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Editorial

Ladies and gentleman,
dear friends of the House of Finance,

There is a growing number of signs all over the world that we have seen low point of the economic and financial crisis.

However, the fact that certain economic indicators are starting to point upwards again does not solve the problems which have resulted from the crisis such as rising unemployment or larger government debt due to the cost of rescue packages. Nor does it eliminate the causes which led to this crisis of the system. A crisis of this kind must not be allowed to repeat itself. Legislators, supervisory authorities, financial market participants and academics all have their part to play in this.

The European Council, the G8 and the G20 have each made it clear at their respective meetings that one of the key elements in bringing about greater stability on the financial markets is regulating these markets more efficiently and monitoring them more thoroughly. This is not motivated by governments wishing for an ever greater degree of bureaucracy. Reason teaches that self-organisation should always take precedence over legislation wherever possible; the state should instead concentrate on ensuring favourable conditions, defining minimum standards and checking that these are being adhered to. However, the crisis has revealed in dramatic fashion that this has all too often not been the case in the past. The trading of high-risk derivatives throughout the financial system, the deficient rating processes and the descent of large financial institutions towards the point of collapse are due to much more than malpractice on the part of individual market participants. They reveal failings in the architecture of the financial markets. It is therefore up to politics to make structural improvements to these markets.

One of the fundamental requirements of a system to regulate the financial markets in the future is greater transparency. There must be a basic assurance that all participants dealing with any kind of product on any marketplace are visible on the radar of the regulators. There must no longer be any unlegislated areas to retreat to – and above all no states which provide such retreats. This may profoundly alter the map of the financial markets over the coming decades. There is no doubt, however, that a great deal of money will still be made through financial services of all kinds in the future – and that these services will make a significant contribution both to value creation and to the prosperity of the global population.

For a financial marketplace such as Frankfurt, it is only a small consolation that the systems of regulation in place here and the way the German Banking Act has been devised did not allow the kind of excrescences which have appeared elsewhere. This certainly does not mean that Germany made all the right decisions prior to and in the course of the crisis – and besides, we are affected by the consequences on an international level. Yet it does illustrate the fact that regulatory systems can bring extremely effective results. In this respect, we have reason to hope that some expertise from Frankfurt will also be called upon in the task of restoring stability to the financial markets.

I am pleased that the House of Finance has developed, in the few months since it was founded, into a centre for scientific analysis and a platform for exchanging opinions and ideas which is valued on the international stage.

The current edition of this newsletter also plays a part in this exchange.

Yours sincerely,

Roland Koch
Minister-President of Hesse

FLEXIBLE WORK, RETIREMENT AGES, *and* INVESTMENT-LINKED INCOME *for the Elderly*

Jingjing Chai

Wolfram Horneff

Prof. Raimond Maurer • Goethe University School for Economics and Business Administration

Prof. Olivia S. Mitchell • Wharton School, University of Pennsylvania

The best case scenario for older workers is to let them decide when to wind down their work efforts and to include payout annuities in their financial picture. This gives them the flexibility to retire earlier and to participate more vigorously in investment markets during their lifetimes. This is a key conclusion of recent work by House of Finance researchers Jingjing Chai, Wolfram Horneff and Raimond Maurer, and Olivia S. Mitchell of the University of Pennsylvania's Wharton School.

Earlier retirement becomes more attractive when workers have both Social Security benefits and investment-linked annuity payments on which they can rely in their old age, the researchers assert. Using a realistically calibrated model with uncertain lifetime labor income and capital market returns, the authors extend the investment universe under analysis to include not only stocks and bonds, but also survival-contingent payout annuities. The paper derives optimal life cycle portfolio asset allocations, consumption and saving rates and annuity purchase trajectories for a consumer who can select her own hours of work and also her retirement age.

Retirement Scenarios

The authors compare four scenarios: (1) a moderately risk-averse worker who chooses her desired consumption, savings and investment portfolio given a fixed work week, a fixed retirement age of 65 years, and no access to annuity markets; (2) a worker who selects her consumption, investment and labor supply, given a fixed work week but a flexible retirement age (of between 62 and 70 years); (3) a worker who can also determine her work intensity, by up to a maximum of 75 working hours per week; (4) a worker able to not only select her work intensity and retirement age, but who can also buy investment-linked payout annuities as well as stocks and bonds. An economic analysis of all these retirement/investment scenarios shows that people with both a flexible retirement age and flexible work hours, in addition to annuitized saving, are much better off than those without. This gain in well-being is substantial, worth 7% of lifetime utility, or more than 62% of the worker’s first-year earnings (see figure).

Model Fits Observed Behavior

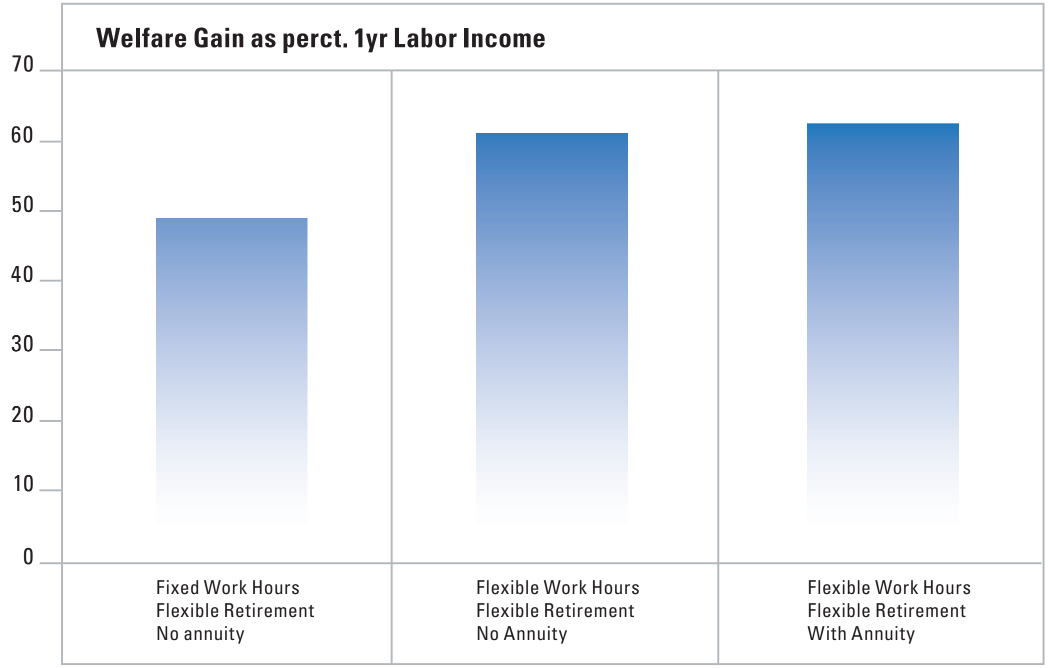
Prior studies have usually assumed that the retirement age is set exogenously; they also predict that older people will hold unrealistically high levels of equity. Using the parameters of previous studies, the authors note that these analyses also imply that older people will not participate in the capital market at all; a result which is incompatible with evidence from the real world. By contrast, allowing the labor supply to be flexible substantially increases work efforts by the young and allows older people to hold more equities. Introducing annuities then permits still earlier retirement and higher market participation by older households. Finally, the fact that a preference for leisure depends on age is not only sensible but also fits observed behavior remarkably well, th authors observe. In this case, work hours and equity holdings are predicted to gradually decline at higher ages - this also generates a sensible dispersion of retirement ages, with a peak of 62 years, as consistent with the evidence.

Investment-Linked Payout Strategies for the Payout Phase

The researchers predict that as "baby boomers" move towards retirement, traditional fixed-payout annuities will gradually be replaced by investment-linked payout tactics for the payout phase. "Evidently, combining work, investment, and lifetime payouts offers better and more attractive ways to manage life's many challenges," they note. "In sum, the benefit from having access to annuities is positive and important in the life cycle context, as is labor market flexibility in the form of adjustable weekly work hours and retirement ages."

Maurer is a Professor and Chair of Investment and Finance at the Goethe University School for Economics and Business Administration in Frankfurt, where Chai is also a doctoral student; Mitchell is a Professor and Chair of Insurance and Risk Management at the Wharton School of the University of Pennsylvania.

This article is available at:
http://www.nber.org/papers/w15079 or http://www.pensionresearchcouncil.org/



Note: *This bar chart reports lifetime utility gains computed with reference to a worker with both fixed work hours and retirement age, and lacking access to annuity markets.*
Reported is the fraction of the first year of labor income he would have to give up in exchange for the additional lifetime flexibility that would make him indifferent relative to the reference case.

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Road towards a Pan-European Insurance Contract Law Regime?

With the Principles of European Insurance Contract Law (PEICL) continuously nearing completion, the question arises how they will be implemented, and if and how the insurance industry will make use of them.

While the European Community has laid the groundwork for all European industries to share in the Single Market, insurance undertakings are still reluctant to cross-border market their services. In this respect, insurers only avail themselves of the freedom of establishment, as laid down in article 43 of the EC Treaty, by founding subsidiaries or branch offices in the respective Member States. However, as statistics show, there is a shortcoming, if not to say a failure, of providing cross-border services in all of Europe, and thus of profiting from the free movement of services as established in article 49 of the EC Treaty.

Obstacles to Cross Border Distribution

This failure is not due to negligence by marketing managers of large insurance undertakings, but rather mainly caused by the particular nature of insurance itself. With some exaggeration, one could say that insurance, being a "legal product", can only exist within the legislative framework provided by the mandatory rules to which it is subject. Hence an insurer would only be able to export its products if it were at the same time able to opt for the application of the law of its home state. This is, however, not possible for all insurance products. Quite to the contrary, for most mass insurance products, the private international law of all European legal systems mandatorily requires the insurance contract to be submitted to the law of the policyholder's habitual residence. If an insurer were keen to market an insurance product in all Member States it would, thus, be forced to develop the product in accordance with the mandatory rules of 27 legal systems. Considering the diversity of legal regimes concerning insurance contracts, such a course of action would be utterly impossible.

The Emergence of a new Insurance Law Regime

In 1999 a group of scholastic insurance law experts, out of their own initiative, set out to remedy this discerned deficit of the insurance sector. The goal of this Restatement Group of European Insurance Contract Law, the so-called "Project Group", was to reveal such features common to the majority of all European legal systems, and from this common ground (one could also say from this acquis communautaire), develop a restatement of law. The work of the Project Group soon caught the European Commission's interest and it was included into a project intended to elaborate the so-called "Common Frame of Reference of Contract Law" (CFR). In fact, the insurance contract will be one of only two contract types to be specifically treated in the CFR – the other being the sales contract – as the drafters of the CFR will, for the rest, confine themselves to outlining the general principles of contract law. A year ago, the Project Group presented the European Commission a part of the PEICL, containing those provisions applicable to all insurance contracts, as a draft of the general part of the CFR for insurance contracts. Since then, the Project Group has been working on special parts dealing with indemnity insurances, insurances of a fixed sum and specific branches of insurance (e.g. life insurance).

As for the general part already submitted to the scrutiny of the European Commission, it bears close resemblance to the rules of the reformed German Insurance Contract Act, with both aiming to achieve an acceptable compromise between the interests of the insurer, of the collective of policyholders and of the individual policyholder. The PEICL have, basically, a bifocal aim. On the one hand they are to serve as a model law to all Member States and invite them to adapt their national regime to the rules common to the majority of Member States. On the other hand, they are to provide the European legislator with a body of text suitable for enactment as something like a European Insurance Contract Code. Furthermore, the PEICL, as the CFR for insurance contracts, may become an important instrument for the European Court of Justice and national courts in the interpretation of the existing *acquis communautaire.*

Alternative Methods of Implementation

To address the individual rules of the CFR would go beyond the scope of this article. One important feature of the PEICL, however, is that all provisions are either mandatory or at least semi-mandatory, meaning that the insurance contract may only deviate from them to


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the advantage of the policyholder. An important question remains as to in which legal form the European Community will pass the PEICL into law, once all work is achieved. The Commission has already insinuated that it plans to enact the PEICL in the form of an "optional instrument". The exact meaning of this is open for suggestions, as neither the treaty currently in force, the Nice Treaty, nor the Lisbon Treaty mentions such an instrument. It is the authors' assessment that the EC will choose the form of a regulation which will, however, contain an opt-in clause so that it will only apply if both contractual parties agree on the application of the PEICL as the law for their insurance contract. In such a way, the PEICL would be turned into the 28th law regime.

Such a course of action would respect Member States' and national insurance industries' interest to safeguard national insurance law and, in this way, not force insurers to change their business models to accommodate a new law. At the same time, insurers would be enabled to create under the PEICL certain everyday products – which they regard as viable for pan-European distribution. While full-harmonization is insofar not on the horizon for the insurance sector, the PEICL could offer a tremendous opportunity for insurers to attain an easier access to new markets within the EU.

For a detailed overview of the Principles of European Insurance Contract Law:
Basedow, J. et al. (ed.) (2009), *"Principles of European Insurance Contract Law (PEICL)"*, Munich.
This article is available at:
http://www.uibk.ac.at/zivilrecht/restatement/

TABLE 1: Pros and Cons of Pan-European Insurance Products

PROBLEMS Hindering Pan-European Insurance Products	ADVANTAGES of Pan-European Insurance Products
• Different mandatory law in all European legislations • Interdiction to choose other law than that of the policyholders' home state • Diverging risk profiles • Different tax and liability law • Socioeconomic systems and expectations toward a certain product may differ • Principles of risk assessment and tariff classification would have to be altered accordingly	• Cost-cutting as no new product must be tailored for every market • Streamlining of company as subsidiaries with specific local knowledge may be superfluous for certain products • Opportunity to easily enter a market in order to create name recognition • Policyholder enabled *"to take his insurance with him"* if he moves to another Member State
PRODUCTS FOR WHICH PAN-EUROPEAN DISTRIBUTION SEEMS FEASIBLE	
• Standardized products for which individual risk assessment is irrelevant (distribution possibly by way of direct marketing) • Annex insurances (insurance policies that are attached to a product) • Insurance of *"euro-mobile"* policyholders (i.e. Europeans that habitually move from one Member State to another) • Insurance of policyholders living *"across the border"* (as risk and socioeconomic situation will often be quite comparable in border zone areas for a Member State and any neighboring state) • Obligatory insurance already harmonized by Community law (e.g. third party liability insurance; professional liability insurance)	

TABLE 2: Alternatives for Implementing the PEICL

FULL HARMONIZATION • PROBLEMS:
- Missing political consensus
- High costs for insurers to adapt their business model to new law
- Insurance law should take into consideration socioeconomic realities which differ in the Member States

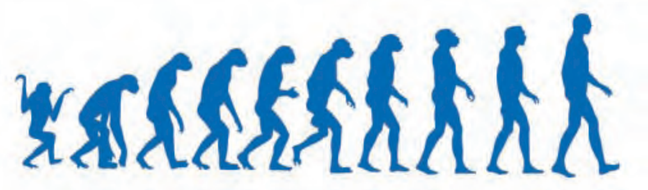
NON-BINDING (SOFT LAW) • PROBLEMS:
- Would in most cases not enable submittal of the insurance to the legal regime of the PEICL (law of the policyholders' state remains applicable)
- Concept of PEICL for insurance contracts (i.e. mandatory rules) could not be achieved

PEICL

OPT-OUT SOLUTION • PROBLEMS:
- As the PEICL would be applicable unless the parties opted for another law, there is a high potential for "surprises"
- PEICL would become the default rule, which seems questionable, as a large majority of products are better dealt with by the national legislator
- Possible violation of the principle of subsidiarity

OPT-IN SOLUTION • ADVANTAGES:
- Respects principle of subsidiarity by leaving national insurance law unaffected
- Respects party autonomy and grants opportunity for cross-border sales
- Low costs for insurers as every undertaking may decide whether to "tailor" a product to suit the PEICL or not

The fiscal stimulus debate:



"Boneheaded" and "Neanderthal"?

By Prof. Volker Wieland

and Tobias Cwik

US economic advisors have called for aggressive fiscal stimulus, and some support further measures. But many macroeconomists are not so sure. This column analyzes fiscal stimulus using a New Keynesian model that exemplifies contemporary academic thinking on the subject. It says that the spending multiplier is much lower than the Obama administration's estimates – government spending may quickly crowd out private consumption and investment.

Not long ago, Paul Krugman warned European governments that:
"We're rapidly heading toward a world in which monetary policy has little or no traction… Fiscal policy is all that's left… if Germany prevents an effective European response, this adds significantly to the severity of the global downturn. … in short, there's a huge multiplier effect at work; unfortunately, what it's doing is multiplying the impact of the current German government's boneheadedness."

Financial Times columnist Martin Wolf, taking a look at the US and Japan (Financial Times, 17 Feb 2009), asserted similarly:
"The bad news is that the debate over fiscal policy in the US seems even more Neanderthal than in Japan: it cannot be stressed too strongly that in a balance-sheet deflation, with zero official interest rates, fiscal policy is all we have."

This urgent, almost desperate, call for aggressive fiscal stimulus was reinforced by the economic analysis of President Obama's advisors Christina Romer and Jared Bernstein, which underscored the power of discretionary fiscal policy. In a paper circulated in January 2009, Romer and Bernstein provide numerical estimates of the impact of an increase in government spending on US GDP and employment. Such estimates are a crucial input for the policymaking process. They help determine the appropriate size and timing of countercyclical fiscal policy packages, and they inform parliaments and their constituents about whether a vote for a policy is appropriate.

Romer and Bernstein make use of two macroeconomic models – one from the staff of the Federal Reserve Board and the other from an unnamed private forecasting firm. Averaging the impacts obtained from these two models, they estimate that increasing government spending permanently by an amount equal to 1% of GDP would induce an increase in GDP of 1.6% above what it would have been otherwise. They conclude that a package similar in size to the American Recovery and Re-investment Act passed in February 2009 would raise GDP by 3% to 4% and create 3 to 4 million additional jobs by the end of 2010.

Stimulus doubts

Nevertheless, many macroeconomists still admit to substantial uncertainty about the quantitative effects of fiscal policy. This uncertainty derives not only from the empirical estimates of model parameters and shocks, but also from different views on the appropriate theoretical framework and empirical method. In light of such model uncertainty, it is crucial to evaluate the robustness of particular policy proposals in different models with different assumptions. Cogan, Cwik, Taylor, and Wieland (2009) conduct such a robustness analysis with New Keynesian macroeconomic models. Nowadays such models are used by many central banks and international institutions. We report findings from two models, Taylor (1993) and Smets and Wouters (2007), but focus more on the latter model, which has been described as representative of the current New Keynesian macroeconomic thinking (see Woodford 2009).

Unfortunately, we find substantially smaller government spending multipliers than those used by Romer and Bernstein. For example, the multiplier associated with a permanent increase in government spending by the end of 2010 lies between 0.5 and 0.6. In other words, government spending does not induce additional private spending but, instead, quickly crowds out private consumption and investment.

We also provide an assessment of the impact of the American Recovery and Re-investment Act. This legislation implies measures amounting to $787 billion and spread over 2009 to 2013, but peaking in 2010. Our estimate of the total impact is closer to 1/6 of the effect estimated by Romer and Bernstein. By 2010 we project output to be about 0.65% higher. Using the same rule of thumb as Romer and Bernstein, this increase in GDP would translate to about 600,000 additional jobs rather than three to four million.

Why is our assessment of government spending multipliers so different? Well, first of all, Romer and Bernstein constrain the Fed to keep interests rates constant at zero forever.
Such an interest rate peg would lead to explosive behavior and instability in New Keynesian models. Instead, we allow the Fed to raise rates eventually, starting in 2011, or more realistically, in 2010. Committing to 1 or 2 years of zero interest rates still implies much additional monetary stimulus. Furthermore, people out there worry about the future. Thus, the models we use take into account that forward-looking households and firms will modify their expectations and change their behavior in response to the new fiscal policy measures.
Finally, at least some people out there realize that higher government spending and debt today ultimately require raising more taxes in the future. Such households will consume less today. This negative wealth effect is particularly strong in the Smets and Wouters analysis. The model by Taylor implicitly allows for the presence of some consumers who consume all of their current income.

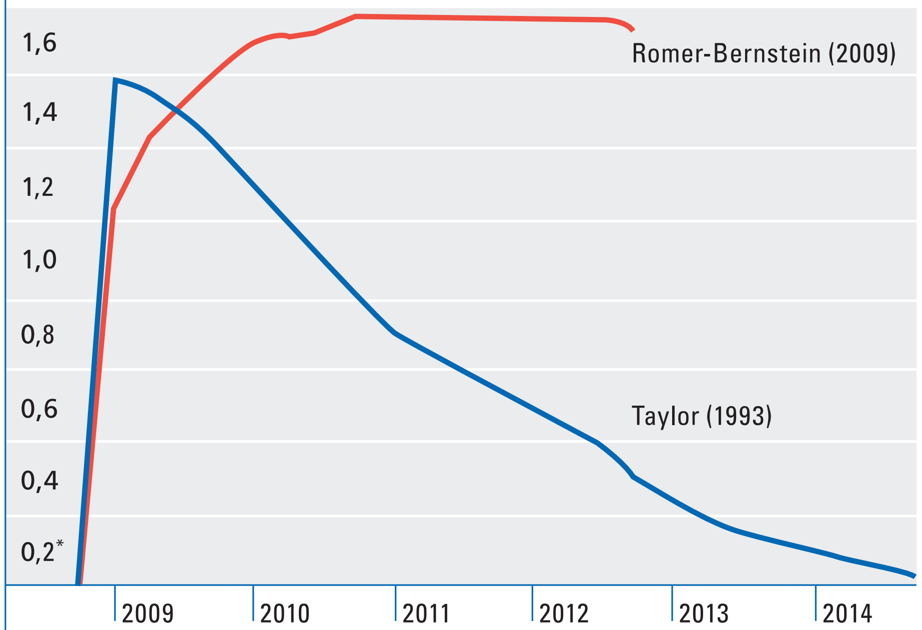
Fiscal policy focus

In light of these findings, European policy makers are well-advised to question the usefulness of further stimulus packages. They ought to carefully monitor the impact of decisions already taken on the burden imposed on future taxpayers. The available funds and remaining borrowing capacity should be utilized where it is still most needed – to prevent a collapse of the financial system and finance the necessary recapitalizations and toxic asset removals. If governments exhaust their fiscal space in measures that have little aggregate effect, they will instead stimulate skepticism of their capability to back up the financial system. Thus, it remains crucial to focus fiscal efforts on the financial front.

What else can be done? Monetary policy is still an option. Sure, nominal interest rates cannot decline below zero. This is a serious constraint on conventional interest rate policy. However, monetary expansion remains feasible, and increasing the relative supply of base money to other assets will lower its value. In other words, the central bank can stimulate inflation and reduce real interest rates by means of quantitative easing, if necessary (see Orphanides and Wieland 2000).

This article is available at:
http://www.volkerwieland.com/docs/Cwik_Wieland_EU_Stimulus_090722.pdf

Estimated Impact on GDP of a Permanent Increase in Government Purchases of 1 percent of GDP



*Percent Change

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Interview

„The House of Finance – a Lighthouse Project for Goethe University"

Goethe University Vice President, Prof. Rainer Klump, is responsible for the faculties of Law, Economics and Business Administration, Sociology, and Political Science, and also holds the chair for Economic Development and Integration in Economics. Moreover, he is a member of the university's interdisciplinary cluster of excellence for Normative Orders.

"The horse power stemming from the multidimensional integration of: various disciplines, publicly and privately funded academic work, top quality research, knowledge transfer into practice, and advanced education – really a truly challenging endeavor – must be exerted on the street."

Newsletter: *What significance does the House of Finance (HoF) have for Goethe University?*

Prof. Rainer Klump: Centrally located in our new main Westend campus, the HoF concentrates 30 chairs performing research and education in the broad area of finance – comprising the departments of Finance, Money, and Macroeconomics from the university's Faculty of Economics and Business Administration, as well as the department of Corporate and Financial Law from the Faculty of Law. These are complemented by selected chairs from Computer Science and Mathematics, which also act as a bridge to quantitative faculties in the university as a whole.

This lively intellectual kernel is substantially extended by a set of institutes renowned in the field of finance that are also housed in the HoF. Altogether, there are 150 researchers forming a truly unique interdisciplinary center of competence; one that is a lighthouse project for Goethe University and which disseminates information to academics as well as the banking and financial community in Frankfurt, in Germany, and beyond.

Newsletter: *How is HoF cooperation with the banking and financial services community organized?*

Prof. Rainer Klump: This business community helps us substantially to reach our ambitious goals – not only in terms of conducting top quality research but also in terms of providing premium advanced education. And we are very thankful for that. We already talked about the gap-bridging function of interdisciplinary research. We have also succeeded in bridging the gap between academia, business practice, and the spheres of politicians and public administrators. Examples of such knowledge transfer include: a convention for business journalists; a Bundesbank conference on financial market regulation conducted jointly with the Austrian National Bank and Germany's Federal Financial Supervisory Authority (BaFin); and workshops with our sponsoring corporations.

Newsletter: *The Graduate School of Economics, Finance, and Management (GSEFM) is a cornerstone of the HoF. What role does this have?*

Prof. Rainer Klump: Top quality research is generated when doctoral students are intensively educated in the latest methodological developments, which takes place under structured doctoral programs. The GSEFM integrates several structured doctoral programs in the HoF – again, with the goal of building bridges. For example, the Ph.D. Program in Law and Economics of Money and Finance is the first of its kind worldwide. Moreover, we run GSEFM together with the Johannes Gutenberg University in Mainz, thus even bridging the gap between universities in order to increase the quality of the education and supervision that we provide to our doctoral candidates. And the results show that this approach has been effective – the HoF now houses 180 doctoral students. This is a tremendous success.

INSTITUTE FOR LAW AND FINANCE
Goethe-Universität Frankfurt am Main

The Institute for Law and Finance (ILF) is actively involved in academic teaching and research, and has played a supportive role as a policy center since its establishment as a public-private partnership in 2002.

The ILF provides interdisciplinary training to lawyers, senior managers and business executives in Germany and worldwide. It also serves as a forum for discussions and exchanges between academia and practitioners. This, together with its extensive research work, ensures the ILF makes an impact on the legislative process.

Teaching

The ILF offers an interdisciplinary Master of Laws program – LL.M. Finance – to well-qualified law, business, or economics graduates in Germany and abroad. Courses in this highly specialized program are conducted entirely in the English language.

Our faculty consists of both prominent academics and practitioners, including law and economics professors from Goethe University Frankfurt with an impressive international experience and partners from major international law firms. Guest professors from abroad, experts from central and commercial banks, regulatory bodies and auditing companies are also here to transfer their knowledge and expertize to our students. An excellent faculty-student ratio of 65 to 45 ensures small classes and closer direct contact between the faculty and students. In addition, all our students have the opportunity to apply the knowledge acquired during this program (and also of making professional contacts) by doing 6- to 8-week internships with our sponsors. Furthermore, the ILF has cooperation agreements for student exchanges with Columbia Law School in the U.S., the Aarhus School of Business in Denmark, and the Amsterdam Business School in the Netherlands.

We are proud of our alumni community which is now 220 members strong and growing. Many of our graduates have found jobs in law firms, banks, consulting firms, as well as ministries of finance and justice all over the world. Since 2008, together with the universities of Deusto, Tilburg and Strasbourg, the ILF also offers a European Master's in Transnational Trade Law and Finance. This is an Erasmus Mundus program which is financially supported by the European Commission. Every year, the ILF offers special 2-week spring and summer schools. Here, experts from law firms and banks on the long list of ILF sponsors provide an intensive insight into the practical issues involved in banking, capital market and company law to about 40 pre-selected legal trainees.

Research and Policy Center

The ILF assists in the process during which important legislative changes are made to company, banking and capital market laws by ensuring that such changes are well-scrutinised and discussed. To this end, the ILF has its own series of working papers and regularly organizes guest lectures, conferences and podium discussions on current topics. Speakers include university professors from Germany and abroad as well as representatives from regulatory bodies, corporations, non-governmental organizations, and legal firms.

Members of the public are cordially invited to attend all ILF guest lectures which are held on a regular basis at the House of Finance.

For further information, please visit our website:
www.ilf-frankfurt.de

Graduation – celebrating after studying hard doing the program!

Selected House of Finance Publications

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Research outside the House of Finance

"When is the government spending multiplier large?"

Lawrence Christiano and **Martin Eichenbaum**, Northwestern University, Illinois,
and **Sergio Rebelo**, Kellogg School of Management, Illinois.

The current financial crisis and the ensuing economic downturn have not only seen extraordinary measures of monetary easing by all major central banks, but also extraordinary measures by fiscal authorities to stimulate the economy.

As discussed by Tobias Cwik and Volker Wieland in this newsletter, support from fiscal policy comes in three forms: bank rescues, the "automatic fiscal stabilizers" mostly due to declining tax liabilities, and discretionary stimulus packages. Like the article by Cwik and Wieland , the paper by Christiano, Eichenbaum and Rebelo (henceforth CER) is concerned with the effects of the stimulus packages. The first part of the CER paper is a very clear exposition of the various features of the standard new-Keynesian economic model that determine the size of the initial impact of an increase in government spending on real GDP, the so-called "spending multiplier". Like Cwik and Wieland, they find that the impact multiplier is, under plausible assumptions, always less than 1.2, and often below 1, and that the effects of a temporary increase in government spending disappear fairly quickly. Their results highlight the importance of the central bank's response to the spending increase, thus directing attention to the importance of the coordination between the monetary and fiscal authorities for the overall effectiveness of the fiscal stimulus.

The main focus of CER, however, is one case in which the government spending multiplier can be much larger. That is, when nominal interest rates are at their lower bound of zero and deflation has set in and is expected to continue. In this case, CER argue that government spending can make a huge difference, as it has the power to break a deflationary spiral. CER trace this result back to Keynes, who called it the "paradox of thrift" - when the nominal interest rate is at zero, deflation pushes up the real interest rate, thereby worsening any existing surplus of private saving over private investment. In the absence of government intervention, the only way to restore the saving-investment balance is for output to fall a long way. In this situation, CER show that government spending can increase output by a factor of four or more.

CER's finding that the multiplier can be large rest importantly on two assumptions: That people believe in deflation spiraling out of control, and that the central bank cannot prove these expectations wrong, no matter how much money it prints. Both these assumptions seem rather unlikely to be relevant in the euro area today. More likely, the most relevant aspect of monetary-fiscal policy coordination even today is to avoid the risk of unsustainable public finances, which would limit the room for maneuver for the central bank.

Prof. Thomas Laubach, Ph.D., Goethe University Frankfurt

The full article is available at:
http://faculty.wcas.northwestern.edu/~yona/research/Multiplier-version12.pdf

Research Paper: Competition for Order Flow and Smart Order Routing Systems

Albert Menkveld, VU University Amsterdam and **Thierry Foucault**, HEC School of Management, Paris.

In European equity trading, market fragmentation is currently triggered by the emergence and relevant market share gains of new execution venues like BATS, Chi-X, Turquoise or Equiduct. Although institutional investors can benefit from this increased competition, their trading can suffer from the fragmentation of liquidity that comes along with new execution venues. Based on the entry of the London Stock Exchange (LSE) to the Dutch equity market the authors analyze potential effects of market fragmentation empirically as well as theoretically.

Their results are twofold: First, they show that fragmentation of order flow can enhance liquidity supply as the consolidated limit order book is deeper after the entry of the LSE. Second, they outline the importance of protecting limit orders from violations of price priority which might happen in fragmented markets and which could lead to trade-throughs, i.e. transactions occuring at a price that is higher than the best posted offer or lower than the best posted bid while orders at these better prices are not included in the transaction.

Prof. Peter Gomber, E-Finance Lab, Frankfurt

The full article is available at:
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1140795

The Deutsche Bank Prize in Financial Economics 2009

On Wednesday, September 30, 2009, the Center for Financial Studies, in partnership with Goethe University Frankfurt, will awards the DB Prize for 2009 to Robert J. Shiller for his contributions to the field of financial economics. Josef Ackermann (Deutsche Bank Group) will be presenting thise award to Professor Robert Shiller. The laudatio will be given by **Karl Case** *(Wellesley College)*, the co-developer author of the widely used of the Case-Shiller Home Price Index widely used for the United States. A special The symposium – 'Financial Innovation and Economic Crisis'– in honor of Professor Robert Shiller will then take place at Campus Westend at 12:00. on Wednesday, September 30, 2009, 12:00 pm. Among the numerous speakers will be Nobel laureate **Robert C. Merton** *(Harvard University and Nobel Laureate)*, **Nicholas Barberis** *(Yale University)* and **Luis M. Viceira** *(Harvard University)*.

For further details please visit: www.db-prize-financialeconomics.org

Prof. Wandt heads Institute for Law and Finance

As of the winter semester, Prof. Manfred Wandt (Institut für Versicherungsrecht) will become Director of the Institute for Law and Finance and Dean of the Law faculty at Goethe University.

"Introduction to Law and Economics" Summer School

The "Introduction to Law and Economics" Summer School held from August 24 till August 28 provided participants with a first insight into an interdisciplinary study of this subject, giving them a fl avor of what this involves, as well as current topics of interest. The Summer School's program directors, Professors Brigitte Haar and Uwe Walz, were very pleased to welcome two world-renowned scholars of law and economics as guest lecturers, namely **Prof. John Drobak**, **George Alexander Madill** Professor of Law at Washington University in St. Louis, Missouri, and **Prof. Benito Arruñada**, Professor of Business Organization at Pompeu Fabra University in Barcelona.

Prof. Fuchs-Schündeln Joins the House of Finance

Nicola Fuchs-Schündeln was appointed Professor of Macroeconomics and Development and joined Goethe University's Cluster of Excellence for Normative Orders in July 2009. Prior to this, Fuchs-Schündeln had been an assistant professor of economics at Harvard University. Her research focuses on heterogeneous preferences and the formation of economic preferences, as well as on household consumption and saving behavior. Born in 1972, Fuchs-Schündeln studied economics and Latin American studies at the University of Cologne and received her Ph.D. in economics from Yale University in 2004, after which she joined the economics faculty at Harvard.

GSEFM Expands to Over 200 Students

With more than 60 highly talented and creative minds from Germany and around the world joining the Ph.D. in Economics and MSQE programs this September, the Graduate School of Economics, Finance, and Management (GSEFM) will expand to over 200 students. According to GSEFM Dean, Prof. Michael Binder, this in part reflects *"the excellent reputation the MSQE and Ph.D. in Economics programs have earned for their quantitative, empirically oriented curricula."* International students from 40 countries account for 65% of the student bodywith 45% female students. Moreover an ever-increasing number are in the top 2% of their class and have top scores in international quantitative exams

Goethe Business School starts Full-Time MBA

On September 10, Goethe Business School started a full-time MBA program with an internationally diverse student body. Besides the usual MBA modules, the curriculum of this program encompasses practical learning experiences, such as those derived from entrepreneurial and consulting projects, as well as an internship with a residency at Tonji University in Shanghai. A cornerstone of this program is the development of interpersonal and leadership competencies, including personal coaching to identify and develop key leadership strengths.

16th Annual Meeting of the German Finance Association (DGF)

The prestigious annual conference of the German Finance Association will be held at the House of Finance on October 9 and 10. Professor Franklin Allen from the Wharton School, one of numerous renowned participants, will be delivering the keynote speech.

Quarterly Event Calender

OCTOBER

Monday, 5th
- EFL Jour Fixe (5pm): Speaker: Markus Fischer, E-Finance Lab

Monday, 5th/Saturday, 10th
- Goethe Business School: *"Financial Risk Management Program 2009"*, Open Enrollment

Tuesday, 6th
- ILF Conference: *"Auslaufmodell AG? – Reform der unternehmerischen Mitbestimmung"* Casino, Goethe University, attendance only on request

Friday, 9th/Saturday, 10th
- 16th Annual Meeting of the German Finance Association (DGF)

Tuesday, 13th
- Seminar in Economics (5.15pm): *"Too big to fail, but too low to bail: Optimal financing of large bailouts"* Speaker: Stavros Panageas, University of Chicago

Thursday, 22nd/Friday, 23rd
- IMFS Conference: *"The Financial Market Crisis – Causes, Remedies and Prevention"* Casino, Goethe University

Friday, 23rd/Saturday, 24th
- ILF Alumni Reunion 2009 • Keynote Speaker: Julian Franks, London Business School

Tuesday, 27th
- Finance Seminar (5.15pm) • Speaker: Viral Acharya, London Business School and NYU Stern

Thursday, 29th
- HoF Brown Bag Seminar (12pm): *"Financial Advisors: A case of Babysitters?"* Speaker: Michael Haliassos, Goethe University

Thursday, 29th/Wednesday, November 4th
- 55. Kolloquium für Führungskräfte des privaten Bankgewerbes 2009

NOVEMBER

Monday, 2nd
- EFL Jour Fixe (5pm): *„Geschäftsprozess-Management (BPM) und serviceorientierte Architekturen (SOA) in deutschen Kreditinstituten: Status Quo und Entwicklungstendenzen"* • Speaker: Steffen Lorenz, Software AG

Tuesday, 3rd
- IMFS Working Lunch (12pm): *„The future of capital markets law in Europe"* Speaker: Katja Langenbucher, Goethe University

Thursday, 5th /Saturday, 7th
- Seminar in Insurance Law: *„3rd Herbstakademie Versicherung und Recht"* • Speakers: Manfred Wandt, Goethe University, and Mainrad Dreher, Johannes Gutenberg University Mainz

Tuesday, 10th
- Finance Seminar (5.15pm) • Speaker: David Lando, Copenhagen Business School

Monday, 16th
- Euro Finance Week: "Rechtliche Auswirkungen von Solvency II" • Moderator: Manfred Wandt, Goethe University, Frankfurt, Congress Center Messe Frankfurt

Tuesday, 17th
- Finance Seminar (5.15pm) • Speaker: Ingolf Dittman, Erasmus School of Economics, Rotterdam

Friday, 20th/Saturday, 21st
- ILF Conference: *„2nd Symposium on Economy, Criminal Law, Ethics",* attendance only on request

Tuesday, 24th
- CFS Colloquium: *"Reform der Globalen Finanzstruktur"*, Speaker: Hugo Bänziger, Deutsche Bank AG
- Seminar in Economics (5.15pm) • Speaker: Hamish Low, University of Cambridge

Wednesday, 25th
- German Finance Association (DGF) in cooperation with Goethe University: *"7. Deutscher Investment-Hochschultag"*

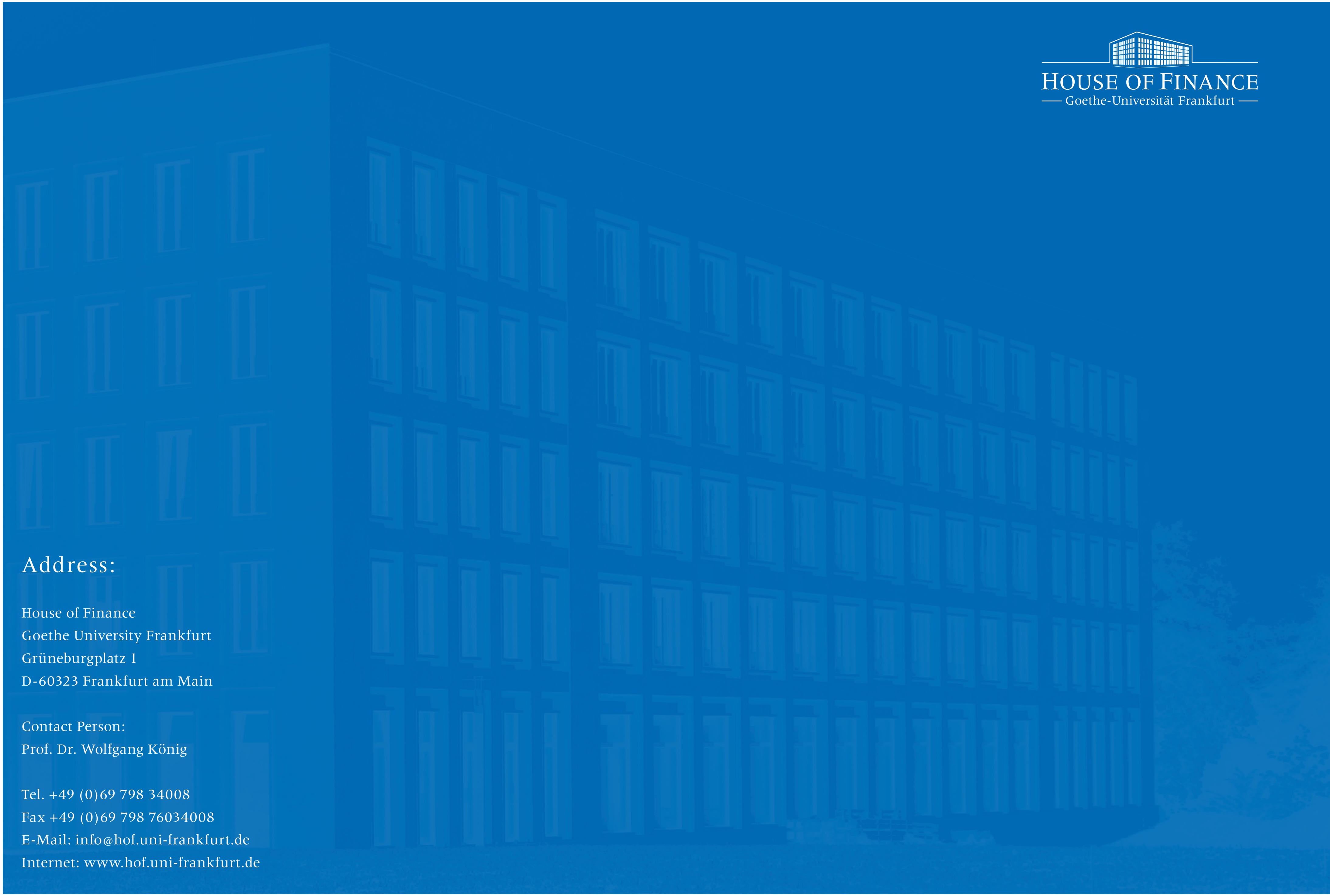
Thursday, 26th
- HoF Brown Bag Seminar (12pm): *"De l'esprit de l'économie"* Speaker: Katja Langenbucher, Goethe University

DECEMBER

Monday, 7th
- EFL Jour Fixe (5pm): Speaker: Robert Gregory, E-Finance Lab

Friday, 4th
- CFS Colloquium: *Redefining Accountability: Lessons from the Recent Financial Crisis, "Reforn der globalen Finanzstruktur"* • Speaker: Eddy Wymeersch, Commitee of European Securities Regulators

For further details please visit our homepage: www.hof.uni-frankfurt.de/events



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