main intervention currency, gradually losing the other reserve functions, but actual and desired Dollar holdings will be brought into balance increasingly through exchange rate fluctuations. Reserve diversification and exchange rate flexibility will feed on each other in a circular process which may develop irrespective of actual payments imbalances." (**Sergio Siglienti**, General Manager, Banca Commerciale Italiana, p. 221)

"... The balance between return and risk that applies today with respect to the Dollar is far from perfect, and it undoubtedly will remain imperfect over the years ahead. But given the extent to which private holders especially have continued to stay in dollars the alternatives apparently are not perceived to be much better. I expect that the U.S. economic performance over the year ahead will continue to be at least favourable enough in relative terms to justify the confidence or optimism being shown both by those from abroad who are making more and more investments directly in the U.S. and those who continue to hold its currency. Thus, if the monetary system evolves along the lines I hope and expect, with the basic conditions continuing to be set by the market place, I think the dollar will continue to play a large role.” (**Frederick W. Deming**, Vice-President and Senior Economist, Chemical Bank New York, p. 254)

– *The starting European Monetary System: why and how?*
An authoritative European voice: “A basic economic motivation of the EMS has been dissatisfaction with floating exchange rate conditions in the last few years, and the conviction that this monetary situation was having adverse effect on economic integration in Europe and in general on growth and employment in the Community ...

... (The) exchange fluctuations have managed to replace partly the old customs barriers in their negative effects on growth and on the development of a large European market and of enterprises with such a dimension. The dismantling of customs barriers and the progress towards integration was one of the elements of faster growth in Europe in the 1960s. The instability and uncertainty as to exchange rate movements between European currencies in the last few years was felt to act as a brake on integration and growth ...

... Expressed in a positive way, the basic objective of the EMS is to contribute to a lasting improvement of the present economic growth and employment situation of the Community and its economic integration through greater exchange rate stability. This objective will be met only if the system is conceived in such a way that it will be durable and contains neither a deflationary nor an inflationary bias.

Those who adhere to the exchange rate system should be ready to adjust their internal monetary economic policies accordingly ... Agreement on this point does not imply that one should wait for a complete disappearance of these differences in inflation rates before adhering to the system. This system itself has a sufficient flexibility and it should not prevent remaining real disparities from being reflected in exchange rates...” (**Jacques van Yperseele de Strihou**, Chairman of the Monetary Committee of the European Monetary Community, p. 294, 296, 300)

An American view: “There are two necessary (but not sufficient) conditions for the viability and longevity of the European Monetary System. Firstly European policy-makers must not have illusions that the minimization of exchange-rate variability will always promote their individual nations’

objectives or their objectives for the Community as a whole. If prudent, they will not make exchange-rate variability an end in itself, and will not seem to be doing so. Secondly, European policy-makers must not look to the minimization of exchange-rate variability as the primary, indeed even an important, catalyst of greater convergence in their national objectives and domestic macro-economic policies. That convergence needs to be actively promoted and achieving in its own right, as a prior step. Exchange-rate stability can result from, but cannot by itself engender, an integrated Europe."
(**Ralph C. Bryant**, Brookings Institution, Washington, D.C. p. 172)

Colloquium 9: Bank Management in a Changing Domestic and International Environment

Helsingør, Denmark
October 1980
President of SUERF and Chairman of the Colloquium: Hans-Eckart Scharrer

Colloquium Book
Editors: Donald E. Fair and François Léonard de Juvigny
Authors: R. Bertrand, H. Bockelman, B. Brittain, F. Bruni, T. Carlsson, P.A. Davies, W. Eizenga, B. Griffiths, J. Guillou, E. Hoffmeyer, R. Lab, J.M. Laporte, P. Ledoux, G. Maynard, M. Monti, I. Morison, H.J. Muller, P. Munthe, N.-A. Nielsen, A. Porta, J. Revell, N. Thygesen, J. Werding, D. Wigny. G.E. Wood.
Publishers: Martinus Nijhoff Publishers, The Hague, Boston, London, 1982, xii, 342 pp.

– *To be or not to be...*
"Nous sommes ici au pays de Hamlet et la question fondamentale (du) colloque ne devrait-elle pas se formuler: 'Pourra-t-on continuer à être banquier dans les années 1980?' Le métier de banquier devient un métier de répartiteur d'une denrée rare et, le plus souvent, selon des critères qui sont ceux de la réglementation ..." (**Pierre Ledoux**, Président de l'Association Française des Banques, p. 10)

"The time had come for a topic of more direct concern to individual bank managements, (facing) major new challenges: the rise in energy prices, high rates of inflation, balance of payments disequilibria, fast-growing indebtedness of lesser developed countries, rapid structural change in industrial economies and growing intervention by governments ..." (Preface by the editors, p. ix)

– *On competition and convergence among financial institutions:*
"... My interpretation is that competition has considerably intensified among banks and near-banks, and that it is likely to proceed further along this road as remaining regulations are eroded in the 1980s. Some movement towards universal banking is still in the pipeline, though not primarily through further

concentration; since economies of scale beyond a certain level do not seem important there was no reason to favour further concentration." (**Niels Thygesen**, as general rapporteur, p. 334)

"It seems reasonable to expect that the breaking down of demarcation lines between different types of financial institutions will continue. One of the chief results of such a trend should be a further reduction in the traditional distinction between different national banking and financial systems. ... In no two countries will the role of banks in the financial system ever be exactly the same. But the secular trend is clearly for past imbalances to be evened out, and gaps filled in the range of services provided." (**Ian Morison**, Inter-bank Research Organisation, London, p. 57, 58)

"*Le problème le plus important, c'est de placer dans des conditions de concurrence équitable les diverses institutions financières." (*__Pierre Ledoux__, op. cit, p. 10, in italics in the original text)

– *On the vulnerability of savings banks*
"The structural weakness of the savings institutions is not that they are involved in maturity transformation by borrowing short and lending long, but that they commit themselves to fixed interest lending in a time of rapid and variable inflation." (**Niels Thygesen**, ibidem, p. 333)

"In comparison with the USA, Dutch savings banks had much greater freedom to take suitable steps in response to rising interest rates – although I would argue those steps have not been sufficient. More specifically, their flexibility with regard to the asset side of the balance sheet was much greater, besides which Dutch savings banks offer a complete range of services as far as retail banking is concerned, which cannot be said of many American thrift institutions." (**Wietze Eizenga**, Professor at the University of Leyde, p. 78)

– *On the impact of shrinking corporate profitability*
"High debt-equity ratios, high borrowing costs – no doubt implying a significantly positive real interest rate in recent years – and considerably increased perceptions of the risk attaching to extensions of the real capital stock have combined to depress corporate loan demand." (**Niels Thygesen**, ibid, p. 334)

"On peut aujourd'hui tenir pour acquis que, dès lors qu'elle accepte de financer des besoins permanents – et elle ne peut que l'accepter puisque les autres sources de financement sont insuffisantes – la banque renonce de facto au remboursement de ses concours et se trouve liée à l'entreprise pour des durées largement indéterminées, en ce qui est la caractéristique essentielle de l'ère de l'endettement permanent." (**Jacques Guillou**, Banque de l'Union Européenne, Paris, p. 115)

"For continued investment and growth of the entrepreneurial sector, a restoration of a positive gap, ex ante, between expected return and the cost of capital is a prerequisite. The existence of an expected adequately positive gap is decisive for the willingness of entrepreneurs to expand, for the private investor to buy shares, for the willingness of the banks and the capital market to lend." (**Torsten Carlsson**, General Manager and Adviser, Skandinaviska Enskilda Banken, Stockholm, p. 112)

– *On bank performance: Inflation as the general determinant of the rising cost of intermediation*

"... There was much criticism on the emphasis (in the Revell Report) on inflation as the general cause that lay behind the cost of intermediation. The experts were more inclined to put the blame on such banking facts as branch expansion and in general to seek special explanations for their own countries.

In terms of immediate causation the experts may be right since inflation has little direct impact on institutions like banks whose liabilities are expressed entirely in nominal terms ... It is necessary to identify the indirect routes and to see how inflation combines with other factors ..." (**Jack Revell**, Professor of Economics, University of North Wales, p. 291)

– *New aspects of the crowding-out debate*

"When the public deficit is largely financed by the central bank through creation of monetary base, an expansion of deposits takes place which allows banks to finance both an additional share of the deficit and the borrowing needs of the private sector. Crowding-out of the private sector is thus unlikely. By contrast, the less there is monetary base creation, the more bank financing of the public sector crowds out credits to the private sector and is unlikely to be extended without some portfolio constraints on banks. Is lending to the public sector a problem for the individual bank? The answer has been shown to depend crucially on the extent to which such lending results from autonomous bank decisions. or from portfolio constraints, rather than on the public nature of the borrower. Spontaneous lending to the public sector contributes to the achievement of a bank's objectives, although in the long run it may downgrade in several ways both the contents of banking activity and the management style. On the other hand, lending to the public sector resulting from direct or indirect portfolio constraints increases the rigidity of banking firms and prevents them from reaching their optimal liquidity-risk-return combination. Constraints may thus be regarded as disguised taxes levied on banks ... They (the banks) are usually able to shift part or all of such taxes on to other agents. To the extent they do so, banks may be viewed as parts of the transmission mechanism of disguised *fiscal policy,* as they are in the case of *monetary* policy." (**Franco Bruni, Mario Monti** and **Angelo Porta**, respectively Associate Professor, Professor of Monetary Theory and Policy and Professor of Economics, Bocconi University, Milan, p. 150)

– *On international financial intermediation after the oil shocks*
"In their task of international financial intermediation the banks will face in the eighties three interrelated challenges of major dimension: (a) to finance growing and probably more unstable international payments imbalance: this is *the recycling challenge*; (b) to finance the huge investments required for the development of new energy resources: *the energy challenge*; and (c) to finance the huge investments required in developing countries to increase productivity and alleviate poverty: this is the *development challenge* ... Three major types of action which the bank should undertake ... (a) weigh out more carefully the price they charge for their international intermediation services, having in view particularly *an improvement of the margin structure* for Euroloans and *a strengthening of their capital basis; (b)* commit themselves to a more *serious management of their country risk exposure; (c) strengthening cooperation between themselves and with international financial institutions."* (**Damien Wigny**, Director, Kredietbank, Luxembourg, pp. 188, 210)

"OPEC's ability to accumulate financial assets essentially depends upon the financial system's willingness and ability to intermediate the amounts invested. A build up of financial assets would see bank balance sheets becoming increasingly overloaded with short term liabilities to OPEC on one side and, on the other, increasingly exposed to LDC indebtedness ... Prudent banks will need to hold greater capital, reserves and liquidity to face the increasing concentration of their short term liabilities and the greater risk and concentration of their longer term assets. Borrowing margins will accordingly need to rise." (**Geoffrey Maynard** and **Peter A. Davies**, respectively, Vice President, Director of Economics for Europe and the Middle East and Associate Economist, Chase Manhattan Bank, London, pp. 176, 177)

A dissenting and contested view: "Spreads seem more closely related to industrial production in the OECD countries than to measures of US liquidity. I would infer, therefore, that declining spreads are also associated with better earning prospects for borrowers and therefore with lower levels of risk.” (**Bruce Brittain**, Economist with the BIS, p. 232)

– *A turning point in regulation and supervision?*

The trend toward more detailed (government) control has also been noticeable on credit markets, and has interfered with private banking activities quite considerably. Bank management has had to pay even greater homage to government requests and regulations, and to make decisions based on macro-economic considerations ... The fact that there is today growing opposition to government regulations is largely due to the notion that they are very far from being as perfect as theory would have us believe ... It is also generally agreed that the more all embracing public regulations are, the more difficult it is to avoid goal-conflicts and inconsistencies ...” (**Preben Munthe**, Professor at the University of Oslo, p. 261)

“We may expect that banks and supervisors will respond to the results of this analysis (i.e. of the past) particularly in the following areas: 1. Improved risk management; 2. Resistance to further erosion of profits and capitalization ... To meet these challenges in an increasingly interdependent international banking environment presupposes ever intensifying *contacts and cooperation* between the parties concerned ...” (**H.J. Muller**, Executive Director, De Nederlandsche Bank, pp. 274, 275)

Colloquium 10: International Lending in a Fragile World Economy

Vienna, April 1982
President of SUERF and Chairman of the Colloquium: Hans-Eckart Scharrer

Colloquium Book
Editors: Donald E. Fair in co-operation with Raymond Bertrand
Authors: Jacques R. Artus, Helmut von der Bey, Adrian Blundell-Wignall, Jean-Claude Chouraqui, W. Peter Cooke, Richard Dale, Fritz Diwok, Hermann-Josef Dudler, Frans A. Engerig, Rainer E. Gut, Armin Gutowsky, Helmut H. Haschek, H. Robert Heller, Manfred Hothus, R. Barry Johnston, Stephan Koren, Alfred Kuehn, David T. Llewellyn, Joël Métais, Jeanne-Marie Parly, Tadeusz M. Rybczynski, Luigi Spaventa, Alexander K. Swoboda, Tom de Vries, David Williams.
Publishers: Martinus Nijhoff Publishers, The Hague, Boston, Lancaster, 1983, xii, 421 pp.

– *Heading towards an international financial crisis?*
"Risks to the Stability of the International Financial System: gloom without drama." (Title of the contribution of **Luigi Spaventa**, Professor at the University of Rome, p. 324)

"There is a marked deterioration in the world economy's macroeconomic performance in the 1970s as compared to the 1960s. The worsening of macroeconomic performance, is, however, not necessarily synonymous with increased fragility, The sequel of over fifteen years of rising inflation, of increasing payments disequilibria and, more recently, of high real interest rates and volatility of financial market variables do, however, leave the world economy more susceptible to further exogenous shocks. Combined with a deterioration of national and international financial relations, they may also lay the ground for endogenous instability and crises in the international financial system ... The present concern with the possibility of a serious financial crisis, followed by a collapse of the real economy goes beyond the usual gloom associated with every recessionary or stabilization phase ..." (**Alexander Swoboda**, Graduate Institute of International Studies and the International Centre for Monetary and Banking Studies, Geneva, p. 396, 399)

– *Those international bankers ...*
"... Le rôle assumé par quelques dizaines de banques multinationales – notamment américaines – dans l'intermédiation financière internationale appelle une analyse théorique et empirique des stratégies et comportements de ces agents ... La spécificité de la firme bancaire n'est pas de nature à empêcher l'examen de sa multinationalisation à partir d'une extension de l'analyse des multinationales industrielles. Les résultats de quelques travaux empiriques limités aux banques commerciales américaines incitent à une certaine circonspection quant à la rentabilité des activités internationales. La détérioration de cette rentabilité pour 6 des plus grandes banques de l'échantillon, entre 1972 et 1979 fait redouter un désengagement relatif de ces banques..." (**Joël Métais**, Maître-Assistant, Université de Paris Dauphine, pp. 65, 82, 83)

"... There has been a steady stream of new banks entering the market and it is estimated that the number of banks participating in syndicated lending has grown fivefold in the past decade. There are both good and bad aspects to this. The number of new entrants has certainly helped to spread the burden and the risks of international lending to sustain the necessary recycling of funds. On the other hand, a large number of the new entrants have necessarily been smaller and relatively less experienced than the larger and older established banks, and therefore perhaps less well prepared to handle the specialised problems posed by international lending." (**W. Peter Cooke**, Head of Banking Supervision, Bank of England, p. 20)

"The banks were flooded with sizable deposits from the oil producing surplus countries ... The banking system has for years accepted the deposits offered to it and has tried to find outlets for them only afterwards ... It is small wonder that in this process the solidity of the debtor as well as prudence suffered. The result has been twofold. On the one hand, a large number of countries have become saddled with a heavy debt burden ... The second result has been to reinforce international inflationary tendencies." (**Tom de Vries**, Alternate Executive Director, IMF, p. 362, 363)

– *A top international banker's view*:
"... There exists a curious conflict between bankers' theoretical and practical approaches... The oil price hike created international payments and financing problems on an unprecedented scale. At the time, the banks seriously doubted their capacity to cope with this huge task. However, the governments which were called upon for support not only hesitated, but, moreover, were forced by domestic constraints to cut development aid precisely at a time when it was

needed more than ever. The IMF as well reacted only gradually to the changed circumstances. And what were countries to expect of a World Bank which, on the average, takes three years from credit application to disbursement? The international banking system had therefore to fill the gap, almost against its will ... Second, the banks had to meet these new financing requirements when political tensions and a monetary system with floating exchange rates considerably heightened the risks. The fear of the consequences of their own courage is understandable and has found expression in a banking climate which might be described as cheerful pessimism. Third, the oil shock brought about a change in the structure of international financing. Whereas bond issues and export credits guaranteed by supplier countries had previously been the chief instruments of international capital movements, the emphasis has since been shifted to ordinary bank credits. Instead of governments or buyers of foreign bonds, the banks have become the principal risk bearers ... Fourth, the geographical scope of the business has expanded considerably ... The widening of the geographical base has naturally boosted the opportunities for international financial operations. But with the growth in foreign exposures, the appearance of payments difficulties in several countries, and various unexpected political developments, such as Iran, Poland or Argentina, the banker's always acute sense for risk aversion has been noticeably sharpened of late.

... In uncertain times one of the bank's traditional methods of averting risks is to grant financing for as short a term as possible in order to withdraw their investments rapidly in case of danger. They are well aware that such a procedure pursued collectively may bring about just that collapse of which all are afraid. But macroeconomic considerations of this type cannot seriously influence the attitude of institutions which in risky situations do not wish to be the last ones that – as a German saying goes – are bitten by the dogs ..." (**Rainer E. Gut**, Chairman of Crédit Suisse, p. 8, 9, 14, 15)

– *Once again the* '*mystery' of Euro-markets*
"... The substantial growth experienced in the Euro-dollar market ... is associated not with a high internal multiplier but with a similar rapid growth in monetary and financial aggregates in the United States. Thus, in line with standard portfolio balance theory, all markets share in the distribution of any increase in the total supply of dollar assets and through a learning process and a strong competitive position, the Euro-dollarmarket has tended to increase its share of the total. This is similar reasoning to that applied with the growth of non-bank financial intermediaries within domestic financial systems.

As the leakages are high and because interest rates adjust quickly a continuous flow of funds from the United States is unlikely, the concept of an internal multiplier is of limited value and, in any case, is likely to be low."

– *On the threat of the Euro-markets for national monetary policy*
"The *static* credit effects of the Euro-markets are shown to be determined by the profit maximising strategy of both domestic and Euro-banks, and the competitive structure of the domestic market. The *dynamic* effects relate to whether, from an initial competitive equilibrium between the domestic and euro-markets, the effect of monetary policy is offset by increased Euro-market intermediation... This depends upon the form monetary policy takes and in particular the extent to which it relies on non-market and control mechanisms and influences the competitive position of the domestic sector vis-à-vis the Euro-sector. If policy is conducted in terms of the interest rates and banks are not constrained in their liability management, and maximise profits in both the long and short run, the Euro-markets pose no threat to the conduct of monetary policy ..." (**David Llewellyn**, Professor of Money and Banking, Head of Economics Department, at the University of Loughborough, pp. 91-92, 106-107)

"The preliminary empirical (econometric) work finds evidence of close links between US non-bank transactions in domestic currency and euro-dollars and that to a large extent the growth of non-bank Euro-dollar deposits reflects wealth-holders' general portfolio allocations. Euro-dollar deposits and borrowing are also related to trade transactions. Here the endogenous expansionary process in the Euro-market is more difficult to disentangle." (**R. Barry Johnston**, Economist with the Bank of England, pp. 50-51)

"(Le phénomène des opérations en eurodevises) procède de leur absence de réglementation et de leurs avantages fiscaux liés au statut 'off-shore' de ces activités sur les principales places financières internationales à partir desquelles elles sont menées. Il n'est dès lors pas surprenant que les opérations en eurodevises ne soient souvent que de simples substituts des opérations de crédit domestique." (**Joël Métais**, op. cit., p. 74)

– *On the political economy of international indebtedness*
"Ce n'est pas tout à fait un hasard si les problèmes de stabilité sont de nos jours volontiers posés à propos du système *financier* international alors que récemment encore ils concernaient plutôt le système *monétaire international.* Ce glissement conceptuel est en effet significatif d'une évolution profonde des relations monétaires et financières internationales ... Le développement

progressif d'euromarchés a permis de répondre à l'accroissement très rapide des besoins de financement qu'entraînait une intégration mondiale de plus en plus poussée des échanges et de la production. Ce mouvement a abouti à l'économie d'endettement international que nous connaissons aujourd'hui et qui repose pour l'essentiel sur l'activité d'intermédiation de très grandes banques commerciales à vocation internationale." (**Jeanne-Marie Parly**, Professeur at the University of Paris-Dauphine, p. 310)

"The tranquil and unconcerned view of the situation which prevailed until recently enjoys now less widespread support and is held with far less certainty... why have such clouds appeared on the horizon of the international financial scene? There are, first, some specific facts. Foremost, of course the Polish case... In spite of rescheduling, Poland is in a state of 'effective but undeclared default'.

... A deterioration of the liquidity situation of the LDCs in general and specifically of some of the largest borrowers from private sources has been noticeable in the past year or so ...

The (recent) reduction in the growth of the debt, far from being the welcome symptom of improved conditions of the borrowing countries, appears to be the result of increasing constraints on credit supply and also on credit demand." (**Luigi Spaventa**, op. cit., pp. 326-328)

"... In the 'new concept of international financial morality' debtors are not expected ever to default, unlike in earlier periods of history. But the rules of the game also require that creditors cooperate to avoid the debtor's default and by accepting those further commitments which allow everybody concerned to pretend that the debtor is not defaulting ... This is, after all, what rescheduling operations are about: both parties agreeing that formal default is to be eschewed, the outcome will depend on the bargaining power of the debtor." (ibid, p. 334)

"May I leave to your imagination, to compare the immediate postwar period up to the mid-1970s with the fragile world we are living in now. Personally I have a strong belief that the present situation needs more cooperation on an international level; but the precondition for this cooperation is to restore confidence between lenders and borrowers. This confidence, which has deteriorated so much in recent years, is in itself indispensable for solving international problems." (**Stephan Koren**, Professor, Governor, Oesterreichische National Bank, Vienna, p. 6)

“In spite of the talk about the importance of central banks and the necessity for closer cooperation between different institutions it was felt that the responsibility for their international lending remains with the participants in the market. Finally banks will ultimately have to supervise themselves and to rescue themselves.” (**Fritz Diwok**, Secretary General of the Austrian Bankers’ Association, in his general report of the Colloquium, p. 420)

– *The supervisors’ dilemma*

“*... On the one hand, the supervisory authorities have the responsibility for restraining banks from overreaching themselves and exceeding the prudent limits of lending, but on the other it is clear that to restrict the recycling capacity of the banking system, in the absence of any viable alternative intermediaries, might precipitate the very crisis which the prudential regime is designed to avoid. In playing their part in coping with this dilemma, the supervisors have to stand up and speak out for their first priority which must be to maintain a sound prudential framework for the international banking system.” (**W.P. Cooke**, cf. supra, p. 23)*

Colloquium 11: Government Policies and the Working of Financial Systems in Industrialized Countries

Madrid, October 1983
President of SUERF and Chairman of the Colloquium: Mario Monti

Colloquium Book
Editors: Donald E. Fair in cooperation with F. Léonard de Juvigny
Authors: José Ramon Alvarez Rendueles, Palle S. Andersen, Christian de Boissieu, Rolf Caesar, Jean-Claude Chouraqui, Anthony S. Courakis, Jean Dermine, Otmar Emminger, Einar Forsbak, Giampaolo Galli, Dermot Glynn, Pieter Korteweg, Börje Kragh, Christian Lutz, Rainer S. Masera, Peter E. Middleton, Mario Monti, John Odling-Smee, Raimundo Ortegaz Fernandez, Dominique Strauss-Kahn, Andrew Threadgold, Robert Vandeputte, Joseph Vuchelen, Uwe Westphal.
Publishers: Martinus Nijhoff Publishers, Dordrecht/Boston/Lancaster, 1984, vii, 432 pp.

– *The explosion of government deficits at a time of stagflation:*
"...By 1982, only one country, Norway, (i.e. of the main fifteen industrialized countries in the world) was recording a surplus, whereas nine years earlier (i.e. just before the first oil shock) only three countries had a deficit." (**P.S. Andersen**, Head of Section, BIS, in a penetrating empirical analysis, p. 42)

"We certainly find ourselves in a gloomy situation of generalized increases in government deficits and of low economic growth ... There is an important structural component in such a situation, which can be seen as a characteristic result of the slow response of government policy to a changing economic environment, or rather, as governments are not that short sighted, as a result of strong social resistance to the adjustments required ... Several developments have been taking place simultaneously in our financial systems that ... are bound to be a check on unwarranted delays in adjustment: (a) ... the important and generalized upgrading of inflation rates ... has been an underrated influence upon financial policy. Such inflation rates deeply eroded whatever monetary illusion pervaded agents' behaviour and devastated those financial institutions and instruments that relied on low levels of inflation. ... Inflation broke the rules of the game, forcing a complete reconsideration of financial intermediaries and markets; (b) a second element ... is the marked shift of monetary policy from interest rate targets towards quantitative targets for monetary expansion ... the very shift to quantitative monetary control has forced authorities to reconsider their instruments of action leading them ... to allow for a growing role of market forces in monetary policy intermediation; (c) when government deficits started to grow, ... these could have been accommodated by higher rates of monetary expansion, but this has not been the rule. Instead, compensatory adjustments have tended to be imposed upon the financing of the private sector, which incidentally may have contributed to make "crowding out' a lively subject; (d) other domestic developments (p.m.); (e) On the external front ... the acceptance of floating rates (and) the massive growth of the external debt of many countries ... Governments have proved more sensitive to depreciating exchange rates than expected ... (The growth of external debt) has implied a terrible erosion of the role of exchange controls as an instrument of monetary policy and has forced authorities to be extremely careful for the external repercussions of their monetary and fiscal policies." (**José Ramon Alvarez Rendueles**, Governor of the Banco de España, p. 14-16)

– *Towards a 'law of government retrenchment' in a non-Keynesian world*
"It is high time to reverse for good this (Wagner) law of increasing government expenditure and to replace it by a 'law of government retrenchment'. And as concerns the Keynesian notion of fiscal policy as the great 'stabiliser', we should recognise that this concept has often led economic policy astray." (**Otmar Emminger**, Former President of the Bundesbank, p. 27)

– *A dissenting opinion*
"... Derrière cette pression à la réduction-voire même à la suppression 'par décret' – des déficits publics, se cache une volonté d'empêcher en partie l'Etat de poursuivre deux de ses missions principales: la régulation conjoncturelle et l'allocation des ressources. Or c'est grùce à un déficit actif et contrôlé que l'Etat peut effectivement diminuer l'amplitude des fluctuations économiques et participer de manière décisive à la nouvelle politique industrielle, nécessaire pour sortir de la crise Il convient dès lord de s'interroger sur la stratégie réelle poursuivie par ceux qui souhaitent retirer à l'Etat – notamment par la contrainte politique – les moyens nécessaires à son action." (**Dominique Strauss-Kahn**, Professor at the University of Paris, p. 131)

– *Crowding-out: the star of the Colloquium?*
"Quite clearly, it (i.e. the star of the Colloquium) turned out to be young 'crowding out'. It appeared in constantly changing disguises – financial crowding out, portfolio crowding out, transactions crowding out, exchange rate crowding out, indirect or ex post crowding out versus direct or ex ante and versus accustomed crowding out, allocation policy – as against fiscal policy – crowding out, crowding out of safety and crowding out of quality, not to forget about over-crowding and crowding-in. Even when it produced a no-show, as it happened in several econometric tests, it made an event out of it..." (**Christian Lutz**, Director, Gottlieb Duttweiler Institut, Zürich, p. 411)

"... While, on balance, econometric evidence does not rule out some activity-supporting role for budget deficits, these are currently seen, at worst, as constituting an impediment to economic recovery by crowding out private investment and, at best, too high to exclude the possibility of counter-cyclical fiscal action. This apparent contradiction between the conclusions to be drawn from most econometric models and the principles upon which fiscal policies are presently based, stems from two shortcomings in the current state of quantitative knowledge. The first is the imprecise estimation of the interest rate effects of budget deficits, given the complexity of factors influencing the private sector's financial savings behaviour. The second derives from the difficulties of assessing the impact of budget deficits in a medium-term context, and of incorporating expectations and confidence elements into the analysis." (**Jean-Claude Chouraqui**, Head of Monetary and Fiscal Policy Division, OECD, p. 247 – and in the same sense, for Germany, **Rolf Caesar** pp. 83-84)

– *Why interest rates have remained so high...*
"In the first place interest rates remained so high in comparison to current inflation because of the financing of large government deficits which, despite some crowding-out, have meant that the total recourse to the capital market has risen sharply. In some industrialized countries more than half of the available resources of the capital market is now taken up by the government ... Secondly, after bitter experience in the past, the financial world has gradually dropped the 'veil' of money ... Thirdly, all over the world banks are being compelled to resist the erosion of their solvency ..." (**Pieter Korteweg**, Professor, Treasurer-General, Ministry of Finance, The Hague, p. 36)

"The American mix of fiscal and monetary policy, as long as it is keeping US interest rates and the dollar high, is exerting a strong influence on other countries' interest rates and monetary policies." (**Otmar Emminger**, op. cit., p. 26)

– *Monetary policy and the policy mix at times of huge government deficits:*
"... It is a fact that at the very time when exploding budget deficits became a cause of concern, monetary targeting became a reality, which opened the eyes to a truth: monetary and fiscal policy may be institutionally independent from each other – but as soon as their aims are conflicting or their paces are incompatible, one of them will win. And in this case, perhaps in contrast to the early 1970s, it was, in general, the monetary policy which won. It is, quite obviously, this change of conditions which made crowding-out a star..." (**Christian Lutz**, op. cit., p. 418)

"With the decline of Keynesianism and the rise of monetarism the relationship between fiscal and monetary policy has changed in many countries. High public deficits need not inevitably lead to an over-expansive monetary policy. In fact, however, we see that in those European countries where budget deficits are very high in relation to net national savings, central banks are often under irresistible pressure to finance at least part of the deficits by money creation ... Another important aspect is that high structural deficits, and accumulated indebtedness with its high interest burden, are a corset for government policy and severely restrain the room for manoeuvring of fiscal policy." (**Otmar Emminger**, op. cit., p. 25)

"It is difficult to isolate the discussion about the financing of the deficit from a discussion about the size of the deficit. In most countries, solving the second problem would also solve to a large extent the first one. It is however probable that policy-makers reason the other way round, by solving the financing problem they probably think they solved both problems ..." (**Joseph Vuchelen**, Professor in the Free University of Brussels, p. 309)

– *The interesting and fairly representative Spanish experience*
"... The need to counteract the expansive effect of government borrowing in order to keep the growth of the quantity of money within the established targets has had a double result: in the first place, it has limited the independence of monetary policy itself, preventing it from having the effects that might be foreseen in the struggle against inflation and involving it in a hopeless battle, doomed to failure, to keep up the peseta's exchange rate; secondly, obliging the Bank of Spain to create its own version of short-term debt, restricted to financial institutions, has distorted the whole structure of interest rates with the resulting negative effects for an adequate financing of the economy." (**Raimundo Ortega**, Director General del Tresoro y Policita Financiera, Ministerio de Economia y Hacienda, Madrid, p. 407)

– *Financial system versus Government*

"There has always been and there will always be conflict between governments and financial systems ... If in the short run government has many chances of overruling the financial system, the latter has, in the long run, a no lesser chance of gaining the upper hand on government.

Consequently, financial institutions cannot claim that they are always on the losing side, so let me say that financial institutions, rather than longing for the non-existing of conflict with government, should take this for granted and think how to make the best of such a situation ... I can see only one clear way to achieve such a goal and it is by developing to their utmost those features of the financial system that reinforce its role as a power able to counterbalance the unrealistic aspects and results of government economic policy and activity. That is to say, by stressing the role of market forces ..." (**José Ramon Alvarez Rendueles**, op. cit., p. 13)

Colloquium 12: Shifting Frontiers in Financial Markets

Cambridge, March 1985
President of SUERF and Chairman of the Colloquium: Mario Monti

Colloquium book
Editor: Donald E. Fair
Authors: Marie-Christine Adam, Akbar Akthar, Richard Aspinwall, Andrew Bain, Morten Balling, Didier Bruneel, Carlo Cottarelli, Franco Cotula, Michel Develle, André Farber, Charles Freedman, Wolfgang Gebauer, David Gilchrist, Charles Goodhart, Christopher Johnson, Jan Koning, Patrick Lawler, Robin Leigh-Pemberton, Mario Monti, Giovanni Battista Pittaluga, Jack Revell, Tadeusz Rybczynski, Hartmut Schmidt, Niels Thygesen, Pehr Wissén.
Publishers: Martinus Nijhoff Publishers, Dordrecht/Boston/ Lancaster, 1986, xii, 361 pp.

– *Shifting which frontiers?*
"The shift in financial frontiers has two different dimensions. The first, which can be described as an external dimension relates to the extension of the external frontiers within which the finance industry has been operating. The extension of external frontiers in turn has two elements, that resulting in an increase of clients for the existing and new services offered by the industry but situated in a given area; and secondly, that leading to the extension of the geographical area which the services are made available. The second dimension of the shift in financial frontiers can be described as the tendency for the removal and disappearance of internal frontiers between the activities undertaken by and confined to the institutions which have tended to specialise in providing them ..." (**Tadeusz M. Rybczynski**, Economic Adviser, Lazard Brothers & Co, London, p. 257-258)

– *Factors and motivations:*
"... One reason why (the recent acceleration in structural change) may have been greater in the US and the UK is that the thrust of policy there has moved particularly towards a greater reliance on markets, which in turn has pointed towards deregulation. A second, more economic, factor distinguishing them from Germany, is the greater volatility and level of both interest rates and

inflation in the last 25 years. Some of the changes in instruments, markets, and financial behaviour, have been primarily defensive, to allow financial intermediaries to protect themselves, and in some cases their clients, against the worsening uncertainties and risks caused by such volatility ... Important though this essentially defensive response to worsening risk may have been, I do not regard it as the main factor underlying the recent structural changes; for many of the new initiatives have been undertaken by firms striving for a larger share of the market ... Competitive pressures in domestic markets are leading to the development of new technologies to extend more efficient, lower cost methods from large customers in wholesale markets to smaller customers in retail markets ... How confident can we be that the direction of causality runs only from volatile financial markets to sophisticated innovations and not at least in part, the other way?" (**Robin Leigh-Pemberton**, Governor of the Bank of England, pp. 12-15)

"What were the factors responsible for the weakening and disappearance of the internal barriers between the various financial activities in the UK and those leading to the strong tendency towards conglomeration and changes in the size and character of the financial industry? Broadly speaking the factors behind this development fall into two groups. The fundamental economic factors (group) include an increase in per capita and total income and technological advance within the industry. The regulatory framework (group) cover the legal and institutional framework within which the industry operates ..." (**T.M. Rybscynski**, op. cit., p. 264)

"... While structural factors may often be the underlying cause of changes in the financial system, legislative factors – particularly tax legislation – have a crucial influence on their manifestation. Tax factors have a bearing on the choice between debt and equity issue, on the merits of leasing versus borrowing, and on the advantages and disadvantages of index-linked securities to both borrowers and lenders ..." (**Andrew. D. Bain**, Group Economic Adviser, Midland Bank, London, p. 106)

"A continued thread in these (US) stories is the importance of large budget deficits, just as the main thread in explanation of financial market change a few years ago would have been inflation. Inflation has receded substantially, but variable rate securities remain, even thrive, because real interest rates remain unstable ..." (**Patrick Lawler**, at the time Economist, Division of Research and Statistics, Board of Governors of the Federal Reserve System, Washington, p. 122)

"The French financial scene used traditionally to be distinguished by its profusion of regulations and its segmented markets and circuits. This situation is now in the throes of rapid and far-reaching change. Over the coming years, the developments that are now getting underway can be expected to gather added momentum, gradually bringing the financial structure of the French economy still more closely into line with that of the other leading industrial countries" (**Didier Bruneel**, Director, Etudes Statistiques et Monétaires, Banque de France, p. 63)

– *An (apparent) digression on the persistently high real interest rates:*
"... The absolute level of (real) interest rates on financial assets is of no particular consequence by itself. In particular, it is irrelevant for investment decisions into real capital unless it is related to any useful (operational) rate of return on capital investment." (**Wolfgang Gebauer**, Assistant Professor, European University Institute, Florence, p. 135)

"Real interest rates are not yielding to disinflation due to the high levels of debt and insufficient savings, as the central monetary authorities have adopted a necessarily cautious attitude in an effort to prevent any resurgence of inflation ... A reasonable solution would be to reform taxation and trim the American deficit, while at the same time targeting a smaller growth rate, more in line with its domestic savings capacity. The resulting rise in household savings rate could reduce the drain on international savings. The cutback in public deficits and the continued improvement in the corporate profit ploughback rate, obtained by scaling down household consumption in other countries, would greatly contribute to rebalance world financial flows. At the end of the process could lie a lower real interest rate premium ..." (**Michel Develle**, Chief Economist, Banque Paribas, Paris, p. 162-164)

"Changes in the observed volatility of interest rates and inflation did not follow similar patterns across countries. Except for the general variability following the breakdown of the international monetary system, differences appear in national experiences ... We tested Fisher's relation under the joint assumption that financial markets are efficient and that ex ante real interest rates follow a random walk. Our results show an obvious dichotomy within the sample of countries: while the model provides a reasonable approximation of the UK and the US experience, the results for the Netherlands, Belgium and Germany lead to a rejection of the joint assumption and tend to support the view that there are asymmetries in interest rate adjustments ..." (**Marie-Christine Adam** and **André Farber**, Professors, Université Libre de Bruxelles, p. 178)

– *Some major shifts:*

"Because of greater competition, the emergence of liability management has produced a new financial environment in which the prevalent liabilities of the banks pay market-determined interest rates. As a consequence of the process of financial innovation, fostered by liability management, a myriad of new financial instruments has appeared in the last ten years ... The 'marketisation' of banking and finance – a term that refers to financial intermediation on conditions that are mainly determined by market forces – has not been restricted to the liability side of the balance sheet ... Within a more homogeneous financial system both the liabilities and the assets of financial institutions pay and earn, respectively, market-determined rates. In this financial environment interest rate adjustment has become faster and more important." (**Jan Koning**, Head of Department of Financial Statistics, Netherlands' Central Bureau of Statistics, p. 330-332)

"The main trends which seemed to emerge from our discussions were: *(abbreviated text)* 1.The tendency for corporate borrowers to borrow more at the short end than at the long end of the market; 2. Governments have increasingly, in contrast to corporations, been borrowing at the longer end of the market; 3. Preference for variable rather than fixed interest rates by corporations; 4. Substitution of bond for bank loan finance much more on the part of the public sector than the corporate sector; 5. Innovation in the type of instrument used; 6. New equity instruments in the small to medium sized sector; 7. International instruments ... used in preference to those available in domestic markets ..." (**Christopher Johnson**, Group Economic Adviser, Lloyds Bank, London, as general rapporteur, p. 349-351)

– *Implications for monetary policy: are shifting frontiers destabilizing monetary control?*

"... The problem that the structural changes do bring are not that they diminish the Central Bank's power to control, but rather that the blurring of instruments and institutions make it more difficult to assess and to interpret financial developments, and thence to judge how to apply monetary controls ... In such circumstances, if these are indeed a proper reflection of today's reality, it would hardly be possible, for the authorities to commit themselves *rigidly* to achieving a specified numerical growth rate for any particular definition of money over any period much longer than a year, or two .Nevertheless in a fiat system world, there is an understandable fear that the growth of the money stock, and thence inflation, is driven by the short-term expedients of the authorities, which may not only have a bias to inflation, but also gives no basis for confidence about longer term price stability, nor even what rate of inflation, might be reasonably expected. Against that background, there is an understandable and justifiable demand for the authorities to adopt a degree of pre-commitment, to submit themselves to certain clearly-defined rules, sufficient to allay fears about future uncertain inflation, and to provide the necessary basis of financial stability for the economic system to work effectively. It is the counter-balance between the shifting structure of the financial system on the one hand, and the need for rules and pre-commitment on the part of the authorities on the other, that makes it so hard to select an optimal form of monetary targets ...” (**Charles Goodhart**, Chief Adviser Monetary Policy, Bank of England, p. 324-325)

“...The demand function for money has become sufficiently unstable to offer less guidance for policy-makers than was hoped when targets for the monetary aggregates were introduced in the mid-1970s ... A purely domestic orientation of monetary policy is not stabilizing, if international factors cause the money demand function to shift. To contain the impact of such shifts there has to be some explicit external orientation of policy which brings the exchange rate into focus ...” (**Niels Thygesen**, Professor of Economics, Institute of Economics, University of Copenhagen, p. 24, 26)

“Shocks generated by financial innovations may seriously complicate the use of monetary targets ... In our opinion these targets still can play a vital role in monetary policy, provided that the extent and frequency of financial shocks remain with reasonable bounds. In addition to monetary target aggregates, the central bank should also pay attention to other monetary indicators, especially interest rates ...” (**Jan Koning**, op. cit., p. 340)

– *Implications for supervision: again the supervisor’s dilemma ...*

“Gilbert claimed that a policeman’s lot was not a happy one, but he could just as well have been referring to a supervisor. The supervisor must try to balance an acceptance, even an encouragement of competition, and with that innovation which leads business into new and unfamiliar territory, against the various risks of financial difficulties, whose eventually may bring down obloquy upon his head ... As the form which change takes will depend on policy and supervisory practices, the process becomes one of interactive give and take between the supervisors and the supervised. Change will be allowed to proceed more freely the greater the degree of self imposed prudential restraint exercised by the participants both in structuring their balance sheets and in their conduct of competition.” (**Robin Leigh-Pemberton**, op. cit., p. 16, 18)

"The need to adjust supervisory systems may arise because of weaknesses of old supervisory instruments, introduction of new financial instruments, formation of new multipurpose institutions or groups of institutions, financial innovations outside the supervised area, new information and communication technology, new control systems and reporting and auditing procedures, new tax systems, and because of changes in international financial markets ... A continued internationalization of the financial services industry seems to imply a continued internationalization of the supervisory systems ..." (**Morten Balling**, Professor, Graduate School of Business Administration, Aarhus, p. 300)

Colloquium 13: International Monetary and Financial Integration – The European Dimension

Luxembourg, October 1986
President of SUERF and Chairman of the Colloquium: John Richard Sargent

Colloquium book
Editors: Donald E. Fair and Christian de Boissieu
Authors: Michel Aglietta, Michael Artis, Gunter Baer, Christian de Boissieu, Ernst-Günther Bröder, Franco Bruni, Rolf Caesar, Paolo Clarotti, Sylvester Effinger, Wietze Eizenga, Richard Freeman, Michel Galy, Francesco Giavazzi, Jean Guill, Rolf Hasse, David Llewellyn, André Louw, Rainer Masera, Jan Michielsen, Marco Pagano, Hans Pfisterer, Jean-Jacques Rey, Jacques Santer, J.R. Sargent, André Swings, Geoffrey Wood.
Publishers: Kluwer Academic Publishers, Dordrecht/ Boston/ Lancaster, 1988, xii, 405 pp.

– *Any place for a European dimension in the world of monetary and financial globalisation?*

"... Financial phenomena on a worldwide scale tend to blur the European identity. The questioning of the traditional philosophy (of European integration) is so basic that one has to ask *whether a European identity still has a place in a global system of interdependent and open capital markets* (in italics in the text) ..." (**Michel Aglietta**, Professor of Economics at the University of Paris X and General Rapporteur of the Colloquium, p. 386)

– *Evaluating the first years of the European Monetary System (EMS)*

"... The area of exchange rates, to which most EMS provisions apply, has performed best. Whatever method may be used for measuring the variability of nominal and real exchange rates, that of intra-EMS rates has been much smaller than that of EMS vis-à-vis non-EMS exchange rates and of 'intra non-EMS' rates. The ERM has thus offered the desired protection against volatility and misalignments ... The external policy has consisted mainly of defensive actions which were largely determined by the German authorities. Notwithstanding positive signs, the exposure of the System to external disturbances remains rather high...Viewed from this angle (of economic and social welfare) the performance of the EMS could be somewhat disappointing. Growth of real GDP has remained rather depressed and the situation in the field of unemployment and fiscal policy in the EMS has even worsened... However, it would be unfair and probably premature to blame the EMS for the lack of results in these areas...” (**Jean-Jacques Rey** and **Jan Michielsen**, respectively Head of Foreign Department and Inspector General, National Bank of Belgium, pp. 81-82)

“There is clear evidence ... of an EMS stabilizing influence on the key intra-EMS bilateral rates and only slightly less strong evidence of a stabilizing effect on wider exchange rate relationships; and this evidence extends to real as well to nominal exchange rates ... It appears that the EMS currencies do not afford experience of a medium-term misalignment on the scale experienced by the dollar or earlier by the pound sterling. In this achievement the EMS has proven a significant success and it is one of the reasons why membership of the System has attracted support in the United Kingdom ... The EMS plainly has afforded to its members the opportunity to pursue counter-inflationary policies based on treating exchange rate adjustments as less than fully accommodating ... But this is in itself weak evidence for the view that the EMS has succeeded in providing a framework for cooperation as opposed to a D-Mark anchor against inflation which member countries have been happy to use. On the latter interpretation the EMS can be viewed as a regional counterpart to the global post-1979 episode in which the theme of ‘putting one’s own house in order’ has been dominant, and its success has been in combining the function of a counter-inflation framework with that of stabilizing intra-System real rates. This achievement, solid enough in itself, unfortunately gives no firm basis for predicting the continuing success of the System in a period when unemployment, rather than inflation, is the issue of the day ...” (**Michael Artis**, Professor in the Department of Economics, Manchester University, pp. 210-212)

“The EEC should adopt either a system of floating rates, with a monetary rule in each country, or move to a genuine currency union. Consideration of these courses should not be put aside on the grounds that the EMS has succeeded; for the EMS has been successful only because it has tried to do so little.” (**Geoffrey E. Wood**, at the time Professor in Banking and International Finance, City University Business School, London, p. 45)

– *Prudent approach to full Economic and Monetary Union (EMU)*
“Monetary integration must comprise ... an exchange rate union ... Such an exchange rate union can be either a ‘pseudo union’ or a ‘complete union’ (to

use the term coined by Max Corden in 1972). The first is an agreement to fix exchange rates, the agreement perhaps being accompanied by promises of economic policy coordination; the second involves pooling of foreign exchange reserves, establishment of a central bank for the monetary union, and the issue of a common currency for the union. Only the second has hope of permanence ... Genuine monetary integration requires a common currency. Only then would there be a convincing demonstration that the union was complete, not pseudo ...” (**Geoffrey Wood**, op. cit., p. 40)

“The liberalization of capital movements and the broader concept of financial integration now seem to be the most important item on the agenda of the further strengthening of the EMS. Assuming it succeeds, it may also turn out to be a major challenge of the EMS ... This new stage of European economic and financial integration should be a transitory stage to a more stable situation where political responsibility for economic policy and welfare throughout the Community is exercised at Community level. This is what economic and monetary union is about; the shorter the transition, the better ... It may be useful to have a new round of thinking on the transition process and minimum requirements of the final stage of the economic and monetary union. While the end of the road will be regarded as politically out of reach and may remain so for long, it is increasingly the case that proposals for further strengthening the EMS are gauged in relation to their ability to move the system forward in the direction of this goal ... A ‘Werner Report revisited’ might help in focusing action on the next most useful steps, be they monetary or non monetary.” (**J.-J. Rey** and **J. Michielsen**, op. cit., pp. 85, 87-89)

“... Il est bien connu que l’utilisation privée de l’Ecu s’est développée plus vite que son usage officiel par les Banques centrales. Ce déséquilibre et l’absence de passerelle entre l’usage privé et l’usage officiel de l’ECU suscitent la plupart des interrogations actuelles ... L’ECU au niveau du SME comme dans chaque pays membre, reste aujourd’hui une monnaie partielle. Ceci apparaît dans la non-utilisation de l’ECU comme monnaie de facturation et monnaie de règlement des opérations commerciales courantes et dans la dualité de l’ECU traduite par la juxtaposition de ses formes publique et privée ... La question de la ‘réunification’ de l’ECU reste avant tout politique: un règlement satisfaisant de ce problème signifierait que l’Ecu est devenu une monnaie complète, ce qui suppose un degré d’intégration monétaire pour l’instant hors de portée ... Apparaît ici un paradoxe de l’intégration monétaire européenne: la logique de cette intégration a fait surgir une hiérarchie en faveur d’une monnaie (le DM) et d’un pays (la RFA) par principe hostile à l’utilisation domestique et à la promotion internationale de l’ECU ...”

(**Christian de Boissieu**, Professor of Economics at the University of Paris, pp. 189, 191-192)

– *International monetary cooperation and/or, perhaps versus European integration?*

"Les économistes et les responsables politiques ont souvent tendance à surestimer les inconvénients des systèmes en place et à exagérer les avantages des systèmes alternatifs. Ainsi, lorsque le régime de Bretton Woods était encore en vigueur, avait-on tendance à mettre en exergue les avantages censés découler du passage à des changes flottants ... Aujourd'hui, devant les inconvénients de l'instabilité des taux de change (en particulier du dollar) la tentation est grande de prôner un retour à des changes sinon fixes, du moins soumis à de moindres fluctuations (cf. la proposition de zones-cibles pour les grandes monnaies) ... Le succès indéniable du SME encourage sans doute la vague de propositions tendant à accroître la stabilité des taux de change ...

... (Le) scénario de trois blocs monétaires (le dollar, l'ECU ou le DM, et le yen, chacun s'appuyant sur une monnaie complète, est séduisant parce qu'il rétablit de la symétrie dans des systèmes fondamentalement asymétriques.(Cependant, il) a toutes les chances d'être transitoire. A un moment donné, les opérateurs établissent une hiérarchie entre les monnaies. La hiérarchie n'empêche pas la diversification des portefeuilles, sauf lorsqu'elle marquée au point d'être représentable par un ordre lexicographique ..." (**Chr. De Boissieu**, op. cit., pp. 187, 201)

"... It appears that support for target zones must rest on attributes other than their capacity to induce cooperative outcomes ..." (**Richard T. Freeman**, Senior Economist, Division of International Finance, Federal Reserve Board, Washington, p. 182)

"Closer international monetary co-operation between the United States, Japan and Germany – if in fact, proved feasible over time – may indirectly have some favourable effects on the evolution of the EMS ... The positive contribution would be that closer co-operation between the three major currencies would establish a framework for the EMS countries to conduct a common policy vis-à-vis third currencies ... By contrast, there appears to be little scope for promoting the official ECU as an international reserve asset ..." (**Gunter D. Baer**, Assistant Manager for International Economy, BIS, Basle, p. 163- 164)

"It is clear that the EMS has certain achievements to its credit which a reform of the world system might make more generally available. But an awkward feature here is that the control of exchange rates established within the EMS has been purchased to a degree by restrictions on capital movements and it seems clear that the removal of these restrictions will confront the System with a new learning curve ...” (**Michael Artis**, op. cit., p. 217)

– *The new learning curve of liberalization of capital movements and of financial integration...*

“Il n’est pas évident de concilier la mobilité des capitaux, la discipline des taux de change et l’autonomie des politiques nationales ...” (**Jacques Santer**, Prime Minister of Luxembourg, p. 9)

– *Two conflicting views on financial integration*

“There are two quite different approaches to the role of finance. The first has Anglo-Saxon origins and rules international financial markets. It is symbolized by the ‘big bang’ in the City of London. It sees finance as an independent industry, having no particular link with the real economy of the host country. Conversely, the second approach puts finance at the service of financing the real economy, above all industry. This is the dominant concept in continental Europe. It favours financial structures which allow the establishment of permanent relations between industrial firms and financial institutions ...

... To make further financial liberalization in Europe compatible with the stability of the EMS, it would be possible to make financial assets denominated in European currencies more attractive to residents of EMS states than those denominated in other currencies. European financial integration would then be characterized by the size of a large financial market and by lower risks, without the necessity of capital controls erected at the borders of Europe ...” (**Michel Aglietta**, op. cit., p. 390-391)

“Although the bulk of world financial intermediation is conducted through national mechanisms, financial intermediation is becoming increasingly global. National financial systems are losing some of their tradition(al) ‘efficiency’ and ‘imposed’ competitive advantages and as such are becoming sub-sets of a global financial system ... In the process, a two-tier structure of banking is emerging in which the corporate sector increasingly has global options while the financial intermediation of the retail/personal sector is still limited mainly to within national financial systems.

It is a combination of interactive factors that has produced these trends. But none of the explicit factors identified (competitive pressures, financial innovation, technology, de-regulation, abolition of exchange control, structural change within national frontiers, and international objectives of financial institutions) have a specifically European dimension.

... The EEC has made some, though limited, progress in terms of free trade in financial services. It must be said that global rather than European factors dominate and any European dimension is swamped by factors that operate at a global level. In this sense, the European dimension to international financial integration is largely irrelevant, or at least of second-order importance." (**David T. Llewellyn**, Professor, Loughborough University Banking Centre, pp. 258-260)

"Although free capital mobility may produce substantial welfare gains, it may also have non-negligible costs in terms of increased volatility of domestic interest rates and/or of need for more frequent realignments of nominal parities. But since the increased interest rate volatility tends to die out as the maturity of the assets lengthens, there exist relative simple ways to reduce these costs." (**Francesco Gavazzi** and **Marco Pagano**, Professors, respectively at the University of Venice and at the University of Rome, p. 282)

"L'efficacité du contrôle des changes n'est sensible que dans le court terme et agit moins sur les mouvements de capitaux que par l'imposition d'une taxe sur les mouvements des capitaux des résidents. Son élimination devrait se traduire par une plus grande variabilité quotidienne des capitaux et des taux de change mais ne modifierait pas durablement l'équilibre de la balance courante..." (**Michel Galy**, Directeur Adjoint, Direction Générale des Services Etrangers, Banque de France, p. 378)

"La libéralisation des mouvements de capitaux, même si elle aura plus d'impact sur les pays qui ont une réglementation restrictive, aura aussi des conséquences heureuses dans les pays qui ont déjà procédé à une large libéralisation de ces mouvements ... Mais cette libéralisation ne sera pas suffisante pour réaliser une intégration complète des marchés financiers en Europe et ... à cet effet, il sera nécessaire de supprimer toutes les entraves 'techniques' à l'échange des services, et notamment les distorsions fiscales ..." (**Paolo Clarotti**, Head of Division, Banks and Financial Establishments, CEE Commission, p. 325)

"A well-known source of difficulties for monetary targeting comes from the instability of the demand for monetary assets, caused by structural changes in the financial system and financial innovation.

Capital mobility seems helpful to cope with this type of difficulty, provided that the authorities control the domestic component of money expansion and are ready to cushion the shocks to the demand for money with changes in reserves. But this help is limited by the fact that capital mobility and financial integration are themselves among the major causes of financial innovations and of instability of the money demand function.” (**Franco Bruni**, Associate Professor, Bocconi University, Milan, p. 236)

Colloquium 14: The International Adjustment Process – New Perspectives, Recent Experience and Future Challenges for the Financial System

Helsinki, May 1988
President of SUERF and Chairman of the Colloquium: John Richard Sargent

Colloquium Book
Editors: Donald E. Fair and Christian de Boissieu
Authors: Johnny Åkerholm,Victor E. Argy, Michael J. Artis, Joseph Bisignano, Henri Bourguinat, Martin M.G. Fase, Jacob A. Frenkel, Morris Goldstein, Gerard Holtham, Christopher Huhne, Otmar Issing, Henk Jager, Lal Jayawardena, André de Lattre, Dietrich Lemke, Ellen E. Meade, Esko Olila, Peter Oppenheimer, Luigi Paganetto, Robert Pringle, John Richard Sargent, Sergio Siglienti, Yoshima Terao.
Publishers: Kluwer Academic Publishers: Dordrecht/Boston/London, 1989, xii, 397 pp.

– *Adjustment as a colloquium topic:*
"... The world has changed more in the last five years than at any time since the return to convertibility in 1958 ... In a world where capital transactions and financial innovation have taken such a pre-eminent role, where international financial institutions have little power and where coordination is recognized as imperfect and denounced as counterproductive by some, there remains the need and finally most of the means – if one really want to use those which are at hand- of an efficient adjustment process." (**André de Lattre**, Chairman, Standard Chartered Bank, Paris, pp. 17, 21)

"The notion of 'adjustment' entails the notion of some prior disturbance or shock to which the economic system, or some parts of it, must adapt. The Colloquium has considered three main kinds of disturbance: the factors having generated the US payments deficit on current account and the corresponding surpluses of other countries, mainly Germany and Japan; the international debt crisis; the stock exchange bubble of 1987, and the volatility of financial markets generally.

It is interesting to observe that initially the debt crisis was a problem analogous to the stock exchange bubble, calling for crisis management and last-resort lending by monetary authorities, to ward off a threatened collapse of financial institutions. With the passage of time however (it is, after all, six years since the crisis erupted in August 1982, i.e. Mexico) it has become more analogous to the US deficit problem: a matter of trying to re-arrange the pattern of world payments in a way that will at once underpin financial stability and encourage a quickening or a continuation of economic growth. And if we seem to be having some trouble with the global payments pattern, let us also recall that the authorities did make a good job of the crisis management ..." (**Peter Oppenheimer**, University Lecturer in Economics, Christ Church College, Oxford, p. 387)

– *The new dimensions of adjustment*
"... The general conclusion of this scenario approach is therefore that an adequate adjustment policy should involve both the US and the other OECD countries and that it would be extremely difficult to get the debt ratio under control without serious economic losses ... Balance of payments adjustment by means of the exchange rate mechanism is insufficient. Not only are reactions to changes in exchange rates slow, but the various economies also show serious rigidities. Important in this respect is the laborious process of structural adjustment which should ultimately effect a re-arrangement of the international division of labour ... The classical instruments of monetary and fiscal policy together with the exchange rates must be used very intensively to restore current account equilibrium. Historical experience shows that policy coordination by means of consultation may be the most fruitful. However, model exercises place this role in a somewhat different perspective, re-emphasising the implications of policy coordination for the developing countries." (**Martin Fase**, Deputy Director, De Nederlandsche Bank, pp. 254, 259)

"... The objective for countries in what is called the 'industrialised" world ... should be, for the group as a whole, one of substantial current account surplus, permitting capital exports and aid to finance the savings gap of the developing world. This does not mean that all countries in the group must have a surplus vis-à-vis the outside world, or must be in strict equilibrium vis-à-vis each other partner in the group, but that one would not accept situations like the present one, where the United States' current account deficit is substantially larger than Germany's and Japan's surpluses, which means that the US are both 'sucking in' Japanese and German savings and also receiving transfers from the developing world, a most abnormal outcome." (**André de Lattre**, op. cit., p. 21)

– *Are the US imbalances intractable?*

– *Relativizing*

"... I am suggesting that the US fiscal stimulus had little upward impact on dollar interest rates or on the dollar exchange rate; and that the strength of the latter up to 1985 had the effect partly of reducing US inflation and partly of dampening the real domestic expansionary impetus of the budget. By the same token, up to 1985 US policy imparted a twofold dose of expansion to the rest of the world, whose exports benefited both from competitiveness or relative price effects (due to the dollar appreciation) and from Keynesian aggregate-demand effects (due to the fiscal impetus) Applying this scheme of thought to developments since 1985, one has no need to search for any missing J-curves or wonder why the dollar's depreciation has not done more to improve the current balance of payments. There has been no exceptional time lag, and the depreciation has had a sizeable effect – but almost entirely on the internal balance... Correction of the current payments deficit is still waiting on effective action to narrow the Federal budget deficit ... The financial or savings surplus of the US private sector (households and corporations) has been low and relatively (though by no means completely) stable over the business cycle. Hence any 'excess' financial deficit of the combined government sector has fed through fairly promptly to the current balance of payments ... If we deny the US budget deficit any special role in keeping interest rates up, how do we explain the persistently high level of interest rates world-wide through the later 1980s? Inflationary expectations, and especially the long lag of these expectations or anxieties behind the reality ... seem to be an important element. Real (interest) rates have been slow to decline. This is particularly unfortunate from the point of view of the world debt problem, and is an argument for some generous form of assistance or relief from the debt burden." (**Peter Oppenheimer**, op. cit., p. 390-391)

– *Emphasizing*

"A common prescription for the cure of severe external deficit positions is a significant reduction in domestic absorption. At the present time such medicine appears difficult to prescribe when the patient is the dominantly world economic player, the United States. A policy of substantially reducing domestic absorption also puts at risk the health of developed as well as developing countries. Another constraint on such a policy is the fragile state of some sectors of the US financial system, which are still attempting to recover from the severe shift in relative domestic and international prices seen in the 1980s ... Neither are the incentives for domestic policy adjustment in the surplus countries unconstrained in the short run or particularly attractive with respect to their longer-run consequences. The large surplus countries have for several years been pursuing programmes of medium-term fiscal deficit correction, which short-term cyclically-motivated expansionary fiscal exercises could seriously throw off course ... The already sizable depreciation of the dollar ... would appear to make further major depreciation undesirable ... It is easy to arrive at the conclusion that the policy options available to the major economies to restore external 'equilibrium, or 'sustainable' current-account balances are limited ... If policy measures are unlikely to induce further adjustment, what private market forces could potentially operate to secure further external adjustment? ... The longer the imbalances remain presumably the greater the chances are that financial markets will be subject to periods of 'excess volatility' and that volatility could itself lead to asset price misalignment. All this is a circuitous way of saying that in a world with a high volume of international trade in financial assets the market-induced adjustment of current-account imbalances may be slow in occurring without direct intervention by monetary and fiscal authorities and may entail considerable instability in financial markets." (**Joseph Bisignano**, Assistant Manager, BIS, pp. 189-190, 202)

"... Le problème majeur qui guette l'économie occidentale pourrait bien être celui qui naîtrait d'une finance que l'on prétendrait laisser aller sans aucun contrôle à l'échelle mondiale alors que, les Etats-Unis prétendraient, simultanément, se cramponner aux instruments de la maîtrise de leur marché des marchandises et autres services. De ce découplage naîtrait vraisemblablement de très sérieux effets pervers ..." (**Henri Bourguinat**, Professeur, Faculté des Sciences Economiques, Université de Bordeaux I, p. 223)

– *Going their own way*

"If the fundamental problems stem from the excessive absorption of world savings by the US, it cannot be the right medicine to compensate for larger American budget deficits by larger ones elsewhere ... Germany's contribution should be to foster growth not by stimulating private and/or public consumption, but by strengthening domestic investment, thereby stimulating economic activity and switching resources from the export sector to domestic production, from tradables to non-tradables. This policy is in Germany's own interest as well as that of its partners." (**Otmar Issing**, Professor at the University of Würzburg, p. 124)

"(For small open economies) the flexibility of wages and prices is decisive to the overall outcome and the chances of maintaining employment in the adjustment process. The room for manoeuvre in economic policies has become rather limited. Irrespective of the exchange regime, monetary policy must to an increasing extent be geared towards the inflation target, while fiscal policy has to be used to correct external balance in situations of disequilibrium ..." (**Johnny Åkerholm**, Head of Central Bank Policy Department, Bank of Finland, p. 65, 66)

– *The case for international policy coordination*
"The rationale behind the coordination process – and we think it can only be regarded as an evolving process – is that you need a mechanism to *internalise the externalities* of policy actions by the larger countries. Specifically, multilateral surveillance is employed to see that the international spillovers – both good and bad – of each country's policies – including the feedback of these spillovers to the country itself – are taken into account in the final, multilateral policy bargain. In some cases, countries may also be able to use 'peer pressure' to help them take policy actions that are unpopular domestically but which are beneficial to them in the long run ..." (**Jacob A. Frenkel** and **Morris Goldstein**, Economic Counsellor and Deputy Director, IMF, p. 303)

"... The basic welfare proposition of coordination abstracts from the fact that coordination is costly and in itself does not privilege exchange rates as a potential target for stabilization. However, analysis suggests that exchange rate stability is an outcome of coordination and that, when countries agree to fix exchange rates, they implicitly pledge to conduct policies which are closer to those indicated by a full coordination than to those they would follow in an uncoordinated floating rate system. Since the cost of a continuous coordination of policy are substantial, this suggests that we might expect to find major coordination directed at a regime-building enterprise in which exchange rates have a privileged role...

Despite the collapse of the Louvre Accord and the evidence of international discord generated en route, in key respects the story of international policy coordination since the Plaza Hotel Agreement of September 1985 – taken as a whole – has been a success ... The Louvre episode illustrates in a concrete way what the theoretical constructions tell us: a significant coordination of economic policies must involve their adaptation to the needs of the international situation. This much is inescapable. Inescapable also is the logic that reveals coordination to be in general a welfare-improving path. Lack of it, after all, abetted the creation of the largest imbalances the developed world has ever seen in peacetime ..." (**Michael Artis**, Professor of Economics at the University of Manchester, pp. 232-233, 237, 240)

“Given improved convergence, cooperation in the European Monetary System has now reached a stage in which individual countries are increasingly urging for monetary policy coordination in Europe and further institutional development of the system. Close cooperation in Europe has brought the international monetary system close to a multi-polar order in which Europe and the Pacific region might be the centres, along with the dollar area. However, in the future, too, world-wide monetary policy cooperation will probably end at the point where individual nations insist on their freedom of action in economic policy ...” (**Dietrich Lemke**, Director, Foreign Department, Deutsche Bundesbank, pp. 288-289)

– *The ‘involuntary’ adjustment of developing countries...*
“... The post-1982 adjustment (of the LDCs) has been largely ‘involuntary’ which is to say that it has not been achieved so much through adjustment policies (although they are being enacted in most countries) as because the external sources of funds needed to maintain a given level of foreign purchases have suddenly dried up ... The forms which external adjustment has taken in the most heavily indebted countries and the economic trends which have taken shape as its result have had a very adverse impact on the growth potential of those countries and have structurally affected their creditworthiness and capacity to service the external debt... From the point of view of their creditor banks, the awareness of these objective difficulties, which can no longer be regarded as temporary, force them to question the approach to management of debt crisis which they have adopted so far. The strategy based on rescheduling has proved ineffective as a means of restoring the main debtors to solvency and has merely enabled the creditor banks to continue accounting their claims against debtor LDCs at face value and so, formally at least, to avoid any capital loss. This result has been increasingly revealing itself a fiction especially after the occurrence of some recent major developments such as the sizeable loan-loss provisions which have been made during 1987 by the banks most heavily exposed towards the LDCs ... Nevertheless, the major US banks are still unwilling to take this tendency seriously enough to alter the long-standing interpretation of the debtor crisis as a *liquidity crisis* rather than a real *insolvency crisis.*

... A policy of negotiated write-off of bank debts would certainly be given a great boost if international financial organizations were to support debt unfreezing plans by taking a direct part in the conversion programmes, for instance by guaranteeing the bond issues and supervising the economic policy commitments undertaken by the beneficiary countries ... This would help towards the final objective of gradually restoring the banks to their proper role in providing finance to the LDCs, which means overcoming the present phase, where their main contribution has been to cover macroeconomic disequilibriums, in order to go back to providing support for trading and project financing ...” (**Sergio Siglienti**, Managing Director, Banca Commerciale Italiana, pp. 309, 321, 326)

“The private sector financial flows to the developing countries need to be guided and supported within an international framework which makes the macro-economic risks marginal. In other words, the rule of thumb that countries never default needs to be made a reality by the suitable development of world institutions, notably the World Bank. There are, however, great dangers both for developing countries and their creditors, in unsupported private sector finance, as recent experience has no doubt done much to emphasise.” (**Christopher Huhne**, Economics Editor, The Guardian p. 342)

“The historical record suggests that sound economic policies in borrowing countries are a necessary but, not a sufficient condition for a sustained flow of foreign capital. Over the longer term, net foreign lending has been sustained only at times when international monetary relations have been governed by accepted standard – whether the gold standard, the gold-exchange standard or the dollar standard ... Unpredictable movements in the value of the currency unit (standard of deferred payments) add to the sum of risks facing creditors and borrowers as a group, and can bring about unintended wealth transfers from creditors to debtors or vice versa: in the 1970s, bondholders were decimated, in the 1980s, it was the turn of the debtors. But it is not as if these swings even each other out: the sum of risks is greatly increased. In these conditions, lending and investment is directed primarily toward lessening risks ... The present-day investor is interested only in the debt instruments of top quality issuers that can be used as vehicles for diversification of risks caused by the unpredictable monetary and fiscal policies of governments and the absence of an international standard. Indeed, instability in the investor’s domestic currency provides an additional spur to such international diversification. But this investment has nothing to do with the economic function of a capital market. Indeed, the pro-cyclical character of contemporary capital flows adds to the instability of the international economy as a whole. Thus, the much-vaunted adaptability of the modern capital market is bought at a high price: it denies financing to a significant proportion of the world’s most productive investment opportunities.” (**Robert Pringle**, Senior Fellow, World Institute for Development Economics, Helsinki pp. 381, 383)

Colloquium 15: Financial Institutions in Europe Under New Competitive Conditions

Nice, October 1989
President of SUERF and Chairman of the Colloquium: Niels Thygesen

Colloquium Book
Editors: Donald E. Fair and Christian de Boissieu
Authors: Ole Aerthøj, Patrick Artus, Forrest Capie, Ivo Caytas, Peter Cornet, Jean Dermine, Geoffrey Fitchew, Christopher Johnson, Leslie Johnson, Philippe Lagayette, José Leal Maldonado, François Léonard de Juvigny, André Levy-Lang, David Llewellyn, Catherine Lubochinsky, Ian Lumsden, Julian Mahari, Georges Martin, Rainer Masera, Joël Métais, Marco Onado, Jean-Paul Pollin, David Ravenscraft, Alfred Steinherr, Niels Thygesen, Marc van Turenhoudt, Norbert Walter, Geoffrey Wood.
Publishers: Kluwer Academic Publishers, Dordrecht/Boston/Lancaster, 1990, xiv, 364 pp.

– *At the centre of attention...*
"The behaviour of individual economic agents and, particularly, of financial institutions, subjected to intensified international competition in an environment of simpler and more unified national and international regulation over a widening range of financial activity..." (**Niels Thygesen**, Professor, Institute of Economics, Copenhagen, p. 3)

– *Why is it all happening now?*
"... What happens now is both a quantitative and a qualitative jump with deregulation proceeding in many countries at a sharply accelerated pace, capital controls being reduced in many parts of the world, innovation becoming a driving force and finance rapidly internationalizing. It is the simultaneous occurrence of these factors, in many part of the world, at a rapid pace which is the new phenomenon ...

I think there are two major forces at work, reinforcing each other. One is the increasing internationalization of the non-financial sector. The other is that existing regulations were largely set up for needs of the past and are therefore not well suited for present needs ...” (**Alfred Steinherr**, Director, Financial Research Department, European Investment Bank, Luxembourg, p. 51)

“... Traditional divisions within the financial markets, often inherited from the 1920s and the 1930s had ossified regulatory frameworks over a nearly-fifty year span. In the 1970s and in the 1980s fundamental economic forces set in motion a long overdue process of financial deregulation, first in the international markets, then domestically in all major countries, albeit to different extents and in different degrees, in part as a consequence of the profound diversity in inherited control systems. However, it soon became clear that deregulation had to be accompanied by re-regulation. Because of the very nature of the financial system, the two processes should be seen as complementary. Rapid growth and diversification of financial transactions, technological change, new market dimensions, securitization and financial innovation proper, all required new approaches to ‘market design’. Innovative regulation was – and is required – to create efficient market structures...” (**Rainer S. Masera**, Director General, Instituto Mobiliare Italiano, p. 320)

– *The European Dimension...if any*

“... None of the factors that have induced the globalization of finance (competitive pressures, financial innovation, technology, de-regulation, abolition of exchange control, etc.) have a specifically European dimension ... At the same time, there has been little globalization of retail banking. Whilst this has been true to date, the position could change in the 1990s. Potentially the arrangements envisaged for the post 1992 EC represent a major challenge in the market environment for all financial institutions and suppliers of financial services.” (**David T. Llewellyn**, Professor of Money and Banking, University of Loughborough, p. 142)

“... It is clear that as we move towards 1992 in the financial services sector, financial institutions in the Community will be the subject of new competitive conditions ... 1992 certainly does not mean an overnight revolution; it does not mean that the Commission or anyone else will pull a switch on 31 December 1992 and the scenery of the promised land will suddenly appear...But we are convinced that we are well on the way to achieving three major advances in the financial services sector: – freedom of capital movements; – freedom of establishment (the right to open branches); – freedom for cross-frontier provision of services ...” (**Geoffrey E. Fitchew**, Director General for Financial Services, Commission of the European Communities, p. 27, 28)

“... On a soutenu que (l’union monétaire) n’était pas une condition indispensable au fonctionnement du grand marché intérieur. Elle en constitue cependant un prolongement logique car un marché unique ne peur fonctionner efficacement qu’avec un système de prix unique, impliquant à terme la fixation irrévocable des taux de change entre les monnaies des pays membres, prélude à l’émission d’une monnaie unique ...” (**Philippe Lagayette**, Deputy Governor, Banque de France in his opening address, p. 15)

– *The new competitive conditions... Global and country-specific aspects...*
“... One trend observable world-wide is for banks to ‘despecialize’. In the United States, Japan and the United Kingdom this means the legal or traditional separation of commercial banking from investment banking is increasingly considered as outlived. On the continent where universal banking has been the norm in many countries the model spreads and the Second Banking directive accepts the universal banks as a model... The recent tendency to merge banking and insurance activities is motivated by the general quest for global finance ... The general trend in favour of ‘despecialization’ is not unchallenged. The major challenge is certainly going to be cost-effectiveness and not regulation...” (**Alfred Steinherr**, op. cit., p. 59, 60)

“... The dominant change, and one that has been both created by competitive pressures and itself reinforcing them, is the process of diversification and the erosion of the historic structured basis of the financial system. The process of diversification has involved existing institutions widening the range of products and services, and institutions purchasing firms in other sectors...” (**David T. Llewellyn**, op. cit., p.127)

“...La flexibilité dans les rapports qu’établissent les banques avec les marchés pour diversifier leurs activités, moduler la structure et la taille de leur bilan et gérer leurs risques ... est l’attribut premier de la banque à géométrie variable (présentée ici comme alternative à la banque éclatée). Une telle institution continue à intégrer la plupart des activités traditionnelles qui fondent la spécificité des banques. Toutefois les innovations financières engendrent de nouveaux services et surtout des formes d’intermédiation qui remettent en question le partage traditionnel des activités des intermédiaires financiers et marchés au gré des évolutions de leurs avantages comparatifs dans le financement de l’économie. Si on considère les intermédiaires financiers comme des variétés internalisées de marchés financiers, on assiste aujourd’hui à une certaine dilution de ces intermédiaires au sein des marchés consécutive à l'érosion de leur frontière traditionnelle sous l'effet des innovations et du progrès technique. Ce caractère désormais mouvant des contours des banques fonde la notion de banque à géométrie variable." (**Joël Métais**, Professor at the University of Paris X, p. 66)

"A major factor in profitability trends (in the U.K.) has been a change in the nature of the banking business. Banks are not exclusively asset- liability transformers. Increasingly they earn income off the balance sheet through the provision of various services ... Perhaps the most important contribution came from a strategic shift (stock-adjustment) that banks made from wholesale to retail banking activity during the 1980s ... This represents a competitive response of diversification in order to maintain overall profitability." (**David T. Llewellyn**, op cit., p. 139)

"...Il apparaît que les pouvoirs publics sont encore loin d'être parvenus à créer sur le territoire français un véritable marché intérieur unifié, c'est-à-dire un marché dans lequel toutes les dispositions sont prises pour que la concurrence puisse s'y exercer dans des conditions saines et loyales, conformément aux exigences du 'level playing field' ... Ce ne sera pas un des moindres mérites de la construction européenne que de contraindre la France à créer ce marché unifié. Mais il faut s'interroger sur les causes de la lenteur mise à la création de ce marché. On peut considérer qu'elle résulte de trois forces: l'attachement de certains réseaux, très puissants économiquement, à leurs privilèges, l'assise politique dont ils bénéficient et surtout l'attachement de la haute administration à un système qui lui donnait de singuliers pouvoirs ..." (**François Léonard de Juvigny**, Deputy Director, Association Française des Banques, p. 94)

"...Competition has certainly increased in the last decade in the Italian banking system, but the results are not clear-cut ... In a sense the evidence of competition is to be seen in the way banks reacted to the stimuli coming from the market conditions of the 1980s.Trying to maintain their market shares, all banks changed their asset and liability structure following the general trend for the banking system as a whole. Particularly they greatly increased the weight of loans on total assets ... The experience of the 1980s has shown that in a very dishomogeneous banking system, competition has had the effect of increasing risk (probably enlarging existing differences) and forcing many banks to suboptimal risk-profitability conditions... The reasons that in the past led the Italian authorities to minimize structural changes (in comparison to other countries) were by no means compelling but now risk creating a sort of vicious circle. The approach to the problem of less efficient banks will be the real trial of regulators' policy in the coming years. If barriers to exit continue to be rather strong, the effects of competition could be perverse ..." (**Marco Onado**, Professor of Economics, University of Bologna, pp. 103, 104-105)

"...Although Germany did not completely miss the trend towards deregulation and innovation, for many years things did not change much here compared with the dynamic development in other countries. Despite the 'Restliberalisiering', regulation of the markets is still high owing to – in part – obsolete ideas of consumer protection or of monetary policy supervision. In fact it acts as a brake on innovation. Securitization is also still strongly underdeveloped. This continues to rob the German capital market of that breadth and depth which international issuers and investors are used to at competing financial centres ... Due to the somewhat belated start and the continued efforts of its international competitors Frankfurt has to make double efforts if it is to catch up with the leading financial centres in the world and to keep the top position on the European continent..." (**Norbert Walter**, Senior Economist, Deutsche Bank, Frankfurt, pp. 150-151, 153)

– *The impact on regulation and supervision...*

"... We assume that deregulation leads to more competition, which leads to more efficiency, and thus there is a trade-off. Less regulation, more efficiency. On the other hand, one might also reason that from the point of view of social efficiency a certain minimum amount of regulation is necessary. This is an argument about the externalities..., like the importance of having a good payments system, the safeguarding of people's wealth, the protection of the investor, and indeed the allocation of funds between savers and investors. So we are looking for the banking system to be not just efficient in itself by its own measurements, but also to play a role which is efficient for the economy as a whole. These two do not necessarily coincide..." (**Christopher Johnson**, Chief Economic Adviser, Lloyds Bank, London, p. 361)

"... La critique essentielle que l'on peut adresser au modèle de la banque universelle concerne la sécurité des dépôts. Car même si la diversification des activités permet de réduire le risque global de l'institution, il n'empêche qu'elle accroît le problème des asymétries d'information, parce qu'elle complique l'évaluation des risques et qu'elle rend de ce fait plus incertaine la valeur des dépôts ... Il n' y a d'autre solution que de rendre plus exigeant le contrôle des activités bancaires ..." (**Patrick Artus** and **Jean-Paul Pollin**, Head of Department of Economic and Financial Studies, Caisse de Dépôts et Consignations, Paris and Professor of Economics, University of Orléans, respectively, pp. 258-259)

“... (Dans le domaine des valeurs mobilières) il en résulte un défi pour les autorités qui, elles aussi, devront dépasser les schémas traditionnels où, bien souvent, la protection du ‘petit ‘épargnant était préoccupation prioritaire, sinon exclusive. Aujourd’hui déjà, l’institutionnalisation et l’internationalisation des marchés, la taille des intermédiaires et les moyens technologiques mis en œuvre posent les problèmes de supervision en termes tout à fait différents.” (**Georges Martin** and **Marc van Turenhoudt**, Head of Economics Department and Adviser respectively, Association Belge des Banques, p. 219)

“... The period (from 1981 to 1985) saw a clear change internationally in supervisory approaches to the solvency position of banks. After years of steadily declining national solvency requirements (denoted by some as a competition in laxity), the supervisory authorities decided to join forces not just to put an end to this situation, but to redress it ... Agreements were made to improve the banks’ financial credibility. To this end banks will have to strengthen their capital ratios. One way to achieve this is by improving profitability; the completion of the European internal market holds out prospects in this regard. The enlargement of the market will speed up the process whereby national and sectoral boundaries are increasingly fading. For the supervisory authorities this development calls for closer cooperation. A major new supervisory area will be that of financial conglomerates...” (**Peter A.A. Cornet**, Chief of Banking Supervision, De Nederlandsche Bank, pp. 276, 285)

“... Existing differences in Europe in the very structure of the financial system and in the regulatory frameworks make the system-competition inherent in the Single Market a major challenge ... The problem lies in the dosage of minimal harmonization and mutual recognition which is likely to lead ... to competition between supervisory frameworks with a gradual convergence on the arrangements that best meet the needs of the market ...” (**Rainer S. Masera**, op. cit., pp. 329-330)

Colloquium 16: Fiscal Policy, Taxation and the Financial System in an Increasingly Integrated Europe

Lisbon, May 1991
President of SUERF and Chairman of the Colloquium: Niels Thygesen

Colloquium Book
Editors: Donald E. Fair and Christian de Boissieu
Authors: Julian Alworth, Graham Bishop, Claudio Boro, Barry Bosworth, Jorge Braga de Macedo, Jean-Claude Chouraqui, Hans-Peter Fröhlich, Jürgen von Hagen, Egon Hlavatý, Helen Junz, Mervyn King, Erkki Koskela, Simon Kuipers, Pierre Llau, Jose Tavares Moreira, Giovanni Ravasio, Rafael Repullo, Beate Reszat, Conrad Reuss, Jean-Jacques Rey, Luigi Spaventa, Niels Thygesen, Matti Virén, Manfred Wegner, J.S.G. Wilson, Dirk Wolfson
Publishers: Kluwer Academic Publishers, Dordrecht/Boston/Lancaster,1992, xiv, 442 pp.

– *Strong emphasis on* ***research****-based discussion...*
"SUERF aims for a profile different from those of our competitors. Our colloquia provide a forum for the exchange of the results of recent research and ideas among economists in universities, research institutions, banks and other private financial institutions, central banks and treasuries and international institutions ..." (**Niels Thygesen**, Professor, Institute of Economics, Copenhagen and President of SUERF, in his opening address, p. 3)

– *Focusing on saving-investment relations...*
"Central to (all the sub-themes) is the role of the financial system in allocating savings and investment and the extent to which it is becoming relevant to see that role in a European – or possibly a global – context ... In recent years, there has been a perception in many industrial countries that savings have constrained investment, with historically high real interest rates tending to keep additions to physical capital below a longer-run optimal rate ..." (**Niels Thygesen**, op. cit., p. 4)

"Almost all the issues of the four commissions, namely: private savings and tax incentives, – public sector imbalances, – international transfer(s), and the policy mix towards EMU in Europe are not only controversial but really most urgent policy problems which are to be solved within a very short time span. What seemed for a while an academic discussion of loosely connected technical questions, suddenly became the subject of radical changes in economic, institutional, and constitutional relations in the real world ... The topics are not only part of the European challenge in preparing some decisive steps towards EMU and the European Union in the 1990s, but they also form part of the fundamental changes going on in Central and Eastern Europe." (**Manfred Wegner**, former Director, IFO Institute for Economic Research, Munich, in his general report, pp. 429-430)

– *The savings puzzle*

"The decline in the private saving rate... remains a puzzle and a cause for serious concern. What policy should the government adopt? A useful first step would be to reduce government dissaving. The saving concept of greatest relevance to future welfare is net national saving. It makes little difference whether an increase in this rate occurs because of greater saving in the private or public sector ... I conclude that tax incentives are not an effective means of increasing national saving, and that governments are better served in designing a tax system to focus on its revenue-raising function: that means emphasizing a simple system with a broad base, low rates, and the minimal number of special exceptions. Within that framework national saving can most effectively be increased by simply reducing the magnitude of government dissaving." (**Barry Bosworth**, Senior Fellow, The Brookings Institution, Washington D.C., in an extensive survey of the US experience in the 1980s, pp. 48, 65)

"The fall in national saving rates in the 1980s is marked. Moreover, national saving rates have fallen by similar proportions of national income in all of the major countries – roughly 6 percentage points ... In answer to the question of why policy-makers are so concerned with the level of saving, ... my principal objective is to offer a (fourth) reason for thinking that governments might be concerned about the level of domestic saving. It is based on the idea that, in a regime of liberal financial markets, there are costs to a policy of raising the growth rate, unless additional measures are taken to cope with the demand expansion that results from the optimal response of agents to a positive supply-side shock to the future growth rate. The economic fashion of the 1980s was supply-side reform. Over a wide range of areas, the 1980s witnessed, in a number of countries, a movement aimed not only at improving the efficiency with which resources were being used but also at raising the trend rate of economic growth. Another related and important trend in the 1980s was the move to open up financial markets to competition with a combination of deregulation and the abolition of controls on capital movements. The combination of the two sets of reforms was powerful. Was it beneficial? I believe it was. But it is easy to see why there has been scepticism, in particular over the effects of financial liberalisation ... Unless the problems posed by the demand consequences of a supply-side shock can be managed satisfactorily, the supply-side cupboard will be bare ...” (**Mervyn A. King**, Chief Economist and Executive Director, Bank of England, Professor London School of Economics, in his opening address, pp. 30-32, 43)

“... As for the saving functions specifications, both inflation and real income growth are precisely estimated and positive which is in line with the misperception hypothesis by Deaton (1977) but does not eliminate other interpretations. The unemployment rate positively affects saving. The new finding here is that the normal interest rate positively affects the household saving rate, which also conforms with the liquidity constraint interpretation. Finally, the cross-section time-series country data evidence is partly in line with the Life Cycle Hypothesis – in the case of the demographic variables – and partly contradicts it, in the case of the income growth variable. Moreover, cross- section data provide some weak evidence fort the hypothesis that the marginal income tax tends to negatively affect the level of household saving.” (**Erkki Koskela** and **Matti Virén**, Professors at the Universities of Helsinki and Turku respectively, as the result of an econometric study of 17 OECD countries over the period 1979-1988, p. 157)

“(Four tentative conclusions) 1. Some of the broader trends in the allocation of savings in recent years appear to have been partly related to tax factors; 2. It is by no means clear that specific incentives have an impact on the aggregate level of savings; 3. The lifting of barriers to capital movements as well as the lower degree of segmentation between markets tends to impose a downward pressure on tax rates on capital income; 4.Given the growing internationalisation of financial markets it has become more difficult to use the tax system to pursue domestic objectives ...” (**Julian S. Alworth**, Head of Section and **Claudio E.V. Borio**, Economist, Monetary and Economic Department, BIS, Basle, in an analysis of 16 OECD countries, p. 99)

– *No escape from public sector imbalances and from the debt problem*
“Clearly, German economic and monetary unification (GEMU) was the most severe real shock by far to affect either German economy in their post-war

history ... Financing GEMU is an exceptional historical challenge ... There is no way to avoid a major departure from the previously protected time path for public expenditure and revenue... It should be noted that the present situation is exactly what had been called for during much of the 1980s. Back then Germany was widely criticized for under-absorption ... The question of how public transfers to Eastern Germany by the Bonn government are financed therefore concerns the whole of the EC. In the final analysis the issue boils down to this: the higher the share of tax financing in Germany, the less will there be upward pressure on domestic interest rates, and, indirectly, on foreign interest rates too. Conversely, exclusive reliance on deficit financing will tend to further increase the scarcity of capital and drive up real interest rates in Europe. This in turn, may force a number of European governments to tighten their own fiscal policy in an effort to increase savings. Such a situation obviously would be highly unwelcome in the face of a general slowdown in economic activity as seems imminent today ...” (**Hans-Peter Fröhlich**, Institut der Deutschen Wirtschaft, Cologne, in a much discussed contribution, pp. 291, 297, 299, 300)

“The overall impression... is that the (Dutch) government has been able to finance its relatively strongly rising debts in the 1980s rather easily ... (This) implies that the disciplinary influence that has been exerted on government financial behaviour by the financial markets has been rather weak ... This conclusion does not mean, however, that the position of government finance is stable in the sense that it is able to absorb external shocks, and that financing and refinancing is possible irrespective of other policies ... A substantial reduction of the public sector deficit will – by the ensuing fall in the public debt ratio – diminish the vulnerability of government finance by making public outlays less sensitive to interest rate movements, and by increasing the robustness of the confidence of the investors that the government is able to meet its obligations ...” (**Simon K. Kuipers**, Professor at the University of Groningen, pp. 179-180)

“... The dark side (of the Italian debt story) is the persistence of a fiscal imbalance: in spite of a rapid rise in the tax burden, debt growth had slowed, but not stopped owing to the inability to curb expenditures and to the increase in the cost of debt relative to the growth rate. Debt management offers a less discomforting prospect, as there have been considerable improvements in the structure of and the market for Italian debt: in spite of the size of the gross issues, their placement seems to meet no particular difficulty. Can we draw any conclusion as to the sustainability of the Italian fiscal position? What we can say with certainty is that, as debt grows, the cost of solvency rises with time, because the primary surplus and, hence, the overall tax burden, required to stop debt growth increase with the level of debt ...” (**Luigi Spaventa**, Professor of Economics at the University of Rome, pp. 194, 196)

– *Transition Policy for Central and Eastern Europe*
“The transition may be divided into three phases on the basis of the trend in production: deterioration, stabilisation, revival. The deterioration and stabilisation phases taken together will extend over 6 to 7 years, between 1989 and the start of ‘self-sustaining growth based on market principles’ ... In the deterioration phase there is a fall in GNP and in industrial production ... Public transfers and aid are needed to arrest the fall in production, to help maintain control of the situation and to prepare the following stabilisation phase. If there is an imperative need of public aid in the deterioration phase, it will become less pressing (in the latter phase) as its place is progressively taken over by private capital flows. The need for western aid will indeed diminish the better it has fulfilled its role as a catalyst. The aim of transition should not be to catch up with the western industrial countries in terms of per capita GNP but to reach a stage where growth becomes a self-sustaining process, on the one hand, and, on the other, the creditworthiness of these countries is re-established, that is to say their ability to assure the interest payments on their foreign debt. This is the reason why self-sustaining growth should be of the export-led variety ...” (**Conrad Reuss**, Economic Adviser, Bank Brussels Lambert, Brussels, pp. 308, 309, 310, 311)

“In the short run, the ability to switch resources to compete in foreign markets, to restructure and modernize capital stock at home and to meet domestic consumption demand that has become significantly more selective depend both on the breadth and speed with which adjustment effects materialize and on the availability of foreign financing. Unfortunately, the ability to attract foreign private investment flows of any size depends, in turn, on the demonstration that a successful transformation of the economy in question is already well-rooted ...

(Lessons to be drawn from recent experience): 1. The importance of not allowing production costs to rise for non-economic reasons. 2. Although gradualism as such is to be eschewed, complete opening up to outside competitive forces may need to be accomplished over time, however, with the time path set out very clearly. 3. Institution building, including the transmission of market signals (price structure, financial system, and enterprise accountability) must go hand in hand with stabilization efforts. 4. Administrative priorities need to aim at supporting the initiative of investors seeking to establish small and medium-sized firms. 5. Privatization efforts need to focus on managerial transformation as well as the spreading of assets among the population. 6. Perhaps most importantly, confidence in the financial system and in the predictability of economic policies, particularly tax and financial policies, must be such as to help innate high propensities to save into savings in financial assets ...” (**Helen Juntz**, Special Trade Representative and Director, International Monetary Fund, Geneva, pp. 287-288, 289)

“... The already implemented system conditions have enlarged the possibilities for foreign capital entry into Czechoslovakia. They are supplemented by a whole range of further legislative and legal measures guiding the entrepreneurial activities. It is natural that foreign investors expect at least reliable and stable conditions which could, to maximum extent, eliminate possible risk factors. Of great importance in this direction are special agreements on investment protection. The content of such agreements concentrates first of all on: – investment inviolability ..., – the most favoured clause ..., – the free transfer guarantee ...” (**Egon Hlavatý**, General Director, State Bank of Czechoslovakia, Bratislava, p. 332)

– *Transition Policy in EMU*
“... The first stage of EMU really began long before the date officially set to start the whole process. In mountain climbing, it is well known that climbing starts only when one has walked a long time already. Beyond a number of formal steps, the challenge of stage One is to allow further progress towards convergence, further progress meaning a catching up process for some countries, a consolidation for others. The required convergence is by no means unambiguous: the substance is dictated by the need to manage currencies within the ERM, the need to eliminate out-of-line performances when they are inconsistent with adherence to EMU and the need to remedy a number of difficult-to-identify rigidities which run the risk of putting the country at a competitive disadvantage when EMU is implemented. To some extent, the process of strengthening convergence is led by market forces which influence both the private and the public sector in trying to improve their competitive position in the new environment. It may be that more leadership could be exercised from Community institutions, particularly the Council.” (**Jean-Jacques Rey**, Executive Director, National Bank of Belgium, Brussels, p. 409)

“Il y a une asymétrie des coûts et avantages dans le temps. La Communauté supporte aujourd’hui les coûts d’ajustement, ceux liés à l’incertitude de change; il n’y a plus de réelle souveraineté monétaire nationale et l’ajustement par les taux de change a montré ses limites. A l’opposé, les avantages de l’UEM ne seront recueillis, pour l'essentiel, qu'à la troisième étape avec la monnaie unique. Ces considérations militent pour une transition la plus courte possible.

Une des difficultés de l'actuelle négociation est qu'elle prend souvent l'allure d'une défense excessive des symboles nationaux. Chaque pays a ses valeurs et ses préférences en matière économique et monétaire. Lorsq'elles sont brandies comme des drapeaux sur un champ de bataille, elles en deviennent des symboles ..." (**Giovanni Ravasio**, Director General for Economic and Financial Affairs, DG II, Commission of the European Communities, pp. 25, 26)

"... Taking part in the process of European integration has a high domestic political value in some countries, especially in the weaker economies where it is considered a sign of international distinction and respectability ... Being denied access to the union because of the persistence of a fiscal imbalance would thus represent a dramatic loss of prestige with the electorate and would at the same time ignite expectations of currency devaluation ..." (**Luigi Spaventa**, op. cit., p. 201-202)

"... Despite the transitory cost of disinflation it inevitably warns us against the temptation of believing that the change of regime can be consolidated without nominal convergence. From that standpoint, reducing inflation to a level close to the Community average is a necessary condition for a sustainable catching-up process ... The parable of union and cohesion suggests that the regime needs to be initiated by strong budgetary adjustment in Greece and consolidation by continued budgetary and monetary restraint in Portugal. In Ireland, nominal convergence was achieved faster but structural adjustment for real convergence has been slower ..."(**Jorge Braga de Macedo**, Professor at the University Nova de Lisboa, Director for National Economies, Commission of the European Communities, p. 278)

"... For the first time in a generation, or more, in 1993 most EC savers will be free to decide where to put their money once the Single European Market is in full operation ... As investors scan the European markets, they will realise that the advent of the single currency will create a fundamental change in the nature of government debt. It will no longer be an automatic safe haven for their savings: risk and reward will have to be assessed ... The markets do not perceive public debt as the residual of Keynesian demand management techniques – they are merely the intermediary for collective saving. The question posed by the saver is simple: will that government pay the interest and principal on this loan on the due date?" (**Graham Bishop**, Salomon Brothers International, London, pp. 211-212)

“... The conclusion from the evidence on the US is clearcut: a stabilizing function of the federal fiscal system ... is virtually non existent ... For Europe it seems that the argument in favour of a large Community budget or greater fiscal coordination is less general, hence less powerful than often perceived ...” (**Jürgen von Hagen**, Professor, School of Business, University of Indiana, Bloomington, p. 356)

“In face of system changes like those experienced now – with the developments in eastern Europe, the German reunification and adjustment burdens and power debates triggered by the Gulf War – attention should focus on measures strengthening existing relations and maintaining the viability of the EMS, instead of introducing new inflexibilities that only add to emerging conflicts ...” (**Beate Reszat**, Economist at HWWA Institut für Wirtschaftsforschung, Hamburg, p. 421)

“... The combination of a small Community budget with large, independently determined national budgets leads to the conclusion that, in the absence of fiscal coordination, the global fiscal policy of the EMU would be the accidental outcome of decisions taken by Member States. There simply would be no Community-wide macro-economic fiscal policy ...” (Alexandre Lamfalussy (1989) as quoted by **Dirk J. Wolfson**, Professor, Scientific Council for Government Policy, The Hague, p. 368)

Colloquium 17: The New Europe – Evolving Economic and Financial Systems in East and West

Berlin, October 1992
President of SUERF and Chairman of the Colloquium: Christian de Boissieu

Colloquium Book
Editors: Donald E. Fair and Robert Raymond
Authors: Palle Andersen, André Anikin, Christoph Bandyk, Graham Bishop, Hans Blommestein, Christian de Boissieu, Peter Doyle, Wolfgang Duchatczek, Irina Dumitriu, John Earle, Sylvester Eijffinger, Gerhard Fink, Roman Frydman, Manuel Guitián, Heinz Handler, Emil Karialiev, John Kay, David Llewellyn, Millard Long, Colin Mayer, Paul Mortimer-Lee, Teodor Nicolaescu, Ivanka Petkova, Andrzej Rapaczynski, Beate Reszat, Conrad Reuss, Eric Schaling, Aurel Schubert, Roy Smith, Otto Sobek, Alfred Steinherr, André Száz, Hans Tietmeyer, Ingo Walter, Georg Winckler.
Publishers: Kluwer Academic Publishers, Dordrecht/Boston/London, 1993, xii, 435 pp.

– *The New Europe...What does it mean?*
"... The 'New Europe' refers to two transitions and their articulation. On the one hand, Eastern European economies are still in the transition process to a market economy, and this process is going to continue for several years. On the other hand, EC countries, or some of them, are keen to implement an economic and monetary union (EMU) and, in some respects, a political union ... The two European transitions are different in kind; in some respects quite opposite. Whilst Western Europe is searching for more trade and monetary integration, some Eastern European economies are exposed to a powerful wave of disintegration, after the dismantling of the Comecon. On the other hand, East and West are facing common challenges: the search for models of capitalism, intermediate between pure laissez-faire and unlimited interventionism; the search for efficient financing of non-financial agents (firms, households, ...) in the context of deep banking and financial fragility ..." (**Christian de Boissieu**, Professor at the University of Paris I and President of SUERF, p. 3)

"... The global economy is still burdened by misdirected developments in major industrial countries during the 1980s ... In this uncertain environment the European Community should provide, in full knowledge of its responsibilities, a stable framework for the process of democratisation, liberalisation, and economic growth in Central and Eastern Europe. This cannot be done without cost, i.e. the cost of opening up the EC to both new members and their products. But it would be short-sighted to look only at the adjustment cost, and not to see the benefits for Europe ..." (**Hans Tietmeyer**, Deputy Governor, Deutsche Bundesbank, Frankfurt, p. 12)

– *Which economic model for Central and Eastern Europe?*

"... The challenge for economists and policymakers is to extract from an increasingly obsolete body of expertise and from a still-to-be applicable body of knowledge insights that can help the reforms along in an orderly fashion ... For the economics profession, the challenge is the result of the growing obsolescence of the strand of literature dealing with central planning and the lack of applicability of the knowledge available with regard to the operation of market forces ..." (**Manuel Guitián**, Associate Director, Monetary and Exchange Affairs Department, IMF, Washington, p. 114)

"(In the basic paper the author refers to, he) distinguishes between the *insider* system of corporate ownership of Germany, Japan and most of Continental Europe and the *outsider* systems of the UK and US. Insider systems are characterized by small stock markets, high concentrations of corporate ownership and high levels of ownership by families and companies of other companies. Outsider systems are characterized by large stock markets, low levels of corporate ownership and low levels of inter-corporate ownership...

In the context of Eastern Europe (the) presumption in favour of the insider system has to be tempered by the paucity of resources to manage firms within the corporate or the financial system ... There is a trade-off between following the gradual transfer of control from state to individual owners via institutional ownership (top-down) as against direct individual ownership, possibly followed by state and institutional ownership and control (bottom-up). The justification for the bottom-up approach is that managerial abilities will emerge through initial privatisation. Putting firms up to auction will allow those of greatest ability to gain control of enterprises. The reason for scepticism with the bottom-up approach is that the social/private divergences are sufficiently great during the transition period to make the natural emergence of a ruling class implausible ... Reliance on markets to allocate ownership is likely to reveal the seriousness of the market failures that justify state and institutional/corporate ownership during the transition period ...” (**Colin Mayer**, Professor of Economics and Finance at the University of Warwick, p. 62-63)

“...We suggest that reliance on the Anglo-American model under chaotic conditions and in the absence of a reasonably sophisticated infrastructure is inappropriate, and runs the risk of public disillusionment and rejection of market-based reforms in general ... The West has been long on advice to convert the command-type economies into flourishing market-driven systems by the classic reforms of deregulation, abandonment of price controls and subsidies, (etc.) ... The experience of going “cold turkey” into a free-market system has been a good deal more painful than anything that any Western country has imposed upon itself since World War II ... The place to start in Eastern Europe is with the laws and the institutions – the infrastructure ...” (**Roy C. Smith** and **Ingo Walter**, respectively, Professor of Banking and Finance, New York University and Professor of International Management, INSEAD, Fontainebleau, pp. 56, 57, 58)

“...Privatisation (in the UK) has symbolised a determination to take seriously the need to instil commercial spirit in the public sector. The government would neither interfere in managerial decisions nor intervene to prevent bankruptcy ... There has, however, been an increasing trend to regard privatisation not only as a symbol of the new commercial management approach but as its cause, and hence to be too ready to allow commercial freedom to firms which do not face competition. ...Where competition and privatisation are alternative policies – as has sometimes been the case – then it is competition which should be put first...” (**John Kay**, Chairman, London Economics, London, p. 84)

– *Economic reform in the East: some scanning of plans, factual evidence and opinions...*

“There is no unique blueprint or ‘royal road’ to a successful economic reform. Catching up with the economic progress made in the West over several decades will not be easy task in any case ...” (**Hans Tietmeyer**, op cit., p. 7)

“... Vouchers represent artificial capital that may generate domestic demand, avoid the need for costly prior valuation of assets, and thereby allow privatisation to proceed both much more rapidly and, according to prevalent sentiments, more fairly, compared with sales to either domestic or foreign investors ... Remarkably, plans to use vouchers as an important element in the transition process have emerged more or less independently in a number of East

European countries. No two countries have adopted identical policies, and arguably the different situation of different countries implies that the policies should differ...” (**John Earle**, **Roman Frydman** and **Andrzej Rapaczynski**, respectively Visiting Professor of Economics, Central European University, Prague, Associate Professor of Economics, New York University, and Professor of Law, Columbia University, New York., pp. 16, 22)

“(Under two assumptions made by the author) democratisation (understood as representative political institutions and a legal framework for a market economy) should be followed by privatisation and then by liberalisation of prices ... These sequential considerations lead to the conclusion that either price liberalisation in Poland has been introduced too early or the privatisation progress has been too slow as price reform became effective ...” (**Christoph G. Bandyk**, Vice-President, Investment Banking, Swiss Bank Corporation, Zurich, formerly Ministry of Privatization, Prague, pp. 98-99)

“... The most significant risk is not yet very much addressed: the Romanian plan involves issuing securities of hundreds if not thousands of companies, some tens of millions of bearer ‘certificates of ownership’, securities that most of the people don’t understand ... Maybe we should bear in mind the failure of the ‘System’ of John Law or the “South Sea Bubble”: ambitious, tempting, but not very sound systems and instruments can lead to disaster, if introduced too early for their time and even if at the beginning everything looks fine ...” (**Theodor Nicolaescu**, Director General, National Agency for Privatisation, Bucharest, pp. 108, 109)

“... The real choice (for Russia) is how to minimize the damage of disintegration, to build up, in a relatively short time, a new system of economic and financial relations within the former USSR, to prepare the basis for a fundamentally new type of possible union ...” (**Andrei Anikin**, Institute of World Economy and International Relations, Moscow and Professor, University of Moscow, p. 396)

“... In terms of restructuring the first problem is not to ‘pick winners’, in the near term the objective is only to liquidate the obvious losers that are the heaviest drain on available resources. This would free resources to be used more profitably elsewhere in the economy; also the example set by liquidating some of the least profitable enterprises would engender behavioral changes in other enterprises. Success in recovery lies both in liquidating loss-making ventures and in promoting successful ones... Privatization will take years to complete. Meanwhile pressure must be put on enterprises to use resources efficiently...” (**Millard F. Long**, Senior Advisor, Financial systems, World Bank, Washington, pp. 142, 143)

– *Monetary and Financial Reform and Policies in the East...*
“... The previously centrally planned economies face one of their most difficult challenges in the area of banking reform. And yet, meeting the challenge can prove to be the *litmus test* of the effectiveness of the reform process and of the efforts made by the countries to the east of Europe and beyond to install market-economies ... Progress has been made in the conversion of the monobank structures typical of central planning into two-tier banking systems along the lines of those existing in the market economies. But the depth of progress has been more apparent than real. On the central bank front, ...(installing a currency board) can be seen as an arrangement that provides an alternative to an central bank. But it can also be considered as the first step toward the establishment of a full-fledged central bank. On the commercial bank front, a measure of progress has been made but, so far, its scope has been limited on two fundamental counts: the lack of competition in the banking sector, due to excessive concentration and undue reliance on public resources and subsidies; and the vulnerability of bank portfolios... At present, the interplay of weak portfolios, restricted credit flows and resulting inter-enterprise arrears exhibits vicious circle characteristics, which does not bode well for efficient bank reform...” (**Manuel Guitián**, op. cit., pp. 120, 125, 126)

“... A key objective of banking reform is to improve the efficiency of resource allocation. However, there is limited evidence in Hungary, Poland and the CSFR of a significant increase in competition and changes in portfolio composition ... Although bank privatisation by itself would not directly lead to greater competition, it would contribute to the process of de-specialisation. In the medium-term competition by the non-banking financial sector might become a significant factor. However, it might be necessary to adopt a more drastic approach by restructuring the portfolios of the large savings banks and credit banks ...” (**Hans J. Blommestein**, Senior Economist, OECD, Centre for Co-operation with European Economies in Transition, Paris, p. 165)

“... The economies of the formerly communist countries need an efficient monetary and financial system to mobilize and allocate saving and investment. Until the transmission linkages – from the instruments of monetary policy to financial markets, and from financial markets to the rest of the economy – have been developed in Eastern Europe, monetary policy is unlikely to be effective. Inflation is likely to remain one of the most pressing problems of Eastern economies as the liberalization of prices needs to be continued and as the present large scale distortions in relative prices have to be further corrected ...” (**Wolfgang Duchatczek** and **Aurel Schubert**, respectively, Deputy Director and Economist, Austrian National Bank, Vienna, p. 250)

– *Excerpt from the General Report*

“... P.S. Andersen stressed the importance of domestic savings for the development of the East. Heinz Handler and Alfred Steinherr estimated the capital needs of Eastern Europe so that this region can partially catch up with the West by 2005, allowing for an initial no-growth period until the mid 1990s. According to Handler-Steinherr, an import of foreign capital of more than 150 billion dollars is required for only five countries ... Since there is a global shortage of capital, growth in Eastern Europe, however, cannot rely on foreign capital inflows. From these points the two papers are complementary to each other: if the East does not get the foreign capital, then it will not catch up with the West (Handler’s and Steinherr’s conclusion), unless it discovers the importance of domestic savings (Anderson’s point). In this context, two different views can be stressed. The first argues, by using historical examples, that the import of foreign capital may be harmful or, at least, that foreign financing has not been essential to economic growth. Instead, an efficient allocation of domestic savings is needed (disciplining the country from inside) The second view holds that the best way to get domestic market reforms is to force a country to make itself eligible for foreign investment (disciplining the country from outside) ...” (**Georg Winckler**, Professor of Economics at the University of Vienna, p. 429)

“... The external situation of reforming countries with respect to possible large capital imports is hardly improving. The attractiveness of reforming countries for risk-averse private investors is remaining modest as long as the turnaround to a well functioning market economy is not achieved...” (**Gerhard Fink**, Professor, Economics Department, University of Vienna, p. 354)

– *Transition in the West: the bumpy road to EMU...*

“... I believe that the further integration of European countries in the direction of an Economic and Monetary Union is necessary, for economic as well as for political reasons. Given the changes in Central and Eastern Europe and the necessary extension of the Community, Europe needs a real perspective for strengthening the process of integration ... It is however essential that the concept agreed upon at Maastricht be given a realistic economic and political basis. Without such a basis the vision of Maastricht could turn out to be an illusion. We have just experienced turbulences on the exchange markets that show what can happen if economic reality is ignored. The increased stability orientation of member states' economic policies in the course of the 1980s was a major factor behind the success of the European Monetary System. This implied, however, that imbalances were recognised in time, and prompt and appropriate action was taken to deal with them ... The events on the exchange markets over the last few weeks have their deeper-lying causes, above all in the divergences that have built up between some countries' economies in the five years since the last realignment of exchange rates in the EMS. I very much hope that after the recent exchange rate adjustments a new and durable basis for the functioning of the EMS will soon be restored. The EMS is an important stop-over and also a test on the road to EMU ... Broadening the Community's membership contains the potential danger of retrogression to a free trade area with a tendency towards disintegration. The possible frictions resulting from broadening the Community may call not only for the necessary deepening of the cooperation but also for an institutional reform of the Community. Accommodating countries with heterogeneous economic conditions and social preferences could pose new problems. Europe might as a result develop at variable speed. Under no circumstances should such an approach be allowed to lead to internal instability, which might even put the cohesion of the core group at risk ..." (**Hans Tietmeyer**, op.cit., pp. 9, 10, 11)

"... Within the Community as presently composed any development toward genuine political union would ... be likely to be controversial as the Danish referendum has demonstrated. It is unlikely that the others could block a Franco-German agreement unless they were united, which they are not. Franco-German cooperation will probably remain the core of European integration, and whatever its inconvenience for the others, it is preferable to the absence of such cooperation ... Thus the others face the choice between joining or not joining. A case can be made for a European Community in which members do indeed have that choice. Not integration à *la carte*, but the choice between a limited number of menus: one comparable to EC membership as it is now, including participation in the internal market, a second comprising EMU, and a third one also including the other pillars, notably a common foreign and security policy ... It could reconcile deepening and widening as far as the EFTA countries are concerned. And it would enable the Community to hold out the perspective of membership to Central European countries, thus contributing to stability in a part of Europe where disintegrating forces are gathering strength ..." (**André Szász**, Executive

Director, De Nederlandsche Bank, Professor of European Studies, University of Amsterdam, pp. 233-234)

– *Financial developments in the West...*

"... Several developments... might indicate that, in some limited respects, banking may exhibit some of the characteristics of a 'declining industry' ... In various ways the related pressures of competition, deregulation, financial innovation, and technology have eroded some of the comparative advantages of the banks in their traditional financial intermediation business. Regulation to some extent exaggerated the comparative advantages possessed by banks because it created a protective market environment ... Market pressures are eroding the market imperfections which gave rise to the banks' comparative advantage over intermediation in capital markets ..." (**David T. Llewellyn**, Professor of Money and Banking, Loughborough University, pp.190-191)

"Inexorable demographic trends, technological advances that cannot easily be halted by politicians, the strong probability of an effective single financial market, and the probable result of a single currency across much of Europe: these four factors will operate in combination to produce a growing pool of highly mobile financial savings seeking to protect their real value. The basic precondition to achieve that goal is price stability, but the second is the need for a diversified group of creditworthy borrowers of those savings. If individuals are building up fixed obligations, then there will be a major role for bonds..." (**Graham Bishop**, Vice President, Salomon Brothers, London, p. 418)

Colloquium 18: The Competitiveness of Financial Institutions and Centres in Europe

Dublin, May 1994
President of SUERF and Chairman of the Colloquium: Christian de Boissieu

Colloquium Book
Editors: Donald E. Fair and Robert Raymond
Authors: Jean-Paul Abraham, Michel Aglietta, Harald Benink, Sigbjørn Berg, Niklaus Blattner, Philip Bourke, Philip Davis, Christian de Boissieu, Michel Dietsch, Lars Engwall, Gerhard Fink, Peter Haiss, Gerd Häusler, Hilary Ingham, Neil Kennedy, Mervyn Lewis, David Llewellyn, Rainer Masera, Pietro Modiano, Per Mokkelbost, Laura Mollame, Andrew Newton, Richard O'Brien, Maurice O'Connell, Thomas O'Connell, Francisco Pérez, Reinhard Petschnigg, Stefan Pintjens, Javier Quesada, David Raikes, Lucio Rondelli, George Sheldon, Jacques Sijben, Patrick Simonnet, Mart Sörg, Wataru Takahashi, Hiroo Taguchi, Steve Thompson, Virna Valenti.
Publishers: Kluwer Academic Publishers, Dordrecht/Boston/London, 1994, xii, 507 pp.

– *Setting the stage: Is competitiveness the lifeblood of banking or is it a dangerous obsession?*

"... Competitiveness is the lifeblood of any industry and banking is no exception. Very few industries have been subjected to such rapid changes in the past decade with the impact of technology, the globalisation of financial services and the development of financial derivatives which were unheard of a short time ago. In stressing the importance of competitiveness, however, let us not lose sight entirely of the wider obligations of banks to the communities which they serve. Banks enjoy a privileged status in a sense, because of their impact on economic life. As a central banker, I must be very conscious of the regulatory aspects of banking and of the obligations on the authorities to keep pace with new developments ..." (**Maurice O'Connell**, Governor of the Central Bank of Ireland, Dublin, in his opening address, p. 6)

"We are undergoing rapid technological change in financial industries, affecting the competitive environment. And as they compete vigorously, banks must be, like Caesar's wife, above suspicion. From the record of the past few years, I would suggest that Caesar had better start checking up on his wife, as she seems to have been a little bit ready for experimentation, diversification and seeking joint venture partnerships. Even Caesar had to compete and never knew when friend would become a foe ..." (**Richard O'Brien**, Chief Economist, American Express Bank, London, p. 497)

– *A solid injection of theory on the junction between financial economics and industrial organization...*

"... The recent research on the operation of credit markets and the associated revitalization of credit in macroeconomics is based on the new economics of asymmetric information and incomplete markets. This view, concentrating on the independent influence both of the amount and availability of credit and the credit-rationing mechanism on economic activity is called the 'credit view' ... Recently in economic literature the lemons principle and the associated asymmetric information has been applied to the operation of financial markets, especially to explain the phenomenon of credit rationing and the importance of the quality of the financial structure of economic agents for macroeconomic performance. The asymmetric information approach provides an important transmission mechanism for how disturbances on credit markets affect aggregate economic activity ... The new microeconomic view has also been applied to the operation of the credit market, emphasizing the issues of adverse selection and moral hazard resulting in quantity adjustments on this market ... Based on the Stiglitz-Weiss' analysis the rise of bad-loans in the banking system and its attendant increase in outstanding debt of firms and households, coinciding in time with a cyclical downturn, has increased financial fragility ... The primary danger for financial stability is that a downturn of the business cycle will interrupt the cash flows of households and firms, giving rise to an inability to service the accumulated debt. Such a process can lead to a crisis in the financial system with negative spill-over effects to the real economy. The robustness of the financial system can be maintained by stable government policies and an institutional environment that encourages sufficient diversification of risks, reducing the risk for future economic and financial crises." (**Jacques Sijben**, Professor of Money and Banking, Tilburg University, pp. 354, 365, 369, 375, 376)

"... The traditional approach which treats the financial system as an epiphenomenon and the intermediary-*rentier* as destined for euthanasia, does not entail the need for a theory of financial innovation. By contrast, (the functional approach of the financial system) requires an explicit theory of the dynamics of the financial system, *a theory of financial innovation.* Process and product innovations in the financial system have four main characteristics: they reduce agency and information costs, second they complete the markets; third, they reallocate and reduce risk; and fourth they reduce transaction and settlement costs ... It is not proper to speak simply of disintermediation in the American financial system, i.e. a process in which borrowers obtain financing *directly* from lenders through the markets. Even when one acknowledges in full the importance and implications of securitization, it would appear more correct to describe the complex process of innovation as being characterized by a *diversification of the forms of intermediation*. A growing role is being played by non-bank intermediaries (institutional investors) and investment banks (in fact securities houses and thus non-banks) that operate in close relationship (*competitive complementarity*) with the financial markets ... The regulatory neutrality that underlies the Single Market can allow banks in Europe to maintain a significant role in financial intermediation. However, this requires the capacity to achieve economies of scale and scope in the production of financial services through appropriate *operational* and *organizational* strategies. Mere growth and unfocused diversification (the financial conglomerate) are unpromising paths to produce such results. Institutional despecialization goes hand in hand with operational specialization: what are required, then, are multispecialist intermediaries with focused growth ...” (**Rainer Masera**, Director General, Istituto Mobiliare Italiano, pp. 11, 12, 14-15)

– *Evidence on markets and strategies: same causes, various banking strategies, often analogous effects...*

  – *Real estate*: “... The recent property boom – indeed, the 1980s in general – looks increasingly like one of those once-in-a-lifetime periods when the ‘boom that will never end’ mentality takes hold, and people temporarily suspend customary prudent standards. Bankers are presumably as prone to such ‘bubbles’ as are others. How else are we to explain why banks and financiers, many of which had experienced more than a century of property and share booms – and busts – suddenly started to behave as if property and share prices could never fall?” (**Mervyn K. Lewis**, Professor of Money and Banking, University of Nottingham, p. 61)

  – *Entry arrangements in the United Kingdom*: “... Financial deregulation in the UK has created an unusual opportunity to study entry by firms previously restricted to a core business ... The general availability of resources, as proxied by firm size, appear to encourage wholly-owned ventures and discourage collaborative ones, lending support to the argument that control costs make joint ventures problematic in many areas. Collaboration appears to be used as a means of easing the resource constraint. Conversely, it appears that risk and high initial outlays encourage collaboration – presumably to facilitate risk spreading. The result also suggests – for financial service firms at least – that the remaining regulatory requirements exert a strong influence on the choice of entry arrangements ..." (**Hilary Ingham** and **Steve Thompson**, respectively, Senior Lecturer, School of Management, Manchester University and Professor, School of Management and Finance, University of Nottingham, pp. 196, 197)

– *Les surcapacités bancaires en France*: "... Dans la période récente, la création de nouveaux guichets a été déterminée par des motifs d'accessibilité et des motifs stratégiques plutôt que par des motifs d'efficacité, l'augmentation des capacités en guichets ne s'étant pas accompagnée d'une réelle augmentation de l'activité par guichet, mais plutôt d'une réduction ... La dispersion des coûts bancaires s'explique davantage par des différences d'efficience entre banques que par des différences des caractéristiques des marchés sur lesquels les banques opèrent. Enfin la part des crédits inefficients parce que trop risqués a augmenté au cours des dernières années, expliquant le déplacement de la frontière rendement – risque du portefeuille des crédits bancaires vers la droite ... L'élimination des surcapacités constitue l'issue principale permettant d'ajuster les capacités bancaires au niveau de l'activité ..." (**Michel Dietsch**, Professeur, Centre d'Etudes des Politiques Financières, Université de Strasbourg III, p. 92)

– *Efficiency in Swiss Banking*: "Size appears to be both a curse and a blessing. Large banks are more efficient but suffer from diseconomies of scale. Scope on the other hand, seems to offer no cost advantage: scope economies do not appear to exist and a diversified product mix is associated with higher inefficiencies ... Efficiency and factor productivity have increased in Swiss banking, a sign of effective competition ... Stiffer competition should place added pressure on banks to economize, causing a growing number of inefficient banks to fail ..." (**George Sheldon**, Deputy Director, Labour and Industrial Economics Research Unit, Basle University, pp. 129, 130)

- *Idem in Spanish Banking*: "... 1. In reaction to the intensely competitive environment, (Spanish) banks have clearly improved global efficiency at the firm level ... 2. Size is a strategic instrument to increase efficiency to be only systematically useful, in what refers to the size of the branch ... 3. The strategic benefits of specialization are difficult to establish. Partial evidence shows that those activities most traditionally related to banks – the creation of means of payment and loan production – enhance efficiency and profitability ... 4. The employment of factors has been seriously conditioned by external regulation ... In this respect the margin for differentiated strategies appears to be very narrow ...

  Under these circumstances, we tend to think that – in what refers to size and specialization – the less externally identifiable components of the strategies are the most relevant ones. Such components depend upon the intangible assets of the firm related to experience and organizational culture, questions about which microeconomics has very little to say." (**Francisco Pérez** and **Javier Quesada**, Professors, IVIE and Valencia University, pp. 146-147)

- *Idem in Italian Banking*: "... The reaction of the Italian banking system was in a certain sense the best reply to the changing of regulatory and structural conditions. The rapid expansion of loans allowed to reach two essential objectives more rapidly: the re-balancing of assets, which were excessively concentrated in public debt securities due to credit ceilings previously in effect, and the diversification of the customer base, which had been limited by constraints on geographic expansion ... It appears the market re-adjustment process is on the verge of being completed. From an asset perspective, the objectives of banks are changing: once banks have achieved an optimal balance between securities and loans and a degree of customer diversification which is deemed efficient, their attention shifts to profit objectives ... Banks are accordingly being asked to modify their operations in order to satisfy the new needs arising from the market. In introducing the universal bank model and sanctioning the end of the separation between banks and non financial firms Italy's acknowledgement of the second EU banking directive provides the banks with the possibility to operate in a broad array of financial services ... This competitive strategy will in turn have important repercussions on industrial structure. Indeed the possibility of consolidating or even increasing market share will undoubtedly be easier for the very large banks capable of fully exploiting the economies of scale and scope which are connected to a diversified supply. As a result, the dichotomy between small and large institutions should grow stronger ...” (**Pietro Modiano, Laura E.Mollame** and **Virna Valenti**, respectively Chief Economist, and Economists, Credito Italiano, Milan, pp. 221, 222)

– *Idem in Austrian Banking*: “... It seems that Austrian banks seem to develop into ‘big banks in a small country’, i.e. go for home market ownership as a necessary prerequisite for profitability improvement and conquering surrounding foreign markets. The large banks are trying to exploit these differences (in information and high cost of information) by market segmentation and at the same time to reduce risk by diversification ...” (**Gerhard Fink**, Professor Vienna University; **Peter Haiss**, Secretariat Bank Austria Lecturer, Graz University; and **Reinhard Petschnigg**, Economist and Austrian National Bank Lecturer, Vienna University, pp. 168-169)

– ’*Bridge, Poker and Swedish Banking*: “...This paper has pointed out the importance of two concepts: liquidity and organizational stress ... The higher the liquidity of an industry’s core product, the higher the risks of introducing rapid institutional changes. Organizational stress is a consequence of uncertainty in a particular field, i.e. the higher the uncertainty, the higher the stress caused by the actions of an organization’s competitors. This stress is also likely to be stronger in a field with a limited number of actors ... On a more practical level (this) demonstrates the need to be careful in redesigning systems. Although the big leaps may appear more spectacular, signalling an ability to act, it seems that a step-by-step procedure, a kind of muddling through, would be a more appropriate way to proceed.” (**Lars Engwall**, Professor of Business Administration, Uppsala University, p. 237)

– *Not so in Estonia*: “... Our measures for overcoming the banking crisis have been well chosen. Firstly, we do not have so much free money as in Finland and Sweden where the renovation of the banks has been carried out with the financial assistance of the state. Secondly, all our banks had taken too great risks and if the state had helped some of them, the others would have followed the former more risky policy ... Thirdly, the banks should fight against risks and crime by themselves and not only hope that police would defend them...” (**Mart Sörg**, Professor of Money and Banking, Tartu University, p. 182)

– *Competition among Financial Centres in Europe; a beauty contest*

- *London*: "... The evidence ... suggests that London has maintained its position as one of the world's leading international financial centres, despite the increase in competition in recent years ... The arrival of the European Single Market does not appear so far to have had a dramatic impact on competition between financial centres. However, it seems fair to assume that in the longer-term its impact will still be important. It is likely to increase competition between both intermediaries and financial centres in Europe: in doing so, it will increase the competitiveness of European financial centres, in relation not only to each other but also to the rest of the world ..." (**David G. Raikes** and **Andrew Newton**, respectively, with European Division, and Financial Markets and Institutions Division, Bank of England, p. 333)

- *Finanzplatz Deutschland*: "Innovations and structural change within 'Finanzplatz Deutschland' are therefore leading to a gradualist approach borne by the strongest market participants ... Now that the Federal Government has explicitly proclaimed the promotion of 'Finanzplatz Deutschland' as a political objective, the Bundesbank may, and indeed must, support that objective. This is a new task ... and one to which classically trained central bankers in Germany have not been accustomed. If, however, the two aims should clash with one another, the safeguarding of the currency clearly has priority for the Bundesbank over promoting Germany as a financial centre ..." (**Gerd Häusler**, Member of the Board, Deutsche Bundesbank, Frankfurt, pp. 254-255)

- *Preserving Switzerland's charm*: "... Preserving Switzerland's attractiveness in the international market segment and its role as an international financial sector in principle requires more caution with respect to international reactions than the preservation of competitiveness in domestic markets. Regulatory competition (partly 'competition in laxity, partly 'competition in stringency') is possible and should be encouraged ... (On the other hand) for bankers in Switzerland the goal is to increase the efficiency and quality of the services provided in order to be able to benefit from a well engineered regulatory environment in difficult times..." (**Niklaus Blattner**, Economic Adviser, Swiss Bankers Association and Associate Professor of Economics and Director LIU, Basle University, pp. 344, 348-349)

- *Ireland (of course)*: "...The small size of the economy implied that Dublin was never going to rank among the major financial centres in the world. Nevertheless, like a number of other small financial centres, the International Financial Services Centre has developed a number of niche specialties – banking, corporate treasury, insurance and mutual funds – on the basis of a good infrastructure, available skilled labour, low costs, favourable tax incentives and an independent supervisory regime..." (**Thomas O'Connell** and **Neil Kennedy**, Advisors, Economic Affairs and Financial Sector Department respectively, Central Bank of Ireland, Dublin, p. 283)

– *Some evidence and conclusions on financial fragility and breakdowns*

"... What can safely be concluded from recent experience in the case-study countries (UK and Scandinavia) is that big shocks to banking systems (such as sharp changes in regulation) almost inevitably produce unstable reactions. However, it cannot be concluded that the aftermaths of such shocks (the transitional effect of the system moving between two different steady-state market environments) indicate the characteristics of the new de-regulated environment itself once the adjustment has been made, and the lessons learned. It is hazardous to make generalisations about the characteristics of a new steady-state environment from the experience of moving to it from a different regime. Nevertheless, the de-regulated banking environment may have made banking potentially more fragile. The erosion of economic rents induced by previous regulation is likely to have made banking a more vulnerable industry than in the past. Secondly, it is possible that the capacity created during the period of regulation was excessive and not sustainable in a more competitive and de-regulated environment..." (**Harald A. Benink** and **David T. Llewellyn**, respectively Assistant Professor of Finance, Limburg University, and Professor of Money and Banking, Loughborough University, pp. 461-462)

"... The impression is that the Nordic governments have considered the financial strength and future stability of their banking industries to be at least as important as the efficient operation of banking production. Deregulation was a forceful push for increased efficiency but banking policies after deregulation have to a substantial degree worked to contain the competitive pressures released. This has been apparent in the governments' attitude to large bank mergers, foreign entry, and national ownership of large banks. The efforts to remove excess banking capacity may also be seen as a way to improve on the stability of the banking industry..." (**Sigbjørn Atle Berg**, Head of Financial Research, Norges Bank, Oslo, p. 491)

"... Our ability to deal cost effectively with the problems of bank stability is not high. Lender of last resort and deposit insurance facilities appear to be inadequately focused and mispriced and the lack of an international lender of last resort is highlighted. In particular, the exposures of small countries, headquartering large banks with significant foreign currency deposits, require attention ... Consideration should be given to the concept of two-tiered deposit insurance with the first tranche provided by private markets and the remainder provided by a consortium of central banks ..." (**Philip Bourke**, Professor, Graduate School of Business, Department of Banking and Finance University College, Dublin, pp. 415-416)

"... Although the five crises – i.e. the Penn Central bankruptcy (1970), the crisis in the Floating-Rate Notes (FRN, 1986), the failure of the Junk Bond Market (1989) the Swedish Finance Company and Commercial Paper crisis, (1990), the collapse of the Ecu Bond Market (1992) – differ in important respects – there are sufficient parallels tentatively to justify their being described as a common syndrome. In particular, the collapses tended to occur in markets for instruments that were themselves financial innovations (whether in terms of instrument or currency), whose properties in periods of stress had not yet been evaluated. Institutional investors rather than retail clients tended to be the main investors in the markets ... The crisis tended to follow a bull market in the instrument, which entailed heavy issuance in the primary market, declines in yields and yield spreads relative to other securities, rising trade volumes and narrowing secondary market bid-ask spreads (as 'liquidity trading' increased) ... These patterns indicate a collective self-deluding failure on the part of market participants to attach more than a low probability to a crisis of the type that emerged. A 'shock' to such confidence ... led in each case to a major re-evaluation of the securities' value. The consequence was heightened uncertainty (both for investors and market makers), an increase in selling, withdrawal of market makers and widening of spreads. In each case they culminated in a collapse of liquidity and of market prices that made primary issuance virtually impossible... and which persisted for some time except for the Penn Central crisis, where the authorities intervened ... Finally, the instability shown poses a general issue whether it is appropriate to rely heavily on securities markets to provide finance – is it a cause for concern if owing to this, banks, which should in principle have a comparative advantage in overcoming asymmetric information between borrower and lender as well as being able to maintain credit lines during market crises, are forced to withdraw from lending to some sectors?" (**E. Philip Davis**, with Bank of England, but seconded to the European Monetary Institute, Frankfurt, pp. 393-394, 395, 400)

“... Plus un système de paiements est vulnérable aux risques de crédit et de liquidité, plus les conditions d’accès doivent être restreintes. *En ce sens, le principe de séparation des responsabilités contenu dans la deuxième directive bancaire aggrave sensiblement les niveaux de risque dans les systèmes de paiement européens...* C’est un enjeu auquel les banques centrales de la Communauté se devaient de réagir. Les principes structurants doivent éviter les détournements de trafic par les banques qui arbitrent entre les réglementations différentes. Cet arbitrage affaiblit la sécurité ders systèmes de paiements. Les principaux problèmes à traiter pour éliminer cet effet pervers de la concurrence bancaire sont: les conditions d’accès, l’organisation du règlement, les méthodes de réduction des risques ...” (**Michel Aglietta**, Professor at the University of Paris X and Adviser, Centre d’Etudes Prospectives et d’Informations Internationales, Paris, p. 437)

Colloquium 19: Risk Management in Volatile Financial Markets

Thun, October 1995
President of SUERF and Chairman of the Colloquium: Jean-Paul Abraham

Colloquium Book
Editors: Franco Bruni, Donald E. Fair, Richard O'Brien
Authors: Bill Allen, Julian Alworth, Sudipto Bhattacharya, Claudio Borio, Bruno Caillet, Andrew Crockett, Philip Davis, Georges Gallais-Hamonno, Charles Goodhart, Robert Gumerlock, Martin Hellwig, Glenn Hogarth, Svend Jakobsen, Colm Kearney, Mervyn Lewis, Markus Lusser, Robert McCauley, Phillip Morton, Lionel Price, Robert Raymond, Arjen Ronner, Ad Stokman, Dirk Trappeniers, Peter Vlaar, Axel Weber
Publishers: Kluwer Academic Publishers: Dordrecht/Boston/London, 1996, xii, 371 pp.

– *Volatility: Anything New?*
"... Volatility is here to stay ... Volatility was not invented by central banks nor was it a market reaction to the creation of the species called central banker. As the story of the seven years of plenty followed by seven years of famine in the Old Testament shows, volatile earning streams were an issue long before today's money was known, let alone central banks ..." (**Markus Lusser**, Chairman of the Swiss National Bank, in his opening address, p. 3)

"... Being a natural contrarian, I shall argue that (the) perception of worsening risk, though fashionable, has been much exaggerated. Volatility is *not* secularly increasing; the recent globalisation is not only desirable, but takes us back towards the condition that had already been obtained at the start of this century; the monetary authorities have *not* lost control over monetary policy; and the emergence of derivatives has *not* made the financial system riskier ... It would not surprise me if, by the year 2010, we looked back at the decades of the 1980s and 1990s as being one of general stability and relatively little structural change ... Many of the problems and disturbances that we face today are neither new, nor by the most objective standard particularly virulent ..." (**Charles Goodhart**, Norman Sosnow Professor of Banking and Finance at the London School of Economics, pp. 41, 45)

"... Research at the BIS suggests that in a number of markets recent asset price volatility is not much different from what we observed in the 1970s to mid-1980s. What may have changed, however, is what might be called 'outlier volatility' i.e. the degree and frequency of sudden large price adjustments that go beyond what could be expected on the basis of conventionally calculated statistical distributions. The equity market crash in 1987, the European exchange market crisis of 1992, the long-term bond price slide in the spring of 1994 and the Mexican Peso crisis in December last year were all outlier events, difficult to anticipate.

Although average volatility may not have risen, the chances for large short-term but potentially disruptive price movements may indeed have increased ..." (**Andrew Crockett**, General Manager of the BIS, p. 17)

"... Price volatility on financial and exchange markets is steered by capital movements and portfolio arbitrage, based on *market expectations.* Central banks always run the risk of being taken by surprise. They should be forgiven if volatility reflects unforeseeable events. At least they should try to understand the genesis of expectations ... Exchange rates, in particular, are shaped by capital movements more than by international trade. Therefore trade and activity are influenced by exchange rate volatility. Volatility is triggered by spontaneous changes in expectations, while globalisation facilitates transmission of external shocks. Such volatility has entailed not only day-to-day or intraday fluctuations, but also medium-term deviations from levels consistent with fundamentals ..." (**Robert Raymond**, Director General of the European Monetary Institute, Frankfurt, in his Marjolin Lecture, pp. 362-363)

– *Analysing, measuring and evaluating volatility and risk, not always in the same way...*

"...Financial risk refers to the possibility of gain and loss to net worth due to unexpected price changes ... The main point of making the distinction between volatility and risk is that the former implies the latter only to the extent that it is unexpected ... Generally, financial asset prices tend to move in an unpredictable fashion in more or less efficient markets so that volatility generally implies risk.

Amongst the most important factors which cause financial volatility are: institutional change ..., deregulation of financial institutions and markets ..., financial innovations in products, services and markets ..., technological development ... and globalisation of international financial markets.

Some countries seem to be inherently more volatile than others ... Using an equally weighted average of the variables included in a study for the period January 1973 – December 1994, the overall rankings in terms of country volatilities are (from highest to lowest): Britain (especially in interest and exchange rate volatility), Italy (particularly in industrial production and in the stock market), Japan, Germany, France and the United States ...” (**Colm Kearney**, Professor at the University of Western Sydney, pp. 89, 90, 104)

“... Interest and exchange risk have become larger at the same time as intermediation margins in traditional banking have been eroded and the ability of financial institutions to rely on oligopoly rents to withstand shocks has been reduced. The erosion of oligopoly rents has also reduced the ability of financial institutions to rebuild equity after bad times without going to the market, thereby enhancing their vulnerability to *successive* negative shocks ... These considerations suggest that the bank failures and banking crises of the past decade are essentially the result of the lack of risk matching between the assets and liabilities of traditional depository institutions ... A major question for the future of the financial system is whether the risk allocation in banking and finance can be improved before banking crises become altogether unmanageable... An alternative assessment of the developments that have reduced safety in banking and finance would put more weight on the role of deregulation, innovation, and the recklessness of financial institutions ... I consider this assessment to be mistaken and harmful. It exaggerates the power of prudential regulation and supervision. It fails to recognize the fundamental unsoundness of traditional banking in a risky and increasingly competitive environment. Finally it detracts from the potentially beneficial role of ‘new’ instruments in actually reducing the overall risk exposure of financial institutions...” (**Martin F. Hellwig**, Professor of Economics at the University of Basle and Taussig Research Professor of Economics for 1995/1996 at Harvard University, pp. 27-28, 29-30)

“... In the bond market turbulence of 1994 we find more evidence of the bond market’s own dynamics at work than of measurable uncertainty regarding fundamental macroeconomic and financial factors. Let us compare the 1994 bond market decline with the 1987 stock market crash ... In terms of the market dynamics which we have emphasised, both incidents reinforce the connection between bear markets and high volatility. Both incidents saw an intensification of spillovers and a broadening of their geographical scope. But the importance of foreign disinvestments distinguishes the 1994 bond market decline from the 1987 crash, and this may make it more modern. Similarly, foreign investors’ extensive use of leverage sets the 1994 episode apart from the crash of 1987, when leverage remained a domestic phenomenon. The role of fundamentals in the two cases remains problematic ... There is just a little weight to be given to the view that increased uncertainty regarding monetary policy drove up bond volatility...” (**Claudio E.V. Borio** and **Robert N. McCauley**, respectively Head of Section in the Monetary and Economic Department, and Economist at the BIS, pp. 82-83)

“... The events outlined above (i.e. equity markets in 1987, ERM crisis of 1992-1993, bond markets in 1994, Mexican crisis of 1994-1995) have a number of common features, consideration of which enable similar patterns in the future to be more easily detected, to offer clues about the appropriate response of the authorities. These (features) included: heavy involvement of institutional investors in both buying and selling waves; bank lending played a rather subordinate role; international investment; signs of overreaction to the fundamentals and excessive optimism prior to the crisis; at times, inappropriate monetary policies; a shock to confidence which precipitated the crisis, albeit not necessarily sufficient in itself to explain the scale of the reaction; rapid and wholesale shifts between markets, often facilitated by financial innovations ...” (**E. Philip Davis**, on secondment to the European Monetary Institute from the Bank of England, p. 152)

– *How to cope with financial risk? Market discipline, private risk management or public intervention?*

“... The mere existence of asymmetric information doesn’t justify new regulations. It is a pure act of faith to believe that the consequences of volatility, unpleasant as they may be at times, could be efficiently prevented by new regulation ... What is needed is a strengthening of market discipline and personal responsibility ... Sensible self-regulation helps to assure the underlying integrity of the market. Furthermore, if market forces rather than regulation are to provide the basic control mechanism for risk-taking activities, the market must be able to assess the risks incurred by firms. This is the reason why disclosure is so important. Disclosure is the basis for well-informed investment decisions...” (**Markus Lusser**, op. cit., pp. 8, 10)

“...Diversification and hedging opportunities have greatly increased in recent years, with improvements in financial technology, the growth of new instruments and financial markets. Both are useful in confronting diversifiable Knightian risk (i.e. an uncertain event in which the distribution of possible outcomes is known or can be approximated by the study of previous random outcomes). But ... both are subject to practical limitations. At times some hedges may fail to work as anticipations and diversification opportunities may decline if prices in different markets begin to move similarly during stress periods. Moreover, all risk cannot be hedged or diversified away. Equity capital should be sufficient to absorb non-diversifiable risks – shocks to a financial institution which cannot be easily hedged or hedged at all. From the experience of the last ten years I would argue that a number of institutions seriously overestimated their ability to hedge and diversify market and credit risk."

"...Clearly this (the need for protection against undiversifiable risk) requires a prudential capital cushion. The question is, how much? There is no scientific answer to the question. All that can be said is (that) systemic protection requires both a strong capital cushion on the part of individual institutions and the availability of official support in the event of truly unforeseen shocks of major proportions ... This presents a fundamental dilemma for financial authorities. An excessive or poorly structured safety net for the financial system may have the effect of insulating intermediaries from desired market discipline and create a perverse incentive structure by potentially encouraging risk taking. This can only be offset by increasing the market discipline of financial institutions. And market discipline can only result from improvements in information and incentives. Greater transparency of the activities and risk exposures of financial intermediation along with the incentives to monitor them, are a necessary ingredient for the fundamental health of the financial industry ..."(**Andrew Crockett**, General Manager of the BIS, pp. 20-21)

"... Practitioners and regulators need to stop thinking about risk in terms of credit risk and market risk with no correlation between the two. They should add refinancing risks to the list. Even more important, they should take account of correlations between the different classes of risks ... To the extent that counterparty credit risks are difficult to assess, prudential supervision should begin to think in terms of the overall system rather than the individual institution. To assess system risk exposure, supervisors will have to make a substantial effort at coordinating reporting of interbank positions ... across financial sub-sectors and across countries. Achieving transparency through such coordination may actually be more important than some of the other efforts at regulatory coordination that are going on ..." (**Martin Hellwig**, op. cit., pp. 36-37)

"... However good a bank's internal control system may be, serious losses can still be made. Once capital is impaired, the danger of loss, perhaps from the conscious assumption of a riskier strategy of management, loss to depositors, deposit insurance or taxpayers, increases. Thus, in addition to provide an outside overview, almost a form of consultancy, on banks' internal risk control models and methods, the supervisors will want to impose increasing constraints on bank activities pari-passu with a worsening decline in its capital, with a view to closure, or enforced take-over, before its capital is exhausted ..." (**Charles Goodhart**, op. cit., pp. 55-56)

"... In many respects we believe that many of the institutional features of bank regulation should remain in their present form. In particular, bank regulation and the 'safety net' should remain in the hands of the central bank or of an institution closely associated with it ... With respect to the new supervisory frameworks developed in recent years – the (1988) Basle Capital Accord, (etc.) – it is possible to draw several tentative conclusions from the discussion in this paper: 1. It is necessary to subject the present system of capital ratios to a period of stress in order to appreciate whether the capital requirements have indeed been able to safeguard the financial system ... 2. Risk-sensitive capital requirements are potentially useful tools in the arsenal of bank regulators. However, practical measurement appears fraught with problems ... 3. The incremental complication which accompanies each revision of the guidelines ... is likely to be a never ending process..." (**Julian S. Alworth** and **Sudipto Bhattacharya**, respectively, associated with Mediolanum Consulenza,Visiting Professor at Università Luigi Bocconi, Milano; Professor of Finance at the London School of Economics, pp. 316-317)

– *Organising risk management in the private sector*

"... Today's trading organisations are typically organised around three major classes of market risk; namely foreign exchange, interest rates, and equities ... Whereas in the past an organisation may have been subdivided into treasury services, cash securities, futures and options, today the preference lies in organising the business along risk sub-categories (e.g. a currency pair or a particular equity market). Synergies can be achieved by managing derivatives together with their underlying instruments. In the past many banks were organised regionally, today a specific market risk is preferably managed centrally in one global book ... Furthermore, in the past, settlement, middle and back office functions were often allocated to the trading areas, whereas today the concept of segregation of duties requires separate management. This development in internal organisation structures reflects the development in the financial markets..." (**Robert S. Gumerlock**, Head of Operations and Control at SBC Warburg, a Division of Swiss Bank Corporation, p. 161)

"... It is a major challenge to embed financial technology in the continuously changing organisational structure of a multinational (industrial) company

(Philips) ... The risks pertaining to the use of financial instruments are limited by defining the ‘internal bank’ as the sole interface to the external financial institutions and by imposing limits. The use of statistical analyses indicating ‘normal variation’ in currency movements is a powerful tool for increasing knowledge about risk. By adopting the use of multi-currency confidence intervals for a portfolio, the business risks can be made visible and cost-effective policies for protecting margins can be implemented ...” (**Arjen E. Ronner** and **Dirk A.M. Trappeniers**, respectively, Director of the Insurance and Risk Management Department of Philips Finance, Professor of Financial Econometrics at the Free University of Amsterdam; Financial Consultant at Philips Finance, pp. 180-181)

“... However valuable computer simulations are for testing the sensitivities of net interest income to movements in interest rates, they should be used in conjunction with other methods and techniques that a bank has at its disposal for risk exposure management. It should be clear by now that measuring interest rate risk in retail banking is very difficult, despite its importance for earnings growth and stability ...” (**Mervyn K. Lewis** and **Phillip Morton**, respectively, Midland Bank Professor of Money and Banking at the University of Nottingham, Visiting Professor in Economics at the Flinders University of South Australia; Manager, Product Development, Lloyds Bank (BLSA), Montevideo, Uruguay, p. 248)

– *Impact of volatility and financial risk on monetary and exchange policy...*
“... I start from the presumption that there is no current serious threat to the Central Bank’s traditional ability to direct monetary policy via its command over short-term interest rates, whether from private financial dynamics or otherwise. Where, instead, structural changes have caused problems for monetary control relates to the questions of how to decide on which interest rates to focus and how to monitor the effect of such interest changes, and through what transmission routes, on the economy ... When the Central Bank now raises the *general* level of short term interest rates, it can no longer be confident of the effect on certain key interest rate differentials (as it could in the past because the imposed stickiness of competing bank/housing finance deposit rates). There is less, quasi-automatic rationing effect. In order to have the same overall impact on the economy the (relative) price effect of interest changes has to be greater ...

As the example from the 1980s suggests, there is no evidence, known to me, that recent market developments, e.g. the still increasing size of the foreign exchange (forex) market, the growth of derivative markets etc. have led to any *worsening* in the proclivity of the forex market to behave in a way difficult to explain in terms of fundamentals. Indeed, compared to the 1970s and 1980s, the forex market in the 1990s has, perhaps, been more responsive to fundamentals (and that *includes* the recent debacle of the ERM in Europe).” (**Charles Goodhart**, op. cit., p. 49, 51)

“A number of countries, including the UK, have reacted to the difficulty in predicting the velocity of money, particularly when faced by liberalisation, by abandoning intermediate monetary targets in favour of final target (ranges) for price inflation. Nevertheless the UK has maintained monitoring ranges for both narrow and broad monetary aggregates. In face of high capital inflows Poland has widened its exchange rate band. Russia, in contrast, where the currency has been appreciating, has recently introduced a short-term exchange rate target range to operate alongside a central bank credit ceiling under the IMF programme ... It would be unwise for either Russia or Poland to base monetary policy on monetary targets to be adhered too rigidly and unthinkingly. Better would be to identify monitoring ranges: a shift of either broad or narrow money growth outside the monitoring range should be regarded as *prima facie* evidence that domestic monetary objectives were unlikely to be met and that corrective action would be needed unless other evidence indicated that the monetary aggregates were giving a misleading signal ...” (**Bill Allen, Glenn Hoggarth**, and **Lionel Price**, respectively, Deputy Director, Monetary Analysis at the Bank of England; Advisor on Monetary Policy at the Bank’s Centre for Central Banking Studies and also IMF external Advisor on money operations and policy in Eastern and Central Europe and Asia; Director of the Centre of Central Banking Studies, pp. 353-354)

“... The sterilization of intervention by all EMS countries and not just by Germany is in part responsible for the collapse of the exchange rate mechanism of the EMS. Sterilized intervention signals a non-credible commitment to long-run exchange rate stability. Foreign exchange markets understood this signal perfectly well and hence have launched a speculative attack ... Ultimately the collapse of the EMS was caused by the fact that neither the Bundesbank nor the central banks in the remaining EMS countries were prepared to give up some monetary autonomy for the sake of exchange stability. In my view the key to future successful exchange rate targeting lies alone in international policy coordination, which needs to be re-enforced in the EMS. Economic and Monetary Union differs from the old EMS primarily in the degree to which monetary policy is coordinated and subject to joint decision making... Exchange rate stability must be viewed as the outcome of a process of policy coordination and convergence in Europe, and not *vice versa* ...” (**Axel A. Weber**, Professor for Economic Theory at the University of Bonn, in his Marjolin Prize-winning contribution, pp. 277-279)

“... The main effect of financial globalisation was to accelerate the transmission of shocks from one currency to another. No country is sheltered from such external shocks ... Although it is not possible to prevent such shocks, a cooperative solution may be preferred to disorderly conditions, at least to minimise their impact. Preventing shocks or reacting properly to them within the framework of a loose cooperation mainly based on national goodwill can only be a global strategy. Cooperation could, in theory, be more justified and more easily applied at a regional level, when the mutual openness of the economies involved would make any deviation of exchange rates vis-à-vis some measure – which can be approximate – of the purchasing power parity very harmful ... If the target can easily be determined, difficulties lie in the transition. This is what it is all about today, on the basis of the Maastricht Treaty ... The challenge is to find the optimal path between some flexibility which would be compatible with the variety of individual situations and a smoothly organised transition ...” (**Robert Raymond**, op cit., pp. 367-369)

Colloquium 20: Corporate Governance, Financial Markets and Global Convergence

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– *Setting the stage...*
– *An introductory 'semantic exercise'*

"... The concept 'Governance' is related to words like influence, power, ruling, leading, guiding, directing and inspiring. The concept of 'Governance' refers to ways of organizing business, the formation and management of joint stock companies, company law provisions on capital, regulation by laws and statutes of manager/shareholder relations, procedures for the appointment of supervisory boards, definition of the respective responsibilities of managers, board members, auditors etc.

... The concept 'stakeholder' is broader than the concept 'owner' or 'shareholder'. Employees, trade unions, suppliers, tax authorities and other public authorities can be important stakeholders, but they will not normally be shareholders ... Most stakeholders want to play a role in the 'Governance' structure – they want to influence corporate decision making in accordance with their own interests, and some of the stakeholders who are not owners do have the power to exert a certain influence ... But in most cases, it is through ownership that people and institutions acquire influence over business management. Managers are hired by boards of directors, which in turn are elected in stockholder meetings, where the owners can exercise their voting power.

... It is not an exaggeration to say that the decisions of managers of companies and banks strongly affect the corporate and financial landscape of Europe ... The institutional structures and the governance systems vary from country to country and they vary through time. There are, however, clear signs of system convergence. In Western Europe, the implementation of the Single Market and international financial integration stimulate the convergence process. The impact of international competition and integration is also felt in Central and Eastern Europe, and financial regulatory systems in that region seem to be gradually adapted to the principles reflected in EU directives ... There are several similarities and common features. In all parts of Europe we can find countries which are moving towards governance systems in which financial markets can be expected to play a stronger disciplining role on corporate managers. And in all parts of Europe, we can observe cases of privatisation, in which it is a main goal for efficiency reasons to expose managers to tougher monitoring from different categories of private investors, whose interest in corporate performance lies in the fact that they will suffer losses, if companies are mismanaged ...

... It seems to me that irrespective of Corporate Governance systems, it is essential that there are stakeholders who are seriously involved in company affairs ... In Corporate Governance stakeholder indifference is understandable but deplorable, stakeholder politeness is all right but secondary, stakeholder involvement, however, is crucial ...” (**Morten Balling**, Rector, Aarhus School of Business, Aarhus, Denmark, in his keynote speech, pp. xi, xii, xxv, xxvi)

– *Insider and outsider systems of Corporate Governance...*
“Corporate governance has been traditionally associated with a principal-agent relationship problem. Investors (the principals) employ managers (the agents) to run firms on their behalf. The interests and objectives of investors and managers differ. Corporate governance is concerned with ways of bringing the interests of the two parties into line and ensuring that firms are run for the benefit of investors. For example, Demb and Neubauer (1992) state that ‘corporate governance’ is a question of performance accountability ...

... Ownership in most countries is in the hands of either other corporations or individual investors. Cross-ownership of shares by one firm in another is commonplace and large family holdings frequently dominate institutional investments. This gives rise to a system of ownership which has been described as an ‘insider system’ (Franks and Mayer, 1994) to distinguish it from the ‘outsider system’ of the UK and the US where ownership and control rests with the outside, usually institutional investors ...

... Ownership and the structure of boards affect the way in which companies are managed and controlled ... Firstly, the flow of information may differ. Closer relations between investors in companies on continental Europe and in Japan may encourage better informed investors. Secondly, investors in different countries may have different incentives to intervene ... Where there are large dominant shareholders, the returns to active governance are greater. Thirdly, markets for corporate control, in particular hostile takeovers are less active in most countries than in the UK and US. The market for corporate control is regarded as an important discipline on the behaviour of firms ...” (**Colin Mayer**, Professor of Management Studies and Deputy Director (Academic) of the School of Management Studies at the University of Oxford, pp. 237, 238-239)

– *The Large Shareholder (LSH) as stakeholder in Corporate Governance (CG)*
“... Two dimensions are relevant to assess the pros and cons of the presence of a large shareholder: (1) the degree of collusion between the LSH and the management; and (2) the context in which the LSH operates, whether or not the market for corporate control is efficient ... A LSH – insider in an environment that does not allow for takeovers – and therefore for the correction of adverse selection problems – could be harmful in the absence of adequate outside shareholders who act as watchdogs. On the contrary, when LSH do not collude with management, they may effectively limit managers’ moral hazards, both because they foster market discipline and, when markets are particularly underdeveloped, they may monitor the management directly. In conclusion, two points may be remembered: 1. It is widely held that the presence of LSH is particularly beneficial in financial systems that are not fully developed ... However, a role for LSHs is present also in countries with efficient financial markets: where ownership dispersion creates a free-rider problem, a LSH can facilitate a takeover, thus strengthening market discipline. 2. It is important to study the incentives that the LSH has to monitor. The size of his stake is an important variable, but other elements should be considered. For example, the activity of the LSH: (whether it is a bank, a mutual fund, or a private non-financial investor) and therefore the other business relations that it may entertain with the firm ...” (**Francesco Giavazzi** and **Marco Battaglini**, respectively, Professor of Economics at Bocconi University Milano, Co-Director of CEPR’s International Macroeconomics Programme and Research Associate of the NBER; Ph.D. candidate at Northwestern University, pp. 170-171)

– *The Banks as stakeholders in Corporate Governance (CG)*
“... Debt finance acts as a *discipline* device. This reflects the important role of banks and other financial institutions in financing the business sector. It is often the case that banks, because of close relationship with companies, may be better informed than other providers of capital. Obviously, it is in their own interest that banks signal financial and economic crises at an early stage and in response, enforce harsh restructuring plans in the firm. If management does not comply with their demands, banks can credibly threaten to withdraw their loans and to shut out the credit channel. The credibility depends to a large extent on the priority of debt finance... Without priority of debt finance, restructuring plans would not be carried out as soon as possible, which forces other providers of capital to demand higher rates of return. In this sense debt finance is *complementary*, since it allows the company to attract other sources of capital from financial markets at reasonable costs ...” (**Wilko Bolt** and **Marga Peeters**, Economists at the Econometric Research and Special Studies Department of De Nederlandsche Bank, p. 94)

“*... Should we trust banks when they sit on the board of directors?* The answer is not unambiguous. The type and degree of a bank’s monitoring activity is deeply influenced by its lending activity. A bank tends to protect its credits and thus to minimize the probability of default; a lender derives no benefits from extra profits since its payoff is limited in good states of nature. This is not to say bank monitoring cannot be useful. In a mature industry, say the steel industry, a bank could do a very good job, and the side effects would be limited since extra profits are in any case very small. But many entrepreneurial activities will not take off-for example when new technologies are at stake – if financiers are not ready to take risks. In such cases an efficient market for corporate control is the best mechanism to allocate resources ... A too close firm-bank relationship hinders the development of such a market because the bank may use its lending power to entrench its control. This is the reason for keeping a wary eye on ‘banks on the board of directors’ ...” (**F. Giavazzi** and **M. Battaglini**, op. cit., p. 192)

“... The role of banks and other financial institutions in the Italian corporate governance system has been traditionally very limited ... Family and coalition devices of corporate control both reduced corporate transparency and, most likely, demanded more confidential services than banks were able to provide ... The only exceptions were Mediobanca and local banks: the former specialized in preserving family and coalition control ... Local banks, thanks to the fiduciary networks in local communities, appear to have fostered the development of small firms which benefit to a large extent from flexible local labour markets. For many years after the war, probably until the early 1960s, weak bank/firm relations did not prevent fast growth, which was indeed warranted by the working of the other corporate governance institutions ... When the self-sustained growth of the reconstruction came to an end, fast rising wages squeezed corporate profits and Enti pubblici were burdened with the constraints to achieve social goals, then the existing corporate governance became inadequate and the negative consequences of weak bank/firm relations came to the fore. Today, consensus has grown on the need for the Italian system of corporate control to undergo a revision; together with the privatisation of State-owned companies ... pressure is growing for the banking system to change too ... This note suggests that the new setting should likely preserve the distinctive features of the existing two-tier banking system that the Italian economy carved out of its experience and needs ...” (**Fabrizio Barca**, **Giovanni Ferri** and **Nicola Pesaresi**, respectively, Division Chief at the Research Department of the Bank of Italy; Head of the Credit Intermediaries Office of the Bank; National expert to the European Commission (Directorate General IV – Competition), seconded from the Bank of Italy, pp. 36-37)

– *CG in Japan*
“... Among large shareholders, banks, particularly main banks, have an important governance role. Some evidence suggests that the financial institutions’ role is more productive than inter-corporate ownership ...

It is not yet clear which of a number of competing hypotheses explain the banking crisis. At least three possibilities exist: (i) The main bank system never did provide monitoring and control of borrowers but it took the ‘bubble years’ to reveal how easily the system had allowed bad management and decisions ... (ii) The system of main bank and large shareholder monitoring functioned well in the past but broke down as the result of increased competition and deregulation ... Banks and shareholders reduced their monitoring in this period ... (iii) The governance structure has not changed significantly. The crisis is the result of *ex ante* reasonable decisions being confounded by *ex post* results ...” (**Jenny Corbett**, Research Associate of the Center on Japanese Economy and Business at Columbia University, New York, p. 131-132)

– *Institutional Investors as stakeholders in CG*
“... The growth of the institutional sector (pension funds, insurance companies, investment companies) has been the driving force behind structural changes in both the process of corporate governance and the

structure and modus operandi of OECD capital markets ... Institutional investors have been growing in size dramatically over the past two decades or so ...

The expansion of the institutional sector has had a growing influence on finance governance channels. First, institutional investors have enhanced their corporate governance role in the form of an increase in market control via equity and debt. Second, an increase of direct control via equity in the form of an increase in shareholder activism by institutional investors has been an important characteristic of the change in corporate governance in the past decade. Third, direct control via debt is an important mechanism of corporate control in Continental Europe and Japan, although the corporate governance role of institutional investors is far from uniform in these countries ... It can be expected that the determinants of the growth of the institutional sector (financial deregulation, liberalization of the investment activities of the institutional sector, an aging of the population, privatization of social security, the growth of the money management industry) will continue to affect both the structure and modus operandi of financial markets and corporate governance ..." (**Hans J. Blommestein**, Senior Financial Economist at OECD, Paris, pp. 41, 42, 67)

"... Given the size of their shareholdings the power of the institutional investors cannot be doubted. In his seminal work, Hirschman (1970) identified the exercise of institutional power within an 'exit and voice' framework, arguing that 'dissatisfaction (may be expressed) directly to management', the *voice* option, or by selling the shareholding, the *exit* option. The latter choice is not viable for many institutional investors given the size of their holdings or a policy of holding a balanced portfolio. The meetings between institutional investors and companies are therefore extremely important as a means of communication between the two parties ..." (**Chris Mallin**, Professor of Finance at Nottingham Business School, the Nottingham Trent University, and Associate Fellow of the Centre for Corporate Strategy and Change, Warwick Business School, p. 229)

"... The CG arrangement in the Netherlands cannot be extricated from the European and other international forces and developments. There is a very real chance that CG of a more Anglo-Saxon guise will become dominant in Europe. CG exercised by insurers and other institutional investors (such as pension funds) – in particular the Financial Governance variant – will manifest itself substantially in due time. This applies primarily to CG within the Netherlands. In so far as institutional investors make use of international (external) investment managers, this effect will be relatively much weaker.

In doing so, an emphasis on the long-term investment perspective will be a countervailing force against an undesirable emphasis on short-term benchmarks.

An increase in CG of insurers (and perhaps of pension funds) may be accompanied by very undesirable risks. This is all the more so since competition policy in the European Union and, in particular, in the Netherlands is becoming stricter and is defined primarily in legal terms. A considerable effort will therefore be required of prudential supervisors – and of those who play a role in this, such as external accountants and actuaries – with the danger of slipping into systems of supervision which are inferior from the perspective of society as a whole ...” (**Arend Jan Vermaat**, Chairman of the ‘Verzekeringskamer’ (the Insurance Supervisory Board in the Netherlands), p. 320-321)

– *Some additional evidence on country – or sector – specific aspects*
– *Board size and composition in Spain*
“... Our results indicate that a Board of Director’s characteristics influence a firm’s performance. This empirical evidence indicates that outsider non-executive directors influence positively a Board’s capabilities to evaluate and discipline managers ... Our results relating to a Board’s size suggest the existing of non-linear relationship between this variable and Board effectiveness. They show that, initially increases in Board size enhance a Board’s effectiveness and a firm’s performance, but after a certain point, increases in a Board’s size decreases a firm’s performance. When the Board is large, the negative effect outweighs the positive one, resulting in an overall negative relationship ...” **(A.I.F. Álvarez, S.G. Ansón** and **C.F. Mendez**, respectively, Professor and Assistants, in the Department of Finance at the University of Oviedo, Spain, p. 12)

– *Privatisation and CG in the Czech Republic and in Poland*
“... In a nutshell, speed may be deemed less important than the search for an effective governance structure, but only if there is a well-defined and credible privatization strategy binding the management to *immediately* adopt practices consistent with profit maximisation in the presence of hard budget constraints while authorities keep pursuing sound macroeconomic policies and creating a regulatory framework that will allow resources to be allocated efficiently.” (**Tito Boeri** and **Giancarlo Perasso**, respectively, Professor of Economics at

Bocconi University, Milan; and Economist in the Country Study Branch of the Economic Department of the OECD, Paris, p. 84)

– *Shareholding Concentration and Pyramidal Ownership Structures in Belgium*

"... We have shown that the Belgian equity market is similar to most Continental European ones as few companies are quoted, ownership concentration is strong, pyramidal ownership structures are used to lever control and there is a market for share stakes. Typical for Belgium is the dominance of holding companies as large shareholders. Pyramiding of shareholding structures violates the one share-one vote rule as ultimate shareholders can exercise control with a low percentage of cash-flow rights. Despite the strong concentration of relatively stable large shareholdings, the existence of a market for small share stakes reveals the importance of reaching critical control levels (blocking minorities, majorities and supermajorities) for the exertion of corporate control ..." (**Luc Renneboog**, Assistant Professor in Finance at the Department of Applied Economics of the Catholic University of Leuven, in his Marjolin Prize-winning contribution, p. 287-288)

– *Stock Exchange Governance in the European Union*

"... The exchange as a firm view is gaining ground in Europe despite being enforced with varying degrees of conviction in the different Member States. Where stock exchanges are defined and regulated as enterprises, they are most frequently owned by their members although that there are some cases of investor-owned exchanges... Self-regulation is expanding and the exchange-management companies subsequently gain regulatory and supervisory powers. However, conflicts of interest may arise especially in the case of member-owned exchanges. These conflicts, which could be limited by investor ownership, must necessarily be considered by exchange governance structures. One remedy, in the case of member-owned exchanges is to ensure that the governing bodies are representative of all their constituencies, so that the exchange policy and regulation reflect a fair balance of interests ... An additional remedy is to create independent executive bodies which take care of market management and supervision and are to some extent, separated from those in charge of the exchange policy. A different course of action is to separate market surveillance from exchange governance and to assign the former to distinct self-regulatory bodies ... A weakness of this separation, however, is represented by the circumstance that the quality of trading services is not controlled by the enterprise running the exchange ..." (**Guido Ferrarini**, Professor of Law at the University of Genoa, pp. 156-157)

– *A European-wide Code of Good Practice for Corporate Governance?*

"... Western European countries have to adapt their corporate governance structures to take the shifts in shareholding structures into account. Whereas before, shareholding was concentrated in the state, firms or families, an evolution is underway whereby the market is getting a bigger role in the financing of firms ... The problem in the Central and Eastern European transition economies is to implement effective corporate governance mechanisms. As part of the privatisation processes followed, these countries have generally gone immediately towards an extensive level of institutional shareholding, with, in the case of successful firms, a strong wealth maximizing behaviour on the part of managers. The institutional investors often lack the expertise, or have conflicts of interest, to adequately exercise corporate governance and to ensure profit maximization. Or they are not properly governed themselves. The common observation for Continental Europe is thus that there is too much inside control, in Eastern Europe as a result of privatisations whereby outside control is too weak, and insiders exploit their position, in Western Europe as the result of economic traditions, where stock markets and institutional investors have traditionally not played an important role in corporate control. A common recommendation could thus be to enforce ways which allow stronger outside controls, such as through the separation of Chairman and CEO, well-qualified outside directors on the board, one share-one vote structures, effective board control procedures, transparent and broad reporting ... Since the statutory change at EU or national level is difficult to achieve, the lead to set common rules on corporate governance should be taken by market players ... As a way out of the regulatory deadlock at European level, European industry should take the initiative and adopt a European-wide Code of Good Practice in corporate control ..." (**Karel Lannoo**, Head of EU Policies and Business Unit and Senior Research Fellow at the Centre for European Policy Studies (CEPS), Brussels, pp. 211-212)

Colloquium 21: The Euro – A Challenge and Opportunity for Financial Markets

Frankfurt, October 1998
Joint initiative with the Centre of Financial Studies, Frankfurt
President of SUERF and Chairman of the Colloquium: Franco Bruni

Colloquium Book
Editors: Michael Artis, Axel Weber, Elizabeth Hennessy
Authors: John Arrowsmith, Michael Artis, Olivier De Bandt, Ray Barrell, Andrea Beltratti, Graham Bishop, Martin Brookes, E. Philip Davis, Jean Dermine, Daniel Gros, Christopher Huhne, Ernst-Moritz Lipp, Robert N. McCauley, Alessandro Prati, Sinikka Salo, Garry Shinasi, Franziska Schobert, Christopher Taylor, Niels Thygesen, Hans Tietmeyer, Rudi Vander Vennet.
Publishers: Routledge, London and New York, 2000, xxii, 394 pp.

– *The euro: a safe haven in a turbulent financial world? The first acid test for an as yet unborn currency...*

"... There can be no doubt that the global environment has become harsher and more turbulent for Germany, and Europe as well, in the past weeks and months. A number of East Asian countries are beset by a deep-seated, persistent financial crisis ... On the continent of Europe, by contrast, conditions have so far been distinctly more favourable ... But besides the comparatively reassuring perception that those crises are unlikely to spill over to us (at least in the short run) through the channel of trade relations, there is increasing concern that the crises might, instead, come right into our 'front room' through the channel of financial relations, via the global financial markets.

... Given the crises besetting many parts of the world, the euro has passed its first acid test. That is gratifying. The markets regard the euro as safe haven. In that respect, it has already become a serious rival to the dollar ... That demonstrates two things: the markets have accepted the transition to monetary union as being irreversible, and the euro and the independent European Central Bank are enjoying a high degree of confidence in investors' eyes..." (**Hans Tietmeyer**, President of the Deutsche Bundesbank, pp. 5, 6, 9)

“... The financial crisis and the forthcoming EMU will be the driving forces for the future architecture of the international capital markets. First, the introduction of the euro itself will be much more problematic if the euro area does not prove to be resistant against the contagious effects of the current crisis ... Second, the reintegration of the emerging market economies into the international financial system is of crucial importance for an efficient allocation of capital, which is a precondition for the future growth and wealth not only of the affected countries but of the world as a whole. Third, the international financial system can look forward to momentous change with the launch of monetary union. EMU will integrate the monetary sphere of an economic area whose real economy is roughly comparable to that of the United States ... The euro has passed its first critical test before it comes into existence, but the experiences of the Asian tiger states have shown that every trust must be earned *ex post* ...” (**Ernst-Moritz Lipp**, Member of the Board of Directors of the Dresdner Bank, pp. 11, 15)

“... *One size fits all?* According to the *Oxford Companion in Classical Literature*, Procrustes was ‘ a legendary brigand of Eleusis, who used to lay travellers on a bed, and if they were too long for it, cut short their limbs, but if the bed was longer, stretched them to make their length equal to it’ This legend holds a moral for member countries of the Eurozone: whatever their individual preferences and needs there will be only one monetary policy, only one interest rate structure, a ‘one size fits all’ monetary policy ... By measuring the homogeneity of the groupings (of 18 countries) we can obtain some impression of where the strains and difficulties are most likely to come, and what might be done to ease the problems of adjustment ... Participation in the Union is a cost-benefit calculation for each country ... Some countries will be observed to face some costs; the positive way to view this is to ask what policy adjustments can be made to minimize those costs ...

The results (of the clustering) indicate a clear cohesive ‘core group’ around Germany regarded as the centre country (France, Netherlands, Belgium, Austria) and two peripheral groups among the European countries – a “Northern periphery” (Denmark, Ireland, Switzerland, Sweden, Norway, Finland, UK) and a ‘Southern periphery’ Group (Italy, Spain, Portugal, Greece) while North America and Japan are clearly indicated as separate groups ...

A distinctive characteristic of the ‘Northern periphery’ group is that its business cycle is poorly correlated with that of Germany, while its real DM exchange rate has exhibited a good deal of volatility ... The ‘Southern periphery' group distances itself from the core in different respects: inflation convergence is weak, labour markets are less flexible and the monetary policy cycle is weakly correlated with Germany's ...

... Consideration has to be given to the issue of substitute policies for the loss of independent monetary policy by those countries for which it is likely to matter most ... The most important macro-policy weapons left in national hands after monetary union are fiscal policy (within the limits allowed by the Growth and Stability Pact) and wages policy, though regional policy may constitute an important third prospective entry ..." (**Michael Artis**, Professor of Economics at the European University Institute, Florence, on leave from Manchester University, pp. 19, 20, 23, 24, 26)

– *Twenty-five years of European monetary unification in the light of five evolving ambitions*

"I note five major ambitions and survey how they evolved, gradually gaining ground and overcoming the opposition, mostly from national policy makers, but also – and sadly from my point of view – from a majority of academic economists ...:

- reducing, then eliminating nominal exchange-rate fluctuations
- reducing, then eliminating inflation
- developing rules for non-monetary national policies, then scope for coordinating them without undermining the rules
- developing a potential role in the international monetary system, then adjusting it to the realities of today
- developing a European profile in financial regulation.

Truthfully, only the first three, or maybe more correctly two and a half, of these ambitions can be said to have been fulfilled with EMU as it has started on 1 January 1999 ...

... In his remarkable book *The Road to Monetary Union in Europe* Tommaso Padoa-Schioppa (1994) notes that the utopian perspective of full currency union was confirmed as a realistic option by the 1992-1993 crises in the EMS. With the degree of capital mobility achieved at the end of the 1980s, fixed-but-adjustable exchange rates might have become impossible to maintain. Central bankers found it difficult to face this issue, and claimed in most cases that the experience with the EMS was sufficiently promising to justify aiming not further than a well functioning EMS. It is more surprising that many, if not most, academic economists, also found it extremely difficult to accept this ambition as reasonable in economic terms. I suggest that this is due to two important biases in much of the economic analysis of full monetary union. The first is that the alternative to EMU is viewed in too optimistic a perspective. The second is that the issue of asymmetric shocks affecting the participants in EMU in a differential way has been played up too much in the economic debate, confounding the possible with the probable...

"... I listed five ambitions which have gradually evolved as the project progressed towards realization. There is a logical order in them, as we look back over the past two decades since the start of EMS. Increasingly rigid exchange rates – an important benefit in themselves – required convergence of national inflation rates, hence raising the issue of who should exercise the *n*-th degree of freedom in an increasingly joint monetary policy. Basically, such a policy required an explicit stand on the principal objective of monetary policy: to provide a stable nominal framework for the area as a whole. With the inflationary experience of the 1970s and early 1980s still fresh in the minds of policy makers, this issue was settled in a clear and forceful way in the Maastricht Treaty ..." (**Niels Thygesen**, Danske Bank Professor of International Economics at the University of Copenhagen, in his Marjolin Lecture at the Colloquium, pp. 30, 31, 32, 53)

– *Challenges and opportunities for the European banking system*.
– *The EMU as a factor provoking changes in banking structure and performance*

"There are different ways to consider these changes. First, EMU may be seen as the extension to the European context of ... world trends by way of progress towards frontier opening, pressures on regulatory differences, and respect of market principle. Second, EMU may be viewed as a further step in the direction of European economic and financial integration, so that it may be difficult to distinguish its effects from those of the Single Market and the Second Banking Coordination directive. In particular one may argue that one of the major gains of the single currency is that it makes the single market real. Third ... one can consider that EMU may,in itself, have very direct and specific consequences on the European banking system, for instance by exacerbating underlying trends or even having a catalytic role. Of course, EMU should not be seen as the only driving force behind current developments in the European banking industry ... The single monetary policy will generate new activities, in particular in connection with the emergence of larger and deeper financial markets. This will require changes in the strategic focus of banks operating in the euro-area. In addition, competition is likely to increase significantly with the single currency, as one of the major obstacles to financial integration will disappear, although retail banking markets will keep, at least at the beginning of EMU, many of their 'local' features, in particular those due to tax differences. Market participants are adapting their accounting and operational systems and can now define their strategies. One realistic scenario is therefore that the final impact of EMU will be to increase the competitiveness of banks in the Single Currency area and to favour the emergence of some large Europe-based global banking groups, while at the same time, smaller institutions may develop profitable niches ..." (**Olivier De Bandt**, Head of Unit in the Research Department of the Banque de France (SEMEF), pp. 92, 117)

– *A new Eurobanking world*
"... One can anticipate the creation of a new Eurobanking world. A major international consolidation of the European banking industry will take place in the capital market business, and further domestic rationalization of commercial banking will be needed. An important premise of the analysis has been that European size will dominate domestic size because it enables diversification benefits to be realized. The objective of the 1992 single market programme was to reinforce the efficiency and competitiveness of European firms. As concerns banking, it is a clear conclusion that the introduction of a single currency will not only make the creation of the single market irreversible, but that it will, besides the obvious fall in revenue from intra-European currencies trading, alter fundamentally the nature of several businesses. A new banking world will emerge with very different sources of competitive advantage ..." (**Jean Dermine**, Professor of Banking and Finance at INSEAD, Fontainebleau, pp. 136-137)

– *Eliminating excess capacity*
"... There are three ways by which an excess capacity problem can be resolved: productivity improvements, restructuring and exit ... Public policy should on the one hand allow market forces to operate, but on the other ensure that the process is smooth and not disruptive. These tendencies may of course go in the same direction, for example if delay were to make adjustment sharper and more abrupt... The perspective of EMU, which may well lead to a further intensification of competition, thus heightening the problem of redundant capacity, could increase the importance of orderly removal of capacity, although it may reduce concerns regarding the effect of concentration on competition ... (**E. Philip Davis** and **Sinikka Salo**, respectively, Senior Economist at the Bank of England and Senior Economist at the Bank of Finland, currently on secondment to the European Central Bank, pp. 84, 88, 89)

– *Searching for the most efficient type of bank*

"... In terms of cost efficiency, specialized banks appear to exhibit no disadvantage relative to diversified banks or financial conglomerates in traditional intermediation activities, However, the latter are more cost efficient when non-traditional banking activities are taken into account. Universal banks are characterized by significantly higher average levels of operational efficiency relative to specialized banks. They also dominate their non-universal competitors in terms of profit efficiency. Part of the superior profit efficiency in universal banks is probably related to the comparative information advantage acquired through their corporate insider status. Both for cost and profit efficiency size does seem to matter. Especially the very large banks appear to outperform their smaller competitors in terms of revenue efficiency. In general, fairly large unexploited scale economies were found for the small banks, especially the specialized ones ... The bank sizes for which no diseconomies were found are higher than reported in the 1980s. As a consequence, the continued expansion of financial conglomerates and universal banks in Europe, partly as a response to EMU, should lead to a more efficient financial system ..." (**Rudi Vander Vennet**, Professor of Financial Economics at the University of Ghent, in his Marjolin Prize-winning contribution, p. 162)

– *Challenges to public authorities*
– *A lender of last resort (LOLR) function for the European Central Bank (ECB)*

"... The 'narrow' concept of a central bank that inspired the Treaty and the Statute of the European System of Central Banks (ESCB) led to the creation of an institutional framework that may completely preclude the involvement of the ECB, and even of the National Central Banks (NCBs) from crisis management. If the Governing Council of the ECB decides to move in this direction, this would represent a departure from current practices for most EMU central banks, including the Bundesbank ...

... Another possible direction in which the framework might change is that the ECB might evolve into an institution that would assume a leading and coordinating role in crisis management. If no other institution can satisfactorily take up LOLR responsibilities at the EMU level, then it might devolve to the ESCB, or to the NCBs. It could evolve to the NCBs, but the ECB would, at a minimum, need to be able to assess the systemic implications of a crisis rapidly, especially if it involves pan-European institutions. This implies that the ECB would have greater access to supervisory information on an independent and regular basis than is currently foreseen.

The ECB and the other relevant authorities might be tempted to maintain ambiguity about crisis-management mechanisms, on the principle that some ambiguity would be 'constructive' and would reduce moral hazard... However it is quite a different matter, and would be risky and even counterproductive, not to clarify in advance, and perhaps even make public, the channels of communications and the division of responsibilities between the ECB and the several national authorities and central banks ..." (**Alessandro Prati** and **Garry Schinasi**, respectively, Economist and Chief of the Division of the International Capital Markets and Financial Studies Division in the Research Department of the IMF, pp. 249, 250)

– *Streamlining the balance sheets of the European Central Banks and disposing of their excess foreign exchange reserves*

"... A monetary union and the creation of the ESCB constitute a good occasion to simplify and streamline the balance sheets of national central banks, which in many cases contain items that are only of historical interest. Moreover, the ESCB should stop the tendency for central banks to hide the true state of their balance sheets from public view. There is no reason why the ESCB should not be completely open about the financial situation of its constituent national central banks. As this area belongs formally to the responsibility of national central banks, it is up to them to act and dispose of parts of their assets and liabilities until the remainder is equal to the monetary base plus a small capital and an appropriate revaluation reserve.

... The issue of excess foreign exchange reserves arises, however, whether or not our proposal of reducing the balance sheet of the ESCB is adopted. The general question that arises in this context is why central banks, which are after all part of the public sector, should hold large amounts of low-yielding assets when the government at the same time pays more on its debt ..." (**Daniel Gros** and **Franziska Schobert**, respectively, Senior Research Fellow, Deputy Director at the Center for Economic Policy Studies (CEPS), Brussels, and Ph.D. student in the Department of Monetary Economics, Goethe University, Frankfurt, pp. 222, 223)

– *A Strategy for managing the euro in a tri-polar world*

"... Contrary to policymakers' ambitions for the euro, the widespread view among economists is that the new currency is likely to be less stable (in a tri-polar world) than its main national predecessors ... Subsuming all (the) arguments is the worry that, if and when the euro develops into a global currency, it will prove to be at least as unstable as the dollar and yen have been, and further polarization might add to these instabilities ... Given the

ECB's virtually certain opposition to any strategy that would conflict with its freedom to select and pursue its price stability objective, the focus of the strategy should be the euro's real exchange rate (preferably in effective terms, but bilaterally against the dollar if transparency is at a premium). This focus would permit the ECB to pursue, with a modest degree of short-term flexibility, an internal inflation objective independently of the other major blocks; and it would be entirely consistent with the strategy's objectives, namely to lean against exchange-rate misalignment rather than to provide a (redundant) nominal anchor for the euro area ...

... The EMU authorities and especially the ECB given its influence at the heart of the new regime, must ... also be prepared to give some weight to minimizing euro instability against third currencies, principally the US dollar'... Despite the fairly discouraging omens, global co-operation to minimize fluctuations between the key currencies of the tripolar, or more probably bipolar, post EMU world would also be worth trying to revive, if only for the familiar reason that, in the past, DM/US dollar fluctuations have periodically created tensions between currencies in the old ERM, and could pose similar problems for the euro and its prospective partners in the new one ..." (**John Arrowsmith, Ray Barrell** and **Christopher Taylor**, respectively, Senior Research Fellow, Director of the World Economy team, and Visiting Fellow, all three at the National Institute of Economic and Social Research, London, pp. 169, 198, 199)

Issues for portfolio management and corporate finance

– *The consensus on the impact of EMU on European financial markets and portfolio management:*

- "Government bond markets will be more closely integrated and yields closely correlated.
- Non-government borrowers will increasingly borrow directly from investors by issuing debt securities rather than borrowing from banks, leading to a US-style corporate bond market.
- The national bias in equity and fixed income investments will diminish and funds will be increasingly managed against Euro-wide benchmarks, possibly involving some reallocation of existing investments.
- Equity markets will grow, as more companies go public and more investors seek to invest funds in equity markets.

... One feature of (the) potential flows is particularly worth noting. Typically, when investors rebalance portfolios they concentrate new purchases on large-cap names. This suggests that cross-border equity flows which result from re-balancing may be skewed towards large-cap stocks. One factor reinforcing this is that the most widely used benchmarks for pan-Eurozone equity investors are likely to be large-cap biased ...” (**Martin Brooks**, International Economist and Executive Director at Goldman Sachs International, London, pp. 310, 323)

– *Non-European securities favoured by the re-balance of portfolios?*
“There are many theoretical reasons for believing that the introduction of the euro will change the optimal asset allocation of European investors. Given the increase in the covariances between stockmarkets and between bond markets, one may expect an increase in the share of non-European securities... There is some switch towards non-European stocks and a general increase in the demand for non-euro bonds (according to simulations on the basis of historical data).” (**Andrea Beltratti**, Associate Professor of Economics at Bocconi University, Milan, p. 281)

– *The ratings after the euro introduction*
  – ”The ceiling rating for the whole area will be AAA for all three major agencies (Standard and Poor’s, Moody’s and Fitch-IBCA) reflecting the Eurozone’s net creditor status, diversified foreign exchange earnings, deep markets and strong liquidity position ...
  – There will be no distinction between local and foreign currency ratings. Only one set of ratings will be published from 1 January 1999 within the Eurozone.
  – The focus of sovereign analysis will increasingly be fiscal (budget deficits, financing requirements, public debt levels and public debt service relative to revenue and GDP) rather than the balance of payments ...
  – In the medium term sovereign ratings should improve to AAA. However, the short-term risks of a sovereign liquidity crisis increase for two reasons. First, investors no longer have an incentive to hold their government’s paper in a crisis: a flight to quality may result in a flight out of one government’s paper and into another’s ... Second, each government will no longer be in a position to encourage its central bank to support its paper in the market. As a result, an important liquidity support for sovereign is removed just as the liquidity risks increase ...
  – Policy on bank rescues – the LOLR function – is opaque and is likely to remain so. However, it is clear that ultimate liability will devolve on national fiscal authorities, and that this may make bank rescues less likely for second-rank banks ...” (**Christopher Huhne**, Vice Chairman

of the Sovereign Department, Fitch IBCA, and a Member of the European Parliament, pp. 347, 348)

– *A political implication of the basic shifts*

"... The existence of very large and liquid capital markets may well have profound political implications for the EU. Institutional investors – such as pension and life insurance funds – may neither be, nor feel themselves to be, restricted to securities offered by their own government. Instead, they will have several competing governments and a profusion of non government issuers, whether regional governments, traditional corporate bonds or new securitized issuers that underpin innovative credit opportunities for the Eurozone economy ..." (**Graham Bishop**, Adviser on European Financial Affairs at Salomon Smith Barney, London, p. 308)

– *The impact of portfolio shifts on currency competition*

"... There is no immediate prospect for the euro's use as an anchor currency outside Central Europe and the Mediterranean. Still, a successful euro could deepen Europe's financial markets and conceivably make the evolution of European bond prices more independent of developments in New York. Both greater depth and better diversification possibilities could attract more international investment to the euro. The prospect of substantial portfolio shifts into the euro, however, does not by itself justify forecasts that the new currency will appreciate against the dollar over an extended period. Liability managers outside the euro area should also find the enhanced liquidity and improved diversification possibilities of euro-denominated debt attractive. Thus, in response to a shift in demand, global financial markets are capable of producing euro-denominated assets by changes in the currency habitats of international borrowers ..." (**Robert N. McCauley**, Senior Economic and Financial Representative of the BIS' Representative Office for Asia and the Pacific, Hong Kong, p. 372)

Colloquium 22: Adapting to Financial Globalisation

Vienna, April 2000
President of SUERF and Chairman of the Colloquium: Franco Bruni

Colloquium Book
Editors: Morten Balling, Eduard H. Hochreiter and Elizabeth Hennessy
Authors: Enrique Alberola-Ila, Eric Barthalon, Joseph Christl, Andrew Crockett, B. Gerard Dages, E. Philip Davis, Ignacio Fuentes Egusquiza, Hans Geiger, Linda Goldberg, Barry Howcroft, Daniel Kinney, Kenneth N. Kuttner, Karel Lannoo, Jacques de Larosière, Klaus Liebscher, Luis Molina Sanchez, Claus Norgren, Tommaso Padoa-Schioppa, Adam S. Posen, Teresa Sastre de Miguel, Thomas Spaniel, Peter Van Dijcke
Publishers: Routledge, London and New York, 2001, xii, 349 pp.

– *Globalisation and Irrational Exuberance... The issue of financial stability on the top of the international policy agenda*

"... One outgrowth for us central bankers is that in addition to our concern with price stability, our acknowledged home turf, we must increasingly also be concerned with the stability of the financial system both regionally and globally. Today we operate in an increasingly interdependent world, where there is a growing divergence between the national political sphere and the global economic and financial sphere..." (**Klaus Liebscher**, Governor, Oesterreichische Nationalbank, Vienna, p. 28)

"... Asset prices have moved higher and their volatility have increased ...These large asset price swings are themselves a palpable manifestation of the increased financial instability experienced around the world since at least the 1980s ... Just as policy makers appeared to be emerging victorious from one exhausting battle, that against inflation, another equally challenging front was opening up. Lower inflation, it appeared, had not by itself yielded the peace dividend of a more stable financial environment ...

Financial globalisation has transformed geography, with significant implications for the character of instability. Globalisation has heightened the significance of 'common factors' in the genesis and unfolding of financial distress. It has done so by extending and tightening financial linkages across institutions, markets and countries ... In addition, globalisation has heightened the significance of size asymmetries in the world, between the main industrial countries, on the one hand, and emerging market economies, on the other, that is, between core and periphery ...

... Paradoxically, success in taming inflation can provide an environment more vulnerable to those waves of excessive optimism that breed unsustainable asset price dynamics ... The search for a solution to this basic problem can be seen as a search for adequate anchors in the monetary and financial spheres. There is little doubt that all the work already done and put in train in order to strengthen prudential safeguards is in the right direction. Upgraded minimum capital requirements have been the cornerstone of (the) strategy: the Core Principles for Effective Banking Supervision provide a consistent, broader corpus of guidelines that has served as the model for regulatory and supervisory arrangements world-wide. Whether the current efforts can, by themselves be sufficient to guarantee financial stability is less clear. My analysis points to two potential weaknesses that still need to be adequately addressed. The first relates to the *limitations of market discipline* ... It would be a mistake to believe that moral hazard is the only source of incentives for imprudent behaviour. In a highly competitive environment there is no dearth of pressure to take on risks or to conform behaviour to the prevailing norms, regardless of their inherent validity. More prudent behaviour requires a heightened recognition that, in finance, an ultimate source of competitive advantage is the credit standing of the institution ... The second potential weakness relates to *the raw material on which the regulatory framework can draw.* It stands to reason that the regulatory apparatus should align its risk measures to those used by private participants ... From this perspective the current proposals for the revision of the Capital Accord are a major step forward. This positive step, however, still leaves unresolved the problem posed by existing biases in the measures of risk, particularly the shortcomings in assessing the non-diversifiable risk associated with the financial cycle.

The bottom line is simple. If my conjectures are correct, there is a material risk that the current anchors in the financial sphere may, by themselves, be insufficient to deliver financial stability. In a sense, anchors are no better than the ground in which they are planted. And that ground could, at worst, turn out to be quicksand ..." (**Andrew Crockett**, General Manager of the BIS, Chairman of the Financial Stability Forum, Basle, pp. 5, 9, 10, 12, 13)

– *Adapting the European financial landscape*
– *The emergent Euroland banking system*
"... In wholesale and capital market activities, the signs of the emergence of a single Euroland banking industry are rather strong, especially if we consider that only one and a half years have elapsed since the launch of the euro. In the case of retail activities and ownership structures, cross-border operations are largely lacking, but we should not expect the signs thereof to materialize very soon. After all, the two aspects – localised retail banking, which is the most visible area of banking for the public, and the lack of cross-border mergers – are present even in mature monetary and banking systems, such as the US system ... Technology and infrastructure present a diversified picture and this is the area in which – in my view – the existing obstacles are least justified. Cost savings could be achieved through consolidation, and the competitiveness of the euroland banking industry – vis-à-vis, say, the US banking industry – could be enhanced. On these issues there is an important role for policy to be played, including the competence of the European Commission in the field of competition ..." (**Tommaso Padoa-Schioppa**, Member of the Executive Board, ECB, Frankfurt, p. 57)

– *Financial consolidation*
*"...**The rationale for M&As: too many large national banks, no big European bank*** (in bold in the text) ... Most banks seem to favor a twofold M&A strategy: Firstly they are keen to defend their position in the domestic stronghold against potential foreign competitors, which leads them into mergers with national competitors. Secondly, in a more offensive way, they seek to establish bridgeheads in the pan-European market by acquiring interests in foreign institutions. The aim of such moves is to deter similar ones by competitors and to increase market shares.

... I believe European banks will develop a multi-pronged strategy: Cross-border acquisitions where synergies can be realized by rationalizing networks and information systems in particular, but also where profitable markets can be reached (for instance, retail networks in those emerging countries where banking systems are still largely inefficient); partnerships where it is more efficient to use existing networks in order to market specific services in which one of the partners holds a competitive edge; internet activities ...; eventually becoming truly global in terms of investment banking through internal and external growth..." (**Jacques de Larosière** and **Eric Barthalon**, respectively, Advisor and Economist, BNP Paribas, Paris, pp. 16, 19, 25)

– *Bank strategy of Spanish Banks*

"... It seems that in the case of mergers and takeovers in Spain one can speak of two types: those which have sought to expand business and those which have opted for increases in productivity and improvements in the level of efficiency. The ambiguity of the results obtained in terms of profitability per unit of assets would suggest that is practically impossible to achieve both things at the same time ... The effects of other strategies have also helped banking institutions to confront growing competition. Strategies based on product diversification like the development of investment and pension funds, derivative products and securitisation take advantage of the delivery system of banking institutions and allows them to compete in other segments while minimising the loss of business and income. Moreover, by widening the range of products offered, Spanish banks have rationalised the use of their branch networks and increased their efficiency levels. Finally, these strategies, as they reduce the size of the balance sheet, allow banking institutions to expand their level of activity with fewer problems of capital resources ..." (**Ignacio Fuentes Egusquiza** and **Theresa Sastre de Miguel**, Senior Economists in the Research Department, Banco de España, Madrid, p. 182)

– *Emphasizing efficiency*

"... Increased competition, ongoing consolidation, continuing pressure for the reduction of existing excess capacity and shrinking profitability in the European banking industry have put efficiency high on the agenda of most banks as they monitor their performance over time and against competitors ... The rationale of looking at the cost to income ratio and its dispersion is the growing use of it as a proxy for bank (in)efficiency. Possible dispersion is often interpreted as an indication of (in)efficiency ... Despite the recent consolidation, on average only a small reduction of the rate is recorded ... The findings seem to confirm that changing scale and scope has a limited impact on the cost to income ratio. By using the available inputs efficiently in order to generate a given (or) higher output level the direct impact on the ratio itself is much larger ... Overlooking the efficiency literature ... this means that banks can improve their overall cost efficiency to a greater extent if they emulate the banking industry's best practice, thereby increasing their managerial and technical efficiency (reducing X-inefficiencies) rather than by size (scale economies) or diversifying (scope economies) ... Useful and valuable benchmark information is available when the cost to income ratio is set against the bank's main competitors and similar banks. Overall, the analysis shows that the reduction of the cost to income ratio is taking place at a rather slow pace mainly due to the consolidation process. However the residual analysis (i.e. the analysis of residuals of a sample of banks based on a fitted regression model) shows that changes in efficiency are taking place at different pace across individual banks and across EU countries ...” (**Peter Van Dijcke**, Senior Economist at Artesia Bank Corporation, Brussels, in his Marjolin Prize-winning contribution, pp. 295, 308, 324-325)

– *The impact on payment intermediation*

“... Further globalisation of the world economy will lead to growing demand for trans-border payment services in the business-to-business transactions and also in the business-to-consumer ones. The high proportion of global trade taking place among multinationals requires special global payment and transaction services for these companies. The emergence of E-commerce which is by nature not limited to national borders, might shift the balance of power from payment intermediaries to transaction intermediaries. The rapid development of information technologies favours new competitors for commercial payment services. In the area of financial transactions, the internationalisation of exchanges calls for an internationalisation of clearing and settlement systems. Information technologies also favour new competitors for financial transactions and payment services. The initiative of central banks and bank supervisors will exert a continuous pressure on the traditional payment intermediaries to reduce the financial risks in all payments systems. The completion of the European currency union will transform today’s largest market for international commercial payments into a local payment market. The pressure by the European Union and the European Central Bank will add to the demand by the customers for rapid improvement in the European payment systems.” (**Hans Geiger**, Professor, Swiss Banking Institute, University of Zurich, pp. 203, 205)

– *The impact on consumer behaviour and its implications for banking strategy*

“... It is possible to construct a matrix of consumer behaviour which provides greater insight into the interaction modes ... Each of the ideal types described in the consumer behaviour matrix (i.e. repeat-passive, rational-active, no purchase, relation-dependent) has implications for strategy, in that they give rise to contingencies which demand a strategic response ... This approach has not been widely explored or used in the financial services industry as choice was traditionally limited and consumers had little incentive to switch between bank providers. However, this situation no longer prevails as competitive forces enable and encourage consumers to adopt rational-active forms of buying behaviour. As these changes occur the retention of customers assumes greater importance as the costs of recruiting new customers are significant and because existing customers should provide cross-selling opportunities ...”

(**Barry Howcroft**, Professor of Retail Banking and Director, Loughborough University Banking Centre, Loughborough, pp. 220, 225)

– *Financial stability in emerging market economies*
– *Currency boards*

"... During the Nineties, the process of economic reform has gathered pace in Latin America, while a group of Eastern European countries has gone through a complete transformation to become market economies. The world-wide upsurge in the magnitude, scope and speed of financial movements has eased the implementation of the reform processes by providing the much needed inflows of capital, but, at the same time, it has increased their vulnerability: in a context of financial globalization, countries which have been perceived by markets to have weak fundamentals, particularly in terms of inflation, public finance and/or current account, have suffered from swift reversals in the inflows of capital, which have put at stake the process of reform ... The quest for macroeconomic stability has traditionally had one of its central elements in the choice of exchange rate regime. Many countries have based their programs of economic stabilization on regimes of rigid or semi-rigid exchange rates. The rationale for this strategy is the following: inflation is perceived as a structural problem, and fixing credibly the exchange rate allows them to tie down inflation expectations; this induces a more disciplined behavior in economic agents, facilitating overall economic reform ... Nevertheless, the empirical evidence is at odds with this theoretical prior ... We observe that fixed exchange regimes have only attained a limited macroeconomic stability in emerging markets, compared to countries with flexible exchange rate regimes ... The weakness of the fiscal system and the inability to finance them in an orthodox way tend to fuel inflation through monetization of deficits even when they are low, leading to the collapse of the peg in fixed regimes ...

In contrast, a special type of exchange rate arrangement, the currency board, has shown its strength in the context of financial turmoil. At first sight, a currency board might just be considered a hardened version of a fixed regime, in which the exchange rate is predetermined by law and the growth in the monetary base is backed by foreign reserves. The aim of this article is to show that currency boards are intrinsically different from standard fixed exchange rate regimes because they deter monetary authorities from financing fiscal deficits ... The constraints on monetary and fiscal management imposed by currency boards require the very wide support of economic and social forces within the country. In this sense, currency boards can be identified with a deep institutional change, which transforms the way economic policy operates..." (**Enrique Aberola-Ila** and **Luis Molina**

Sanchez, Economists in the International Affairs Division, Banco de España, pp. 59-60, 76)

– *Foreign bank participation in emerging markets*
"... We conclude that in both countries (i.e. Mexico and Argentina) foreign banks exhibited stronger loan growth than all domestically owned banks and had lower associated volatility, contributing to greater stability in overall financial system credit. Additionally in both countries, foreign banks showed notable credit growth during recent crisis periods and thereafter ... We found that domestically owned and foreign-owned banks with low problem loans ratios behave similarly, and we found no evidence that the foreign banks were more volatile lenders than their domestic counterparts... Overall, these findings suggest that bank health, and not ownership *per se,* has been the critical element in the growth volatility, and cyclicality of bank credit ..." (**B. Gerard Dages, Linda Goldberg** and **Daniel Kinney**, Assistant Vice President, Assistant Vice President and International Officer in the Federal Reserve Bank of New York respectively, p. 116)

– *Country Risk Analysis*
"...We believe that it is at least possible to see whether a country is in a zone of serious vulnerability – that is, whether the fundamentals are so weak that sudden shifts in expectations will trigger a crisis – and that the serious vulnerability will also adversely impact on its ability to service its foreign debt. If this is possible, the relative vulnerability of different countries might predict the relative probabilities of crises happening in response to a shock ... The C(redit)A(nstalt) country risk assessment brought different results in the forecast of the crises in Thailand, Brazil and Russia ... Our forecasts for Thailand when the crisis came up were reasonably accurate and, therefore, we captured and managed the Thailand risk (as well as the whole Asian crisis) rather satisfactorily. Besides, our forecast for the Russian economy in 1997 was quite correct, but for 1998 turned out too optimistic. In Brazil, on the other hand, we took an overly gloomy view in our forecast. Tending towards the pessimistic side, however, is the superior strategy for a risk assessment process." (**Josef Christl** and **Thomas Spanel**, Chief Economist and Economist respectively, Creditanstalt AG, Austria, pp. 84-85, 96-97)

– *Public Policies: worldwide arrangements*
– *Reducing G3 exchange rate volatility through more transparent monetary policies*
"... It has become established, surprisingly, that this volatility (i.e. short-term volatility in G3 bilateral exchange rates) is not only disproportionally large

relative to the variation in relative macroeconomic fundamentals of Germany, Japan and the United States, but it is in fact largely unrelated to them ... The apparent disconnect between fundamentals and dollar-yen and dollar-euro exchange rate fluctuations has led to perennial complaints about persistent exchange rate 'misalignments', and their real effects on the G3 (and other) economies, giving rise in turn to recurring proposals for government policies to limit this volatility ... If transparency can be increased by central banks either through institutional developments or through being more systematic in policy making (i.e. institutional transparency and transparency in discretion), without altering the fundamental monetary policy capabilities or decisions, this may give central banks an additional degree of flexibility with which to work... The magnitude of the impact of increased monetary transparency on G3 exchange rate volatility, however, remains open to question ... The problem of G3 exchange volatility would not go away, nor should it so long as financial markets' microstructure is the source of it (see Rogoff, 1999) Yet, assuming that part of the dislike for exchange rate volatility is generated by its extreme magnitudes, removing 20-30 percent of it (i.e. on the basis of 'ballpark but consistent estimates of the benefits of transparency' by the authors) would be significant for emerging markets and international businesses – especially since the means for so doing, increasing monetary transparency, increases political legitimacy without economic cost, and adds potentially significant economic benefits ..." (**Kenneth N. Kuttner** and **Adam S. Posen**, respectively, Senior Economist and Research Officer in the Federal Reserve Bank of New York and Senior Fellow, Institute for International Economics, Washington D.C., pp. 229, 230, 253)

– *Towards a new capital adequacy framework*
"... It is not by chance that the Basel Committee talks about its proposals in terms of a framework ... First, a capital regime that is intended to be used in many countries and apply to banks in widely different circumstances must be adaptable ... Second, the Accord must concentrate on the broad principles for how capital requirements are to be determined, and leave the interpretation in individual cases to the national authorities ... Third, it will include several alternative approaches for how the minimum regulatory capital requirement of a bank can be determined ... Fourth, and finally, a framework for capital adequacy is more than a set of rules for computing a minimum regulatory capital requirement. '8%' is not the full answer ... There should be a comprehensive way of looking at capital adequacy which takes into account the bank's ability to identify, measure and control its various risks and the existence of an internal policy for capital allocation and the determination of an appropriate level of economic capital ..." (**Claes**

Norgren, Director General, The Swedish Financial Supervisory Authority, Stockholm, pp. 41, 42)

– *Public Policies*: *European monetary and financial integration*
– *Evolving Subsidiarity*
"... It is sometimes argued that this (i.e. the present) state of affairs requires more centralized regulatory and supervisory institutions at the international level. Though centralization of some tasks might have its merits, I reject this option for the time being for the following reasons. The first reason is a purely political one. The EU has been formed on the principles of subsidiarity, where power is shared among member states ... Taking into account both the positive experience with subsidiarity and the reluctance of national legislators to transfer responsibilities to centralized authorities, we have good reason not to rush to a centralization of regulatory and supervisory duties. The second reason ... relates to economic and institutional aspects. Due to their local knowledge national regulators have a comparative advantage in dealing with idiosyncratic national characteristics of their respective financial intermediaries. The upcoming unification and convergence of European financial markets will gradually remove these distinctions, but this cannot be expected to happen in the near future." (**Klaus Liebscher**, op. cit., pp. 31, 32)

"... Financial supervision in a European context needs to evolve progressively with growing market integration, but a more centralised approach in financial supervision can only be justified where national or local approaches are no longer adequate for performing the task. A coordinated approach is now necessary to handle systemic issues that will no longer be limited to national borders, but also, and increasingly, for monitoring financial institutions with operations in a range of European countries. There is a vital need to identify a lead supervisor for each financial group... A kind of European Forum should be urgently created. This forum should primarily discuss problems in the adequate supervision of large European financial groups and, if necessary, draft a multilateral and multi-sectoral Memorandum of Understanding... A further institutionalisation of supervisory functions at the European level is, as circumstances currently stand, legally and practically impossible and in any case unlikely to be politically acceptable..." (**Karel Lannoo**, Centre for European Policy Studies (CEPS), Brussels, pp. 286-287)

– *Financial crises: lessons from US financial history*
"... US history shows in particular in a large and diverse monetary area with segmented local banking markets, that regional crises can pose a major challenge to policy makers, while the existence of a large monetary area in

a global sense means that there will inevitably be international transmission of shocks generated within it. There is also a need for special care in the case of new monetary arrangements that have not yet experienced major financial instability ... European financial instability has traditionally been of a pattern of bank failures following loan and trading losses, the likely securitisation of euro area markets may pose challenges arising from the occurrence of crises of a type more characteristic of the US, linked to price volatility in asset markets following shifts in expectations ... or the collapse of market liquidity and issuance, which threatens institutions needing to transact or issue in such markets. On the other hand, the presence of both banks and securities markets is beneficial in offering a form of diversification for the financial system ... US experience (also) shows that issues such as too-big-to-fail can arise in a large monetary zone in the same way as a small state with a concentrated banking sector ... Finally, real estate lending booms and rising corporate leverage are shown in the US, as in Europe, to be warning signs for financial stability." (**E. Philip Davis**, Professor of Economics and Finance, Brunel University, UK, pp. 147, 149)

Colloquium 23: Technology and Finance Challenges for Financial Markets, Business Strategies and Policy Makers

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Publishers: Routledge, London and New York, 2003, xvi, 380 pp.

– *A lengthy 'money-macro' prologue in a decor of uncertainty, financial (in)stability and EMU*

The two wings of central banking: "... As regards the first wing of central banking, *monetary stability,* central banks have to provide a durable anchor in order for the price system to appropriately guide economic decisions. A stable value of money is all the more necessary for preserving the information value of relative prices in a changing world, where decisions have to be taken rapidly ... Technological change and financial market developments do not only affect monetary policy instruments but also the whole transmission process and consequently the *strategy* of monetary policy ...

About the second wing of central banking: financial market developments and the heightened risks associated with these rapid changes led central banks to *reconsider the role they had to play* to preserve financial stability. For those central banks that where in charge of the surveillance of individual credit institutions, the implications were straightforward. They had to adapt the modalities of their microprudential activities. However the need to proceed to *macroprudential monitoring* was also felt by central banks, like the National Bank of Belgium, which were not vested with the microsupervision ...

To conclude, let me stress that central banks are fully aware of the close connection and the large convergence existing between the two goals of *financial stability and monetary stability.* Keeping inflation under control, which is the ultimate goal of every central bank, has proved to be the best way to reduce uncertainties on the market, to alleviate distortions and, so, to eliminate one of the fundamental sources of financial instability.

Conversely, central banks need sound and efficient banking systems for ensuring rapid transmission, to the whole economy, of the impulses of their monetary policy. This is all the more important given that the assets at the disposal of central banks – the monetary base in our jargon – is becoming increasingly tiny compared to the assets managed by credit institutions and, beyond that, by financial market operators.

In this context, the monitoring of financial stability may certainly not be considered as a by-product or a mere extension of the traditional monetary stability objective of the central banks. The two functions are closely related but distinct. In other words, the monetary stability and financial stability wings belong to the same bird." (**Guy Quaden,** Governor of the National Bank of Belgium, in his opening address, pp. 13, 15, 17)

– *How to cope with risk in its inter-temporal dimensions?*
"... There is inevitably a conflict between the micro-level and the macro concerns in the operation of financial regulation. At the micro-level there is no doubt that commercial banks and other financial intermediaries will tend to be more fragile, closer to insolvency, during recessions. Yet the real concern, the major externality, in banking lies in the possibility of contagious (and/or correlated) failure for a significant part of the system as a whole. If a large number of banks are constrained by regulatory pressures to reduce their loans during a recession ... then the prospect of contagious collapse may even be enhanced ...

One of the most common human characteristics is to lock the stable door when the horse has already bolted. In the monetary field, the prospect of financial regulation doing the same could result in disaster by further restricting credit and liquidity in the aftermath of (often largely unforeseeable, and certainly unforeseen) crises.

(Gathering some of the threads of the analysis): First, it is difficult to condition regulation on the current deviation of the economy, or key sectors of it, from the 'fundamental equilibrium', since we only get to know what that actually was after the event, and usually many years after the event. Second, we cannot hope to predict, or model, the really big adverse shocks, since these are almost by definition unpredictable. All that we can do is model the aftershocks. Now this leads to a real dilemma. In the event of a serious adverse crisis, financial intermediaries are individually more fragile, but in aggregate you want them to be more expansionary. By the same token during an expansionary boom, individual banks are stronger, but in aggregate you would wish them to be more cautious.

How should, or can, regulators respond?... First, our view is that markets are much better at setting *relative* prices, than being able to fix aggregate fundamental equilibria, and much better at assessing relative volatility (and risk) than aggregate values... What that implies, in our view, is that regulators should place much less weight on the means of the distributions, e.g. of asset values, or of spreads over riskless assets or of the various VAR or credit models, especially when based on short runs of data, and much more attention to the relative position of the various banks and financial intermediaries within the distribution of such models, whether overall those measures seem strong or weak... The second point ... means that regulators need to make strenuous efforts to lengthen the horizon over which regulating metrics and decisions are made... It is ... to ensure that the metrics are constructed over a sufficient length of time to incorporate both bad/volatile periods including some stochastic bunching of severe adverse shocks and also good/calmer periods. A final consideration is whether one can condition regulatory requirements on the first differences of economic outcomes e.g. output and (real) asset prices, rather than on level ... We can measure, by simple arithmetic past trends, and we can estimate with reasonable accuracy whether current growth is above, or below, those trends. So collateral requirements, loan-to-value ratios, minimum capital requirements, etc. could all be raised when such increases, e.g. in asset prices, were above trend, and lowered when there was a recession relative to trend..." (**Charles Goodhart**, Professor of Banking and Finance, London School of Economics, in his Marjolin Lecture at the Colloquium, pp. 19-20, 28, 30, 31)

– *The Impact of Technology: a shift of paradigm in financial institutions, on financial markets, in the new macroeconomic landscape? A spectrum of (sometimes diverging) views:*
– *The new economics of banking:* "...Four central themes:
- A *combination* of pressures operating simultaneously is changing all aspects of banking business in a fundamental way and to an extent which represents a *fundamental shift.*
- One of these pressures in particular (technology) is a dominant driver of change and a major contributor to changing the economics of the industry.
- The pressures inducing structural change in the industry are not *incremental...* but represent a *paradigm shift* where the total impact of the pressures is greater than the sum of the components. A paradigm shift is when the underlying economics of an industry and firms within it change significantly.
- Where many of the pressures operating on the industry can be viewed as potential threats, they also widen (rather than close down) strategic options for firms operating in the industry ..." (**David T. Llewellyn**, Professor of Economics, Loughborough University and President of SUERF, p. 52)

– *Geography does not matter any more?*
"... We recognize that technology is just one of the numerous factors that influence the geographical pattern of financial activity. From our analysis we conclude, however, that technology by itself has not (yet) been so powerful that significant changes in the estimated distributions can be observed. Alternatively one could conclude that either there has been insufficient change in the use of technology or all other factors combined exactly counter the effect of changed use of technology ... These results indicate that technology has not (yet) led to a change in the spatial dispersion of financial activity. All in all, we find no evidence for the hypothesis that technology has eliminated the importance of geography as predicted by the 'Geography Doesn't Matter' hypothesis ... A criticism of our analysis with some merit is that our date pre-dates the coming of age of the Internet and that the Internet will make completely new ways of production possible. We do not disagree, but propose that the Internet will have an impact that is at least as strong as the impact of the other recent innovations in communication technology." (**Iman Van Lelyveld** and **Marieke Donker**, both Researchers at De Nederlandsche Bank, Amsterdam, p. 156)

– *Electronic Trading in wholesale financial markets*
"... Many recognized effects of electronic trading – which include opportunities to harness efficiency gains, better market information, handle higher volumes and lesser physical constraints on trading practices and participation – have a role in contributing to the adaptability and stability of the financial system. And while, as with the expansion of any new market, the route will doubtless end up littered with underperforming and failed systems – this in itself does not necessarily carry systemic threats. Indeed, if this brings about greater strength in the remaining platforms, it should contribute to financial stability ... While electronic trading has brought a range of policy issues to the fore, the associated technological advances may offer routes to solutions ... It seems likely that the direction of resolution of many of the current questions may lie with the technology itself. And likely too that, as with the assimilation of previous technologies, 'electronic trading' will before long cease to be considered as a distinct issue." (**Helen Allen, John Hawkins and Settuya Sato**, respectively, Adviser, Market Infrastructure Division, Bank of England, Senior Economist, BIS, Basel and Head of Special Meetings, BIS, Basel, p. 227)

– *The 'New Economy' in Europe*
"... So far the 'new economy' in Europe is more mirage than reality. Even in the USA there are no clear signs of spillover effects from increased ICT (Information and Telecommunications Technology) investment on the efficiency of the economic process ... While for Europe as a whole most studies show capital deepening with respect to ICT, evidence on TFP (Total Factor Productivity) growth is rather disappointing.... On an aggregated level, it becomes evident that – as in the USA – growth in labour productivity is most vigorous in the ICT-producing sectors, especially in manufacturing, and to a somewhat less pronounced degree in services. Spillover effects are hardly visible ... Having classified the Internet as a GPT (General-Purpose Technology) it is likely that the full-productivity-enhancing effects will be felt only with a significant time lag ..." (**Antje Stobbe**, Head of e-Research, DB Research, Deutsche Bank AG, Frankfurt/Main, p. 332)

– *More on technology in banking*
– *'Something of a paradigm shift'*: "... (Technology) is impacting on the fundamentals of banking business: information, risk analysis, distribution, monitoring and processing. In particular, it enhances management's access to information. Given that banks are ultimately in the 'information business' (**Llewellyn** 1999), anything that impacts on the cost, availability and management of information must have a decisive influence on their business...

Some banking markets (rather than necessarily the banking industry) have become more contestable in that entry and exit barriers have been reducing in significance ... Recent new entrants into banking markets have certain characteristics in common: they tend to be highly focused within a narrow part of the value chain; they have low fixed costs; they have low or zero legacy costs; they have a (sometimes substantial) franchise value in their brand name; they often enter in partnership with incumbent banks; they tend to use technology-based delivery systems; they have low exit barriers and are focused in a narrow product range.

Scale has become less of an entry barrier to the extent that, while technology has increased the economies of scale in processing, many processes can be subcontracted as, with lower fixed costs through sub-contracting, economies of scale can effectively be bought-in from specialist providers of processing services. Scale economies tend to be in bank processes rather than in banks *per se* which means that, if processes can be subcontracted, economies of scale can be secured by firms of varying size.

Developments in technology mean that financial systems are substantially over-supplied with infrastructure and overlapping delivery systems through a duplication of branch networks. Delivery strategies are evolving at two levels: branch networks are being rationalized, and banks are widening the range of delivery options.

Technology is changing optimal organizational structures for financial firms though in different ways for different firms ... The *deconstruction* process (whereby financial products are deconstructed into their component parts: origination, manufacture, administration, processing etc.) focuses on what might be termed *contract banking* which implies financial firms creating internal and external markets for processes. Some processes may optimally be undertaken internally while others are subcontracted ... Contract banking implies a bank offering a full range of services but where the bank coordinates inputs from a wide range of different companies. The core is a contract the bank has with its customers to supply a set of services or products of a particular standard.

... If economies of scale relate predominantly to bank processes rather than institutions, and external contracts can be managed efficiently, the existence of economies of scale does not mean that only large bank can be competitive and survive. What in practice is likely to emerge is a spectrum of different types of bank. At one end of the spectrum will be the traditional fully integrated bank, which, because of the economies of scale in bank processes, will be very large. At the other end of the spectrum will lie the virtual bank. In practice, the majority of banks will lie within the polar boundaries of the spectrum, with some services being provided internally and other outsourced ...” (**David Llewellyn**, cf. supra, pp. 53-54, 55, 56, 59, 60-61, 62, 64)

– *Evidence on the penetration of IT in Spanish banking*

“... Spanish commercial banks tended to increase their IT and communication spending from 1996. In the case of savings banks and credit cooperatives the growth of IT spending began somewhat later and was concentrated in a shorter time period (1998-1999).The differences in the patterns of behaviour of these three kinds of bank seem to be related to the differences in their product specialization and to the existence of a sectoral institution providing services to the institutions on the basis of cooperation agreements ... In the case of the commercial banks, especially the large ones, which have significant activity in the interbank and government debt markets the advent of the single currency (in Stage Three of EMU) required an adaptation effort in these areas, which were those most immediately affected. This type of activity has less weight in the savings bank sector, which is more orientated toward retail banking and was therefore able to adapt more gradually.

... Although the information presented does not enable conclusions to be drawn, it does seem to indicate that, among Spanish commercial banks, there has been a predominant tendency to reduce employment and invest in technology which tends to improve the technical quality of capital, while, among the savings banks and credit cooperatives, the dominant strategy has been to increase more labour-intensive distribution channels, such as the branch network.

... The development of the alternative distribution networks (based on Internet) is not taking place as fast as expected. Despite the advertising drives by institutions more oriented to this business segment, the results are still not very brilliant. The physical presence of the bank with which they operate still dominates the preferences of Spanish bank customers ...

... The application of new systems for risk management and for processing and transmitting data is expected to help improve the soundness of banks. However, during the transition period, a number of uncertainties may arise making greater control by the supervisory authorities necessary in order to ensure the solidity of banks ...” (**Ignacio Fuentes Egusquiza** and **Teresa Sastre de Miguel**, Senior Economists, Servicio de Estudios, Banco de España, pp. 69, 75, 83, 87)

– *Indications on the penetration of remote and direct banking in different groups of consumers in the UK*

"... This group of consumers (i.e. with a consumer behaviour of the relational-dependent type related to lower income and low level of education) prefer branch networks rather than remote delivery channels. This suggests that the least profitable segment of the bank's customer base has a predisposition to use the most expensive delivery channel ... In the group associated with a rational-active behaviour direct and remote delivery channels will increasingly be adopted. This will lead to a situation where fairly affluent and profitable customers are predominantly using the most cost-effective delivery channels. However this group of consumers will pose quite formidable strategic challenges to banks and financial providers. A high propensity to switch, combined with high levels of confidence and involvement, suggest that innovations in delivery channels, value for money products, greater transparency of products, strong brand image, etc. will all be crucial in retaining and generating profitable business from this group of consumers.

Although quite different, both are being driven by developments in remote delivery channels, increased levels of competition and the move towards greater consumer empowerment. These forces of change appear to increase levels of confidence for some customers (i.e. the latter group) and make them more disposed to use remote and direct delivery channels. However, for others (i.e. the former group) an emphasis on technology and consumer empowerment might be reducing confidence levels and making them more disposed to emphasize personal relationships and branch networks..." (**Barry Howcroft**, Professor, Director, Banking Centre, Loughborough University, pp. 106, 107, 108)

– *The impact on employment in the German financial services sector*

"... (In our study) an econometric time series analysis demonstrated that different skill groups have been influenced in different ways by the increasing ICT use in the financial sector. While there is a negative impact on unskilled workers, there are complementarities between high skilled employment and ICT investment. Furthermore, there is a significant negative impact of rising labour costs on the employment of low-qualified employees. For the other skill groups this effect is smaller and insignificant. These results clearly point to an increasing wage differentiation as a suitable measure against layoffs in the low-skilled employment segments. The results of a survey among financial market experts confirm this view: in the coming five years employment in banks and insurance companies is predicted to decrease ... The shift in the skill structure that was observable in the past will continue to prevail...” (**Ralf-Henning Peters** and **Peter Westerheide**, respectively Assistant Professor, Department of Economics, Otto von Guericke University of Magdeburg and Senior Researcher, Centre for European Economic Research, Mannheim, pp. 112-113)

– *More on markets and trading*
– *Network economics effects in wholesale financial markets*: “Network economics effects feature strongly in trading systems and help explain commonly observed features of markets ... In these markets network externalities arise because the value of the network to each participant rises as other participants join ... These positive *network externalities* similarly apply to market liquidity. All other things being equal, it is better to participate in a bigger than a smaller trading network, since each trader brings additional trading opportunities/liquidity ... In the absence of rigidities or other barriers, the presence of these network externalities in a market would imply a *tendency to consolidation* ... However, such consolidation may not occur around an ‘optimal’ system. One reason is *first mover advantage* ... Systems that come to the market later may face formidable hurdles to attract a viable level of participation, even if they offer a better product... These hurdles may mean users feel ‘locked in’ to a dominant system, in which case a *suboptimal equilibrium can be sustained*. However, it is by no means inevitable that dominant market positions will be sustained. Once a critical level of participation (by an alternative system) is achieved, the market *can tip away* from the incumbent and towards the alternative. This switch can be abrupt ...

... Liquidity is essential for trading systems. It enhances the effectiveness of the market overall, reducing costs by narrowing spreads and giving depth such that prices are less affected by particular trades. Electronic systems are developing a number of ways to attract liquidity and seek it out from disparate sources ... Despite the technological and strategic efforts, it is generally those with existing access to order flow (particularly within an existing exchange) that have experienced viable volumes. Few ‘stand-alone’ systems have achieved this. This, however, probably reflects the powerful network effects of liquidity as much as the characteristics of the electronic systems themselves – with liquidity attracting (and ‘locking in’) liquidity ... Nevertheless, in a world of electronic trading, liquidity is much more mobile ...This ‘tipping effect’ was seen when Eurex, within about six months in early 1998, took all the volume in the futures on the ten-year German Bund contract from the previously dominant LIFFE floor.

... Looking across financial markets, it is clear that electronic trading has penetrated different sectors very unevenly ... Existing market structures, regulatory and competitive factors and the varied need of traders have all affected the integration of new technology into mainstream trading. An important element is the asset type, since standardized, homogeneous products have proved ‘easiest’ to migrate to electronic trading.

The contrasting development patterns of equity markets in the USA and Europe show how electronic trading can penetrate the market for the same assets in a very *different* manner. Whereas the US equity market has been characterized by a *proliferation* of alternative electronic trading venues alongside relatively few traditional exchanges, Europe has been notable for the absence of separate systems, with electronic trading instead incorporated *within* its many traditional exchanges. In both markets the common features of the liquidity and relative homogeneity of the major equity issues has made it relatively straightforward and cost-effective to introduce electronic trading ...

While the structure of the foreign exchange market before the introduction of electronic trading was (rather akin to fixed income) a fragmented bilateral telephone market, the rapid adoption of systems in the inter-dealer sphere reflects the liquid, homogeneous nature of the product that can be traded in standardized units. The latter points presumably explain the *earlier* presence of electronic trading in foreign exchange compared to fixed income markets ...” (**Helen Allen**, **John Hawkins** and **Setsuya Sato**, cf. supra, pp. 209-210, 211, 214, 223-224)

– *Stock exchanges*

“With the introduction of computer-based trading and settlement and payment systems with remote access, both benefits, liquidity and low cost of infrastructure do not require an on-site presence any more. Spatial proximity is substituted by virtual proximity on the net ... In principle Electronic Trading Systems allow traders to locate anywhere. However it is to be expected that so-called ‘soft factors’ are keeping them from becoming footloose ... While liquidity and joint use of infrastructure have lost in significance, informational spillovers are moving into the foreground and are increasingly important. This includes informational spillovers within the financial sector (localization effect) as well as between traders – and analysts – and traded firms (urbanization effects). Although the local labour market argument and access to intermediaries have not diminished in importance through virtualization, they do not appear to have increased either. One has to be careful not to underestimate their relevance, although informational spillovers appear to be more prominent ...

Yet the direction of the pull remains unclear. On the one hand there is the pull of localization to the largest agglomeration of traders, i.e. London in Europe. On the other hand, there is the pull of urbanization to local information on traded companies. With these antipodal forces, it is difficult to project where traders will go in the next years, now that stock exchanges have truly become virtual..." (**Vivien Lo** and **Michael H. Grote**, respectively, Research Assistant/Lecturer, Institute for Economic and Social Geography and Lecturer, Institute for Economics, Goethe University Frankfurt/Main, pp. 196, 199-200)

"... With more than 40 independent operators in Europe, the exchanges industry is highly fragmented. Two drivers should lead to a rather rapid consolidation: the pressing demand of the market participants and the (highly IT-intensive) cost structure of the exchanges. Just like a network operator, an exchange has significant infrastructure cost, trading and clearing systems, dissemination and access to many members, but very low marginal costs. The cost of listing one more company or connecting one more member is close to zero. With this cost structure, consolidation creates significant synergies by replacing full IT costs with low marginal ones.

With this goal in mind, consolidation requires bringing national markets together rather than trying to move them to one particular national jurisdiction. Denying the role of the home equity markets is destroying value, especially for the small and mid caps. Technology allows exchanges to serve clients where they are offering them the dimension of a European market. Regulation should not slow down the pace of cross-border consolidation, but it should help exchanges to go in that direction." (**Olivier Lefebvre**, ExecutiveVice-President, Member of the Managing Board, Euronext NV, Brussels, pp. 166, 167, 170)

– *Alternative Trading Systems (ATS)*

"... Two important trends can be distinguished. First, ATS are currently more successful in the USA than in Europe. Second, within the USA there exists an interesting divergence between the impact of ATS on the NASDAQ dealer market and on the NYSE. ATS are attracting about 30 per cent of market share in the NASDAQ market, whereas their impact on the NYSE is rather small. Trading volume on ATS in Europe is currently still marginal compared to the established marketplaces.

Two forces explaining these differences should be distinguished. The first is that European traditional marketplaces were automated earlier than their American counterparts ... ATS are the exponent of automated systems and should therefore be more successful in the USA. Our empirical work shows that automation also has a significant impact on trading costs in Europe, but still less substantial than in an international context. This observation brings us to a second explanation, i.e. the agency nature of trading. European markets are mostly organized as an auction market where traders can submit market and limit orders. ECNs allow investors to trade with each other via a limit order book without the intervention of a dealer. Therefore ECNs are successful in attracting NASDAQ trading volume and are expected to be less successful in competition with the NYSE or European exchanges. Crossing networks are more successful in realizing trades of NYSE listed securities. This leads us to the projection that crossing networks may be a more successful ATS business model in Europe than ECNs ...Crossing networks rely on price discovery at the primary exchange while ECNs actively contribute to the price discovery process ...” (**Hans Degryse** and **Mark Van Achter**, Economics Department, Katholieke Universiteit Leuven (Belgium) in the concluding remarks of their Marjolin Prize-winning contribution to the Colloquium, p. 186)

– *Technology and payments networks*
– *Why are national payment systems different and will they remain so?*
All the major developed countries have created very different retail payment systems. These differences continue to exist, even though all countries have had access to the same payment technologies during the past thirty years ... I would argue that these differences are based on historical coincidences such as the emergence of giro systems in the 1920s. The network nature of many payment systems has caused these differences to persist and at times to increase over the past century. Looking forward, these differences are likely to persist rather than disappear in the short or even the medium term.

Overall these findings have some important implications: 1. Cooperation between players may prevent lock-in into inferior technologies. 2. A pan-European payment network may be further off than most people think. Instead, a continuing patchwork using converters is more likely. 3. If banks or regulators really want pan-European solutions, they will need strong European cooperation platforms to offset the existing national payment organizations. 4. Outside players that want to enter the European payments arena may well be advised to take a country-by-country approach. In spite of a common European currency, for the time being 'one size *will not* fit all'." (**Gottfried Leibbrandt**, McKinsey and Company, Amsterdam, pp. 261, 276)

– *Impact of new technologies in the Norwegian banking industry*
"... The results (for the period 1987-98) show that the elasticity of scale with respect to the share of electronic payments in total non-cash payments has increased as the share of electronic payments has increased. Average variable costs have decreased. The move towards electronic payment systems has affected input demand asymmetric(ally), i.e. non-neutral(ly), causing the cost-shares of both labour, physical capital and materials to increase while the cost-share of funding decreases. The input ratios between labour and both physical capital and materials (including energy) decrease as the share of electronic payments increases. This is consistent with our a priori beliefs; new electronic payment systems have particularly substituted out paper-based and labour-intensive methods." (**Kjersti-Gro Lindquist**, Senior Advisor, Research Department, Central Bank of Norway, Oslo, p. 298)

– *Prospects for e-money*
"... So far, the offline electronic systems have utterly failed to penetrate the payments market. I argue that the obstacles to the success of these systems are due to market structures rather than technological or psychological barriers. These obstacles stem from the essential characteristics of money as (a) a network and (b) a convenience good (wanted not for its own sake but as a way to access other goods and services ...).

The prospects for the development and deployment of e-money systems now look increasingly favourable. The new systems and business models are more effective than previous ones. The payment market has attracted the attention of technology and operators from the TCE industries and some of these have already formed alliances with the credit card companies and the banks. Nevertheless there remain two formidable economic obstacles. The first is the network effect. This means that the promoter faces a large up-front investment cost. It also makes it risky for providers and even individual countries to 'go it alone'. The second obstacle is the oligopolistic nature of the payments industry...

This paper suggests several ways in which the regulator could foster the development of digital money. There is a clear need to ensure open markets; minimize the effect of switching costs; and police the pricing structures of both new and old transaction media ..." (**Peter D. Spencer**, Professor, Economics Department, Birkbeck College, London, pp. 303, 311-312)

– *More on* '*New Economy: reality or mirage?'*

"... To date, economists have not reached agreement about the origin of the relatively rapid growth in productivity in the USA after 1995. One point of discussion is whether the productivity improvement observed is largely a cyclical phenomenon or is of a more lasting nature. According to proponents of the 'New Economy' paradigm, the productivity growth trend has come to lie definitely at a higher level under the impact of new information and communications technologies (ICT).

... However the hefty slowdown in activity in the USA since the end of 2000 has shown that ICT in reality can at the very most mitigate the cyclical volatility surrounding the growth trend ...

Government policy must in the first instance be confined to the elimination of institutional and legislative obstacles so that innovative economic activities can develop to the full ... In addition, the government in the EMU must make extra efforts as regards the support of commercially oriented R&D efforts ... On the demand side of the economy too, the development of new technologies and their impact on economic growth can have a hefty impact. Modern ICT applications are 'knowledge products' *par excellence*... A policy implication of this is that the government may not focus exclusively on promoting innovation in firms, but must also pay attention to strengthening the ICT knowledge and skills among the population ..." (**Johan Van Gompel**, Head of Economic Research, KBC Asset Management, Brussels, pp. 356, 365, 366)

"The availability of the new technologies and inexpensive access for a broad section of the population are not sufficient in themselves to ensure that their enormous economic potential will be developed to the full. The new economy has its own laws and requires more flexibility from market participants. It can therefore only flourish if general national and international conditions allow these requirements to be fulfilled. For this reason, the new economy is more than the reflection of a technological revolution. It highlights the responsibility of economic policymakers to create a framework within which market forces may freely interact and develop. Policies based on the concept of 'Ordnungspolitik' ... are likely, under these circumstances, to come back in their own.

Resistance to such reforms is considerable, especially in Europe... The new economy means more opportunities, but more risks too...

Nevertheless, there is no reason to be excessively pessimistic. In Europe, the radical changes that may lead us beyond the dot.coms are already underway in many areas ...” (**Siegfried Utzig**, Director Economics, Capital Markets, Bundesverband Deutscher Banken, Berlin, pp. 348)

Quid if technology leads to a Cashless Society: a theoretical exploration in monetary economics: “...Innovations in information technologies have improved the prospects for the advent of a cashless society. Although it remains unclear whether the new information technologies will drive out cash completely from the payments system in the foreseeable future, the prospects for such an outcome cannot be excluded either ...

We have analysed how monetary policies will be affected in a cashless society. Our main conclusions are that the central bank will lose its traditional instruments of monetary policy. Standing facilities and open market operations will become ineffective as instruments to control the interest rate and the money stock. This is problematic because in a cashless society where all the money is privately supplied, there is no clear and reliable mechanism that ties down the price level ...

...This leads to two possible avenues for the future role of the central bank. In the first one the central bank becomes very dependent on the Treasury, both as a means of obtaining revenues and as a way of maintaining some effectiveness for its traditional instruments of monetary policies. This road is not without danger because it would imply a return to a system of political dependence of the central banks.

Another avenue consists in redefining the role of the central bank. This consists in strengthening the supervisory role of the monetary authority. This strengthening would include the use of macroeconomic indicators in the control of the quality of the loan portfolios of the money-issuing institutions. It would lead the central bank (supervisor) to design its supervision in a counter-cyclical way. It also implies that the supervision should be expanded to the issuers of e-money...” (Conclusions of **Claudia Costa Storti** and **Paul De Grauwe,** Economist, Banco de Portugal, Lisbon, and Professor Centrum voor Economische Studiën, Katholieke Universiteit Leuven, Belgium respectively, pp. 241, 257)

Colloquium 24: Stability and Efficiency of Financial Markets in Central and Eastern Europe

Tallinn, Estonia, June 2003
In co-operation with the Bank of Estonia
President of SUERF and Chairman of the Colloquium: David T. Llewellyn

Colloquium Book
Editors: Morten Balling, Frank Lierman and Andy Mullineux
Authors: Morten Balling, Dirk Effenberger, Gerhard Fink, Alicia García-Herrero, Christopher J. Green, Peter Haiss, Zsigmond Járai, Vahur Kraft, Tuuli Koivu, Lelo Liive, Hans Christian Mantler, Victor Murinde, Totka Naneva, Nikolay Nenovsky, Ivaylo Nikolov, Luigi Passamonti, Pedro del Rio, Franz Schardax, Mart Sörg, Mariana Tomova, Michel Tison, Janek Uiboupin, Urmas Varblane, Vello Vensel, C Maxwell Watson, Peter Zajc.
Publishers: Routledge, London and New York, forthcoming.

Tallinn 2003: the right topic, the right time, the right place

The road map: transition → convergence → accession → EU membership → EMU membership
"... The efficiency of financial systems is particularly important for Central and Eastern European countries where modern financial systems have been built up almost from scratch over the last ten years. In line with the EU accession process, full integration of Central and Eastern European countries' financial systems to the EMU has increasingly become a priority. The integration and flexibility of financial systems plays an essential role in promoting full convergence and supporting economic stability within the monetary policy framework of the EMU.

... Directly or indirectly, the primary goal of most central banks is price stability ... (But) monetary transmission cannot be efficient if a weak financial system distorts interest signals by increasing margins, or if financial markets have ceased to function for the reason that some of the participants do not trust other players ..." (Q under C24, **Vahur Kraft**, Governor of Bank of Estonia, mimeo)

“Without successful financial sector reform, a fundamental criteria for accession, an economy functioning based on market principles, would not have been met. This has been a major accomplishment. To establish a proper legal and regulatory framework for financial intermediation activities and, within this framework, to have had several hundreds of independent financial institutions mobilize and allocate the nation’s savings in a profitable and sustainable way has been a very significant accomplishment-given initial conditions.

... There are intrinsic limits to how much capital domestic banks can effectively recycle in the local economy given the deposits they can mobilize, the returns available, the intermediation costs to be incurred, the risk profile of potential borrowers, the loan portfolio concentration risk and the equity base that shareholders are prepared to allocate to that particular business in the country...

In the new member countries, much more than in any other EU-15 country, the solution for credit and financial deepening could be found at the level of the EU single financial market- and not within the boundaries of their small financial markets...

It is quite possible that the new member states may become the main beneficiaries of the EU Financial Sector Plan ... EU membership is the platform for a potential leapfrog in financial sector development.

... This is a major exercise. National authorities and the EU will lead it. But it requires the involvement of many players – also, and in particular, of market participants. According to the old City of London adage: *Markets are not created by rules and regulations; they are created by market participants* – in italics in the text ...” (**Luigi Passamonti,** The World Bank, mimeo)

“... Little more than a decade after transition began, the progress that has been made in strengthening the efficiency of the financial sector is impressive – but it gives no grounds for complacency in terms of the path ahead.

Private sector credit, even in economies such as Hungary, Poland and Slovenia, is still only some two-thirds the level typical of banking systems in the EU. With the exception of Hungary and Poland, money markets throughout the region are still relatively narrow. Capital markets remain fairly illiquid- with active equity trading confined to a handful of stocks; private bond markets narrow; and money markets embryonic in most cases. And although banks have been branching out into fee and commission earning activities directly and through their subsidiaries-they remain heavily dependent at this stage on interest income. By EU standards, financial depth typically remains fairly modest-leaving a considerable way to go to ensure that the financial sector functions efficiently and is competitive in the setting of the EU market in financial services ...

... In the period ahead, macroeconomic and financial sector policies will face challenges, as the CEE region remains a magnet for international capital. These flows can accelerate the catch-up in living standard towards those of present EU members, but only if resources are allocated efficiently, and growth is not punctuated by crisis. In these regards, the financial sector has a pivotal role to play ...

The focus must thus remain on initiatives-from non bank supervision to sound fiscal policy-that will allow the sector to contribute fully as policy-makers chart the road to full EU integration..." (**Maxwell Watson,** Wolfson College Oxford, mimeo)

Small Estonia as a success country on the road map
"... Estonia ..., by the late 1990s achieved success through a strictly rule-based macropolicy framework (currency board, balanced budget), a major banking clean-up in the late 1990s-triggered by the Asian and Russian crises; and absolute openness to foreign capital. It is notable that all three (i.e. Estonia, Hungary and Poland) found their different ways to a four-point program that comprised of sound macroeconomics; prudent but comprehensive liberalization; hard budget constraints on firms; and sound basic elements of banking regulation and supervision.The quality and complementarity of these policies, over time ,accounts for their success..." (**Maxwell Watson,** op.cit)

"Estonia has made strong progress to date in developing a privately-owned and market-oriented banking sector and is achieving fairly rapid expansion of the financial sector in general including non-bank financial institutions such as leasing, insurance, investment firms and private pension funds. With substantial influence in recent years from strong Nordic strategic investors, productivity and efficiency of the financial sector is rapidly approaching Western European standards...

The banking sector has been strengthened through the further consolidation behind foreign investors. At the end of 2002, 7 banks were operating in the market (down from 42 banks in 1992 and 11 banks in 1997). Foreign owners own more than 90% of the banking sector capital and 98% of assets...

What else is there to do for Estonia in enhancing the financial markets? There has definitely been a success-story in building up the financial sector and establishing the regulations ... Shall Estonia now only have to maintain its reputation as a country with open and competitive economy and just proceed with integrating the new standards set out by the (European) Commission and international organisations?

It is for sure not the main prospective for us. Capital and financial services activity is, in the global economic market, highly mobile. A balance has to be struck between making an economy friendly and supportive of the financial services sector, on the one hand, and the danger of making a state overindulgent and apparently negligent on the other. In order to attain this we do have a plan to say our word in working out the international standards and in integrating them in Estonian laws.

The regulations must work for the gain of the market place. The new market place for the accession countries is the single market of the whole Europe. That is the perspective to keep in mind. It is time to avoid using regulations to protect national markets and make choices which promote competition and diversify to the benefit of the future European financial markets" (**Lelo Liive**, Deputy Director, Ministry of Finance of Estonia, mimeo)

"The banking sector in Estonia has been among the frontrunners in understanding the opportunities and risks of the internationalisation process. The internationalisation ... has been twofold. At one side foreign banks have intensively entered into the Estonian banking market... At the same time some Estonian banks have tried to enlarge their activities on neighbouring foreign markets..., particularly towards Latvia and Lithuania.Th main reason was the market-seeking argument- the domestic market was very limited by size and competition was heavy. An additional important aspect for entering the Latvian and Lithuanian markets was also the need to serve domestic (Estonian) firms, which moved intensively into these markets since early 1995 ..." (**Mart Sörg, Janek Uiboupin, Urmas Varblane,** all from the University of Tartu, and **Vello Vensel**, Tallinn Technical University, mimeo)

Assessing the role and the performance of the financial sector in transition economies

An ambiguous link between financial sector development and economic growth?

"...Impressive evidence from broad empirical studies indicates that financial sector size and financial sector industry efficiency have an economically important impact on economic growth. Recent work suggests that the degree to which a country's financial architecture is bank-based or securities-based is not necessarily associated with economic growth, whereas the degree to which a country's legal system protects creditor and shareholder rights, enforces law and promotes information disclosure by accounting standards contributes to the development of the financial sector. Looking exclusively at OECD countries, empirical evidence indicates that the correlation of financial indicators and growth is considerably weaker or vanishing. Historical studies for OECD countries detected a strong relation between financial size indicators and economic growth, indicating that especially in early development stages the financial sector has growth-enhancing potential. First evidence for transition countries indicates that growth-enhancing potential lies not so much in financial sector *size* but more in financial sector *efficiency*..." (**Gerhard Fink, Peter Haiss,** and **Hans Christian Mantler,** University of Vienna, on the basis on a systematic literature screening of 11,512 articles between 1997 to 2002, mimeo)

"...We used two variables to measure the level of the banking sector development in 25 transition countries for the period 1993-2001: interest rate margin and the amount of credit allocated to the private sector...The margin between deposit and lending rates describes the efficiency in the banking sector and is closely linked to theoretical models which find that a more efficient banking sector accelerates economic growth by increasing the share of savings allocated to the investments. Our results support the view that an efficient banking sector, where interest rate margins are low accelerates GDP growth.

Our second variable, the amount of bank credit allocated to the private sector production seems to have a more ambiguous effect on economic growth. The higher amount of credit has accelerated simultaneous GDP growth in transition economies but when the amount of credit is lagged with one year the credit seems to have been harmful to economic development. In other words, the loan growth has not been sustainable. This result is different from the results of earlier studies and, according to our view, is related to the special characteristics of transition countries... This result implicates that the development of the financial sector cannot be measured solely by its size, at least in the transition countries. In addition, the countries should not be encouraged to increase the size of the banking sector without first having properly functioning institutions and market structures in place...” (**Tuuli Koivu,** Bank of Finland, Institute for Economies in Transition, mimeo)

“...We analysed technical efficiency of banks in CEE (Central and Eastern Europe – i.e. nine transition economies) and EU (France and Portugal) during the period 1993-2001, using data development analysis DEA) ... and according to two different scenarios: the first is based on the profit-maximizing behavior of banks, while the second is based on the economic growth-generating objectives of the regulatory authorities. On average, banks in transition economies tend to have higher efficiency scores on the first set of objectives and lower performance on the second one.

No matter what measures of performance are used, the technical efficiency of banks in CEE countries in obtaining both sets of objectives was converging to that in the evaluated EU member states in terms of decreasing variability. The greatest decrease in the heterogeneity of banking efficiency in transition countries and between CEE and EU member states could be observed in the year 2000, following the launch of the European Monetary Union.

Despite the trend of decreasing dispersion of performance measures, differences in efficiency levels are still great... (However) banks in the Czech Republic and the Slovak Republic are on average indistinguishable from that in the EU (member states) in terms of ability to obtain commercial banks objectives...” (**Mariana Tomova, Nikolay Nenovsky** and **Totka Naneva,** University for National and World Economy, Bulgarian National Bank and World Bank respectively, mimeo)

Foreign Banks: Friends or Foes?

“... One of the developments characteristic of many CEEC countries is the entrance of foreign banks. Foreign capital has had a positive impact on the financial sector, increasing competition and making it possible to import management culture and professional skills. It is noticeable that no proof of significant negative effects related to the foreign banks entry has been found. It seems that the foreign banks credit policies have been less sensitive to local economic downturns and the entrance of foreign banks has not imported instability in any form...” (**Vahur Kraft,** op.cit.)

"*...Results of the authors' inquiry by questionnaire in Estonia, Lithuania, Poland and Romania:*

- The most important motive for foreign banks are new business opportunities. The expansion strategy was evaluated as the second most important reason...
- Foreign banks have quite different advantages over domestic banks in different countries. In general, reputation of foreign banks was evaluated as the most important advantage, followed by the range and quality of banking innovations. The main advantage of domestic banks is a better knowledge of customers and closer bank-customer relations...
- There are no very significant differences between foreign and domestic banks in the main fields of activities. Corporate financing is the most important field for both domestic and foreign banks...
- Foreign banks' strategies foresee a long-term stay in the Estonian and Romanian banking markets...
- The transfer of various kinds of know-how from foreign banks has been important, especially for risk management...
- Foreign banks' entry increased significantly the overall competition in the banking markets and reduced the profitability and efficiency of operating domestic banks in the host country...
- Long term loans to first class business clients dominated the segments of competitive pressure from foreign banks...
- Foreign banks' entry has improved service quality and innovation in the host country's banking." (**Mart Sörg et al.,** op. cit.)

The dynamics of foreign bank ownership:
"Results (for six CEE countries: Czech Republic, Estonia, Hungary, Poland, Slovakia and Slovenia in the 1995-2000 period) show that foreign bank entry, measured both as the number of foreign banks and as the foreign banks' share in total assets, reduces net interest margin, income and profits, and increases costs of domestic banks. A reduction of the net interest margin and of profits suggests that foreign bank entry enhances competition in the banking sector. A rise in costs may indicate that domestic banks react to new competitors and invest in refocusing their businesses and in introducing new products..." (**Peter Zajc,** Faculty of Economics, University of Ljubljana, Slovenia, mimeo)

"*A dissenting view on the basis of an investigation of economies of scale and scope on 273 foreign and domestic banks located in nine different countries:*

Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland and Romania, for the period 1995-1999:
The paper contests the widespread belief that foreign banks are more efficient than their counterparts... Banks in Central and Eastern Europe are both scale and scope efficient, for the sample period 1995-1999... Foreign banks are not more efficient than the average bank in each of the nine European transition economies. In general the results reject the hypothesis that foreign banks are more efficient than domestic banks in these economies. In addition, the regression results of the system of equations suggest that foreign bank ownership (rather than domestic bank ownership) is not a significant factor in reducing the banks' total costs..." (**Christopher J. Green,** Department of Economics, Loughborough University, **Victor Murinde,** Birmingham Business School, University of Birmingham and Institute for Development Policy and Management, University of Manchester and **Ivaylo Nikolov,** Center for Economic Development, Sofia, Bulgaria, mimeo)

The quest for financial stability

What is the central bank's role in supporting financial stability? – Overview and Estonian practice:
"...Over the past decade we have, once and again, in many countries, witnessed a weak financial system causing a currency crisis that results in capital flight, devaluation and deep recession. This particular threat is especially relevant to fixed exchange rates systems where financial sector assets and liabilities usually tend to have a currency mismatch. Central banks are (also) interested in financial stability as they often have the leading role in crisis resolution by providing emergency assistance and (by) working out restructuring plans.

A central bank's direct responsibilities in maintaining financial stability, apart from its direct supervisory functions, can be divided into three large areas:
– monitoring and analysis of financial system developments,
– designing and building up financial system safety nets,
– often, responsibility for the banking system regulation

The successful fulfilment of the central bank's financial stability supporting functions highly depends on the quality of information and analysis available...The key to vulnerability analysis is successful implementation of, ideally, several analytical tools, including early warning systems and macroprudential analysis. It should ...be noted that creating early warning systems in small countries like Estonia with a highly concentrated banking sector is probably very different from large countries. If you only have 7 individual banks to supervise, close individual monitoring of each bank might be more cost effective than building up a sufficiently sophisticated aggregated system.

...Having in mind the rapidly developing economy and (our) currency board arrangement, we believe that our banking system should have robust liquidity buffers and sufficient capital to withstand the fluctuation of asset prices. Therefore, we have set a relatively high reserve requirement (13 per cent of the banks' liabilities, half of which the banks can hold in high-quality foreign assets)... (As far as regulation is concerned) I would just like to point out that one advantage of being a transition economy has been the possibility to draw the legislation from scratch. This has very much facilitated the compliance with good practices and the *de facto* full adoption of the EU *acquis*. It is important to note, however, that adoption of the *acquis* means not only issuing new legislation but also ensuring compliance with the regulations...

What is a real regulatory challenge for the central bank in our case is the question to what extent should regulatory measures be taken into account in a broader financial policy context. There are arguments for designing the regulations with a view to business cycles, especially as it seems that in the modern world financial systems have become more pro-cyclical than before. In that case, anticipatory measures may pre-empt the possibly devastating effects of asset price volatility and loan losses once the economy starts to cool down. This approach has a particular appeal under the currency board as the active use of monetary measures is excluded and reserve requirements are essentially the only monetary tool. In these circumstances, sound prudential measures have had an important role. Eesti Pank (the Bank of Estonia) increased the capital adequacy ratio with a view to promoting resilience against cyclical risks in 1997 at the onset of Asian contagion, before the peak of the cycle..." (**Vahur Kraft**, op.cit.)

Early warning models

"...The so-called first-generation crisis models, pioneered by Krugman (1979) strongly emphasize economic fundamentals in their explanation of balance of payments/currency crisis...The difficulties of first-generation models in explaining contagion effects and the occurrence of balance of payments crisis in countries with relatively sound fundamentals led to the development of second-generation models .In this approach features of speculative attacks are explicitly incorporated...More recent theoretical work- often referred to as 'generation two and a half' places (again) more weight on the importance of economic fundamentals.

...The results of this study lend support to 'first generation' and 'generation two and a half' crisis models which place a big weight on economic fundamentals in explaining currency crises...

An early warning model was developed using all available quarterly data from twelve transition countries from the beginning of 1989 up to the third quarter 2002. It was shown that a number of indicators (the deviation of the real exchange rate from a trend; the current account; the growth of reserves; the growth of exports; the ratio of M2/reserves; the growth of this ratio; the ratio budget balance/GDP) contain useful information for early warning purposes when evaluated according to a modified signal approach. In this approach, an indicator is understood to issue a signal, if the level of the indicator exceeds a certain threshold. Using a cut-off level for the probability of crisis of 25%, the model proves to perform significantly better than random guesses as well as some comparable early warning models. Overall, the model appears to track developments in individual countries rather well, although the importance of some variables seems to change over time ..." (**Franz Schardax,** Capital Invest, Vienna, Austria)

"A third generation of crisis models was developed in the wake of the Asian crisis. These models stress the importance of microeconomic weaknesses and seek to explain the coexistence of bank and currency crises (twin crises). Here, for the first time, institutions are explicitly considered as major determinants of a currency's vulnerability to crises...

...The study aimed at shed light on the influence of the type and the quality of institutions on the vulnerability of currencies. It was found that above all, the type of exchange rate regime, the quality of the regulatory and supervisory setting and the degree of liberalisation significantly influence the probability of a currency crisis. If all other indicators remain constant, the vulnerability of the CEECs to currency crises is reduced significantly with a currency board or a flexible regime (despite the Bulgarian crisis). The existence of a conventional fixed rate regime or a crawling peg raises the vulnerability. The EBRD indicators of the quality of banking supervision (convergence with BIS or IOSCO standards) prove also to have a significant influence on the probability of currency crises. Finally, the index of economic freedom, published by the Heritage Foundation, proves also to be significant but in a negative sense. This result becomes understandable if the 'degree of liberalisation' is applied to international capital flows. Economies that are closed in this respect are obviously less vulnerable to an outflow of international capital and hence to currency crises.

An early warning system that included these factors provided much better forecast quality than a purely economic benchmark model..." (**Dirk Effenberger,** Deutsche Bank Research, Frankfurt am Main and University of Münster, Germany)

Price stability and financial stability: synergy or trade-off?
"...We look into the role that the design of monetary policy may have in fostering financial stability, in particular the choice of the central bank objectives and the monetary policy strategy. More specifically, we assess empirically whether countries whose central banks focus narrowly on price stability are less prone to financial instability, when accounting for other factors. In the same vein, we test which monetary policy strategy (exchange rate based, money or inflation targeting), if any best contributes to financial stability...We concentrate on banking crises, banks being the major player in most countries' financial system and influence most directly by the central bank... We apply a binary (logit) model to a panel of yearly data for 79 countries (27 industrialised, 32 developing and 20 transition) over the years 1970-1999 (1492 observations) ... We conduct one set of regressions, which can be considered the baseline and three more sets of regressions, as robustness tests.

The study yields evidence that the choice of the central bank objectives significantly influences the probability that a banking crisis may occur. In particular focusing the central bank objectives on price stability reduces the likelihood of a banking crisis, other things given. This result is robust to the definition of banking crisis (only systemic) and to different country groups, except for transition economies.The results for this latter group, however, should be taken with care due to the relatively small number of observations on which they are drawn.

As for the monetary policy strategy, exchange rate targeting appears to be the preferred option in terms of financial stability when all types of banking crises are considered (systemic or not) and for the group of transition countries, but not for industrial and emerging countries. This finding would support the choice of relatively fixed exchange regimes in countries in transition as far as financial stability is concerned while not necessarily for other country groups (i.e. a partly different conclusion from that of Effenberger for currency crises). ... Finally locating regulatory and supervisory responsibilities at the central bank reduces the likelihood of a banking crisis in all the model specifications where this variable has been included...” (**Alicia García Herrero and Pedro del Rio,** Banco de España, Madrid, in their Marjolin Prize-winning contribution to the Colloquium, mimeo)

A legal note: should the prudential supervisor be (regulatorily) immune?
“In a EU perspective the issue of supervisory liability still is ‘under construction’ and different orientations have been identified: on the one hand, individual member states increasingly tend to limit supervisory liability through statutory immunity regimes, thereby supported by the Basle Committee’s Core Principles. On the other hand, depositors more and more put pressure on national courts by relying on EU law as legal foundation for supervisory liability in order to circumvent limitations originating in member states’ law. We have argued that allowing *Francovich*[4]-liability in the field of prudential supervision allows to strike a fair balance between the legitimate expectations from depositors in the quality of supervision and the risk of systematically shifting the cost of banking failures to government

With the problem of accession in 2004 the discussions about supervisory liability will increasingly influence most of the CEECs as well. As CEECs have incorporated the *acquis communautaire* into their national laws, or are in the process to do so, most of them already at present operate under similar prudential standards as the EU member states. However, building a stable and sound banking system requires more than simply ‘transplanting’ the legal rules. It also requires the setting up of well staffed supervisory agencies which can effectively ensure high quality supervision...” (**Michel Tison,** Financial Law Institute, Ghent University, Belgium)

[4] In its judgment in the *Francovich* and *Bonifaci* cases (19.11.1991) the European Court of Justice held that a member state could be held liable for non fulfilment of its obligations under EU law and that this liability could be legally based on EU law, not on the law of individual member states. Since the obligation to exercise prudential supervision and the minimum requirements attach to it are determined by the various EU banking directives, it could be argued that shortcomings in the exercise of prudential supervision constitute a breach of the member states’ obligations under the EU directives and therefore could form the legal foundation for a liability claim directed against the member state for the acts or omissions of its supervisory authority. However, according to the Court’s case a number of conditions must be satisfied in order to establish *Francovich*-liability.

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