04 July 2012

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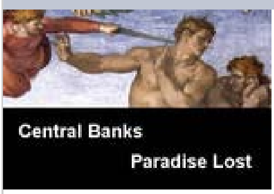

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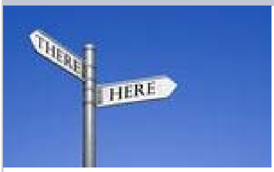

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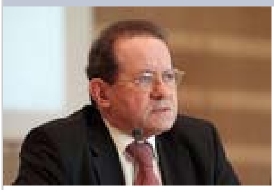

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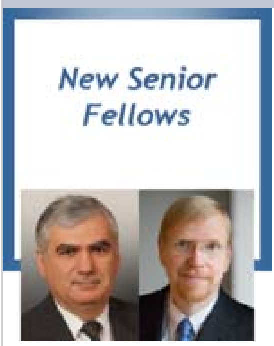

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Orphanides and Mayer

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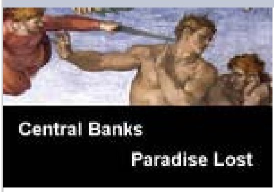

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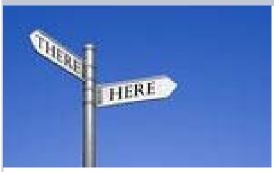

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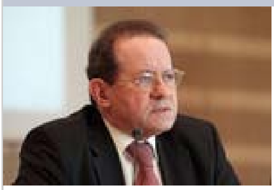

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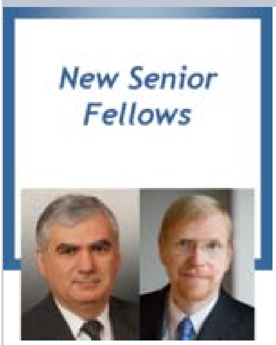

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In its 45 years of existence, CFS has built up a strong reputation as independent and internationally-oriented research institute in Frankfurt. From the outset, CFS was simultaneously committed to a broad research agenda directed at gaining new insights in the field of finance, and to an array of supportive activities directed at sharing these insights with academics, policy makers and also with the general public.

Since its move to the House of Finance at Goethe University's Campus Westend in 2008, CFS has been able to cooperate more closely with researchers from other research institutes and departments at Goethe University. The bundling of strengths in the field of finance, economics and law within the House of Finance has opened many new opportunities for CFS. This is reflected in the Development Plan that was set up in 2010 by the then new team of directors. The activities that are presented in this 2011 report prove that major steps have been accomplished in realizing this plan.

In the context of its 2010 Development Plan, CFS has set up a number of activities that claim to be a catalyst for research. These activities now start to bear fruits. For example, with the Research Visitors Program, CFS could invite very renowned international researchers to Frankfurt. Furthermore, CFS has worked on several applications in the past year. The most notable application has been for a research center S▪A▪F▪E -- Sustainable Architecture for Finance in Europe -- in the excellence initiative of the State of Hessen under the acronym 'LOEWE'. The proposal was created in close cooperation with many researchers of Goethe University.

We are very happy to announce the approval of this application. The support of the State Government of Hessen through this program will allow CFS, in collaboration with Goethe University Frankfurt, to set up a LOEWE research center dedicated to top-level scientific research and research-based policy advice. Over the next six years, the LOEWE Center will receive significant funding to pursue a comprehensive research agenda on the changing role of financial markets and institutions, and to contribute research-based policy advice to meet the politico-economic challenges in the design of a sustainable financial system in Europe and the world. The new Center will conduct research, train young professionals, and reach out to academics and policy makers by creating a platform for dynamic interaction.

Located in Goethe University's House of Finance, the center can use existing relations, events or networks as a stepping stone. S▪A▪F▪E will open its doors in January 2013 and we look forward to working on the challenges we face.

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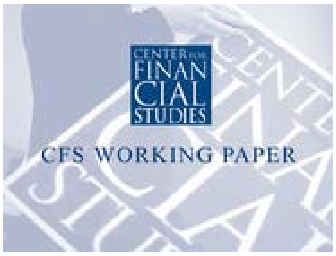

The main focus of the paper is to analyze how the philosophy behind central bank policy developed over time and how the crisis and its consequences will have an influence on this institution.

The Heyday of Central Banks

The paper begins with a short description of how the reputation of central banks evolved during the last 60 years and how it peaked around the turn of the last century.

In the post-war period, there was a reliance on administrative measures such as credit ceilings or other types of quantitative controls. They proved, however, increasingly ineffective and incompatible with free-market conditions causing central banks to abolish such instruments and to rely increasingly on open market operations.

The 1970s had a fundamental impact on concepts of monetary policy. The "great inflation" in the US was identified as a consequence of a discretionary monetary policy misguided by unreliable indicators. When this policy ended in stagflation, the Fed under chairman Volcker reoriented its policy in the direction of pragmatic monetarism.

Theory and practice have discarded the option of a purely discretionary monetary policy. On the other extreme, strict rules did not stand the test in theory either. However, the discussion on rules has delivered many useful insights, namely that central banks should adapt a kind of rule-based behavior as embodied e.g. in the commitment to an explicit monetary policy strategy.

The 1990s generated a huge bulk of literature discussing the optimal institutional arrangement for central banks. There is a broad consensus that a central bank, especially one endowed with independence in its monetary policy decision must be given a clear mandate and that the mandate must include price stability in the form of low inflation. However, the discussion of a single versus a dual or even more-dimensional mandate is ongoing.

As a result of this literature but also practical experience one could conclude that an optimal institutional arrangement for a central bank should include three principles: independence in the conduct of monetary policy, a clear mandate, and prohibition of monetary financing. This consensus is reflected in the statute of the European Central Bank (ECB) which was agreed on in Maastricht in 1991.

Inflation Targeting

In the 1990s, central banks around the world seemed to have reached a general consensus on the optimal monetary policy strategy. Inflation Targeting was identified as state of the art of monetary policy, and proponents still see it as the best-practice

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A widespread consensus among central banks is based on the principle of price stability or rather low and stable inflation as monetary policy objective and pursues a strategy comprising a number of elements:
a) A quantitative definition of the objective of price stability
b) A forward-looking monetary policy
c) Transparency of the decision-making process and communication with the public.

The crucial element of divergence however remains the issue if monetary policy decisions are based on an inflation forecast derived from a real economy model or on a strategy which gives money a prominent role.

Lessons from the financial market crisis

Before the crisis, the dominant view was that central banks should not target asset prices and not try to prick bubbles but should rather follow a “clean-up” strategy in the aftermath of events (what Issing calls the “Jackson Hole” consensus). Considerable flaws characterize this consensus, with the unfolding of the financial crisis being only the most recent and prominent manifestation of those flaws. This passive role together with the preannouncement of the bank’s function as a “savior” once a bubble bursts represents an asymmetric approach, one that might create moral hazard and over time contribute to ever larger bubbles and collapses (ECB 2005). The question of what to do once the bubble bursts should remain but should come only second.

New research and empirical evidence have delivered strong arguments in favor of the potential effectiveness of using the central bank interest rate to stabilize financial markets (Papademos 2009). The policy of “leaning” against the wind of asset price booms must be based on a reliable assessment of substantial misalignments. The ECB’s monetary pillar draws attention to rising imbalances in the monetary sector which are well-correlated with financial imbalances.

The discussion is whether and to what extent central banks should be made responsible for preserving financial stability. There are (at least) two dimensions to this problem.

Full responsibility for financial stability would imply that the central bank is provided with additional tools from the area of regulation and supervision. This however would challenge the independence of a central bank for the reason that too much political responsibility is given to such an institution. A clear mandate to maintain price stability to be delivered by an independent central bank is the nominal anchor in a paper standard system. With the removal of the precondition of independence, inflation expectations would be deprived of this anchor and over time the period of low inflation would remain a rather short lived episode.

This, however, does not imply that central banks should be completely excluded from responsibility – formally or informally. There are strong arguments why central banks should have all the information they need and might contribute or take responsibility for macro-prudential supervision. The “line in the sand” should be drawn where the intrinsic goal of the central bank – maintaining price stability – is endangered.

Reputation at risk

In the sovereign debt crisis central banks were seen as “savior” of last resort. In providing liquidity at zero or close to zero interest rates against collateral which hardly qualifies as “good securities” a number of central banks have gone far beyond Bagehot’s famous principle. This is an inappropriate extension of the role of lender of last resort.

Solvency of a sovereign debtor is traditionally defined as a state being able to service its debt by collecting taxes. Bringing this responsibility into the domain of the central bank means transferring an obligation of public finance into a monetary phenomenon. The dividing line between monetary and fiscal policy is crossed and the central bank becomes part of politics.

In this context a discussion concerning the acceptance of a higher inflation rate by central banks triggers additional pressure. There are two strands of arguments why currently central banks should tolerate higher inflation: One is derived from the problem of the zero bound for nominal central bank interest rates, the other argument is based on the idea that higher inflation would facilitate the service on public debt. Another concerns the coordination – explicitly or implicitly – of monetary policy and fiscal policy, in the belief that policymakers can maximize economic welfare by choosing the optimal mix of monetary and fiscal stimulus.

Once a central bank would accept higher inflation and engage in games of “give and take”, its reputation and credibility would be at stake and its independence de facto would be lost. Central banks might be blamed for all the negative consequences which will be attributed to them for their resistance to participate in the “coordination game”. In the longer term such firmness might turn out as the best contribution central banks can make for the welfare of society.

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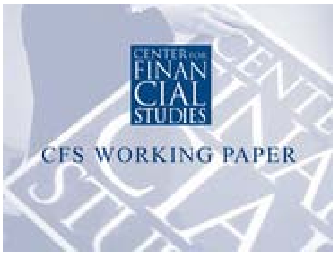

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Laura Moretti
Post-Doctoral Researcher at CFS since October 2010


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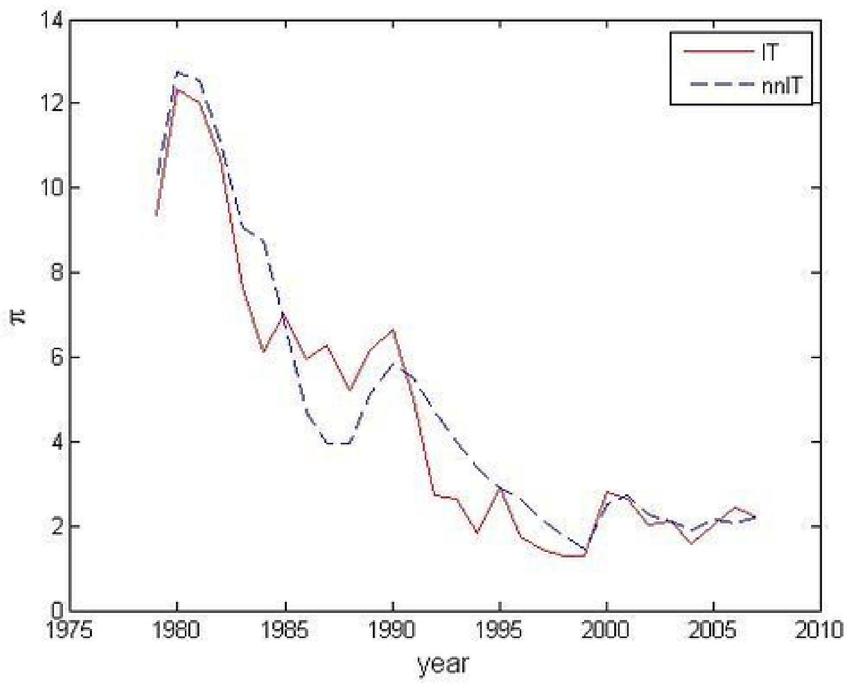
Following the debate over the role of transparency in financial markets, the paper **"Transparency and Government Bond Spreads"** analyzes the impact of enhancing transparency on government bond spreads of emerging markets economies (EME). The International Monetary Fund (IMF) offered member countries after 1999 the opportunity to publish the Article IV reports, prepared by the IMF staff during their regular country visits, and the Report on Observance of Standards and Codes, which contains the IMFs' assessment of the country's compliance with internationally recognized standards and codes. These initiatives were prompted by the widely shared view that the EME crises in the 1990s were partly due to the lack of reliable information. Using a sample of 18 EMEs for the period 1999-2007, I find that the effect of the publication of Article IV is negligible, while the publication of ROSC matters, leading to a decline in the spreads of 15%. I am currently extending the analysis to verify whether those EMEs that become more transparent have been more resilient during the recent financial crisis.

My interest in transparency led to a joint paper with Toru Suzuki (Max Planck Institute of Economics, Jena) on "**Strategic Transparency and Political Competition**", in which we analyze the strategic decision of an incumbent politician to raise transparency in order to increase his chances of reelection. We are particular interested in the endogenous choice of disclosing information given incumbents' power to legislate and the fact that imposed rules are not always effective.

Returning to macroeconomic issues, the paper "**Inflation Targeting and Product Market Deregulation**" analyzes the effect of the adoption of inflation targeting (IT) on the inflation rate directly and indirectly through its interaction with product market deregulation in a sample of OECD countries. It has been noticed that the decline in inflation experienced in the 1990s was mainly driven by institutional reforms within central banks and by improvements in monetary policy, but other factors such as the increased competition due to globalization and product market deregulation played an important role. The results show that the effect of IT is large and statistically significant, but there is an important interaction effect between product market deregulation and the adoption of IT. I am currently working on the analysis of the effect of deregulation on the inflation rate in the euro area where the institutional reform of the central bank occurred at the same time in contrast to reforms regarding competition that were implemented at different points in time.



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Laura Moretti
Post-Doctoral Researcher at CFS since October 2010


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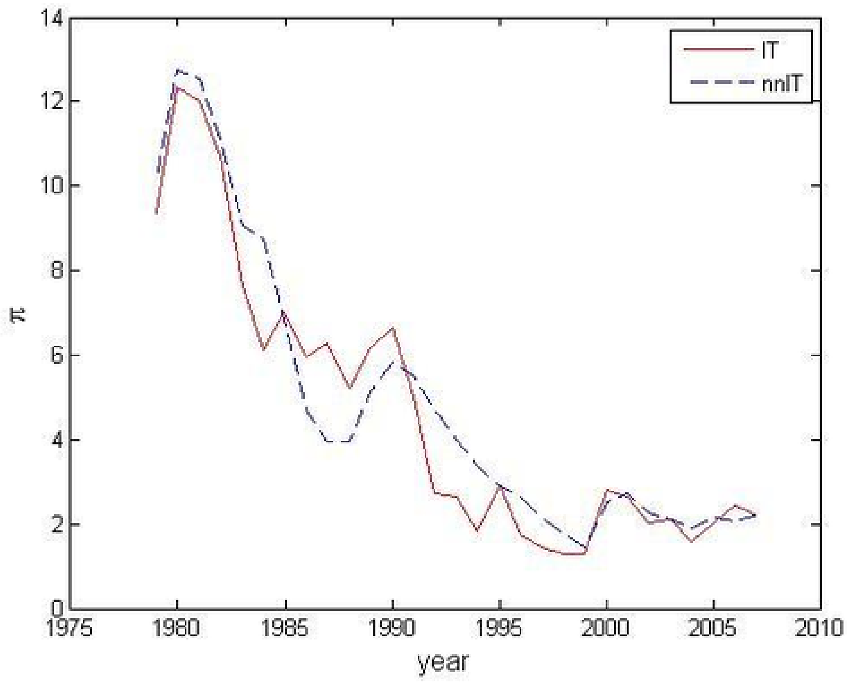

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Foreword

Foreword


Uwe Walz

In its 45 years of existence, CFS has built up a strong reputation as independent and internationally-oriented research institute in Frankfurt. From the outset, CFS was simultaneously committed to a broad research agenda directed at gaining new insights in the field of finance, and to an array of supportive activities directed at sharing these insights with academics, policy makers and also with the general public.

Since its move to the House of Finance at Goethe University's Campus Westend in 2008, CFS has been able to cooperate more closely with researchers from other research institutes and departments at Goethe University. The bundling of strengths in the field of finance, economics and law within the House of Finance has opened many new opportunities for CFS. This is reflected in the Development Plan that was set up in 2010 by the then new team of directors. The activities that are presented in this 2011 report prove that major steps have been accomplished in realizing this plan.

In the context of its 2010 Development Plan, CFS has set up a number of activities that claim to be a catalyst for research. These activities now start to bear fruits. For example, with the Research Visitors Program, CFS could invite very renowned international researchers to Frankfurt. Furthermore, CFS has worked on several applications in the past year. The most notable application has been for a research center S▪A▪F▪E -- Sustainable Architecture for Finance in Europe -- in the excellence initiative of the State of Hessen under the acronym 'LOEWE'. The proposal was created in close cooperation with many researchers of Goethe University.

We are very happy to announce the approval of this application. The support of the State Government of Hessen through this program will allow CFS, in collaboration with Goethe University Frankfurt, to set up a LOEWE research center dedicated to top-level scientific research and research-based policy advice. Over the next six years, the LOEWE Center will receive significant funding to pursue a comprehensive research agenda on the changing role of financial markets and institutions, and to contribute research-based policy advice to meet the politico-economic challenges in the design of a sustainable financial system in Europe and the world. The new Center will conduct research, train young professionals, and reach out to academics and policy makers by creating a platform for dynamic interaction.

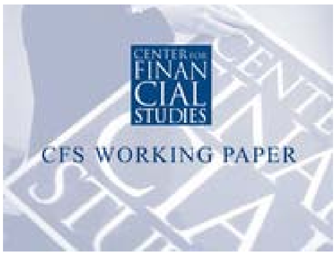
Located in Goethe University's House of Finance, the center can use existing relations, events or networks as a stepping stone. S▪A▪F▪E will open its doors in January 2013 and we look forward to working on the challenges we face.

I would like to thank the staff team at CFS and its financial supporters for making this possible. I trust that readers will find all our activities as inspiring as we do.

WP 12/06: Central Banks - Paradise Lost

WP 12/06: Central Banks - Paradise Lost

Working Paper by Otmar Issing (CFS President)



The main focus of the paper is to analyze how the philosophy behind central bank policy developed over time and how the crisis and its consequences will have an influence on this institution.

The Heyday of Central Banks

The paper begins with a short description of how the reputation of central banks evolved during the last 60 years and how it peaked around the turn of the last century.

In the post-war period, there was a reliance on administrative measures such as credit ceilings or other types of quantitative controls. They proved, however, increasingly ineffective and incompatible with free-market conditions causing central banks to abolish such instruments and to rely increasingly on open market operations.

The 1970s had a fundamental impact on concepts of monetary policy. The "great inflation" in the US was identified as a consequence of a discretionary monetary policy misguided by unreliable indicators. When this policy ended in stagflation, the Fed under chairman Volcker reoriented its policy in the direction of pragmatic monetarism.

Theory and practice have discarded the option of a purely discretionary monetary policy. On the other extreme, strict rules did not stand the test in theory either. However, the discussion on rules has delivered many useful insights, namely that central banks should adapt a kind of rule-based behavior as embodied e.g. in the commitment to an explicit monetary policy strategy.

The 1990s generated a huge bulk of literature discussing the optimal institutional arrangement for central banks. There is a broad consensus that a central bank, especially one endowed with independence in its monetary policy decision must be given a clear mandate and that the mandate must include price stability in the form of low inflation. However, the discussion of a single versus a dual or even more-dimensional mandate is ongoing.

As a result of this literature but also practical experience one could conclude that an optimal institutional arrangement for a central bank should include three principles: independence in the conduct of monetary policy, a clear mandate, and prohibition of monetary financing. This consensus is reflected in the statute of the European Central Bank (ECB) which was agreed on in Maastricht in 1991.

Inflation Targeting

In the 1990s, central banks around the world seemed to have reached a general consensus on the optimal monetary policy strategy. Inflation Targeting was identified as state of the art of monetary policy, and proponents still see it as the best-practice

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strategy, even after the crisis. According to Issing, it is hard to see how inflation targeting can deal with the fundamental flaw which is the neglect of money and credit as sources of risk for price stability. It is mainly for this reason that the ECB adopted a two pillar strategy giving money and credit an important role.

A widespread consensus among central banks is based on the principle of price stability or rather low and stable inflation as monetary policy objective and pursues a strategy comprising a number of elements:
a) A quantitative definition of the objective of price stability
b) A forward-looking monetary policy
c) Transparency of the decision-making process and communication with the public.

The crucial element of divergence however remains the issue if monetary policy decisions are based on an inflation forecast derived from a real economy model or on a strategy which gives money a prominent role.

Lessons from the financial market crisis

Before the crisis, the dominant view was that central banks should not target asset prices and not try to prick bubbles but should rather follow a “clean-up” strategy in the aftermath of events (what Issing calls the “Jackson Hole” consensus). Considerable flaws characterize this consensus, with the unfolding of the financial crisis being only the most recent and prominent manifestation of those flaws. This passive role together with the preannouncement of the bank’s function as a “savior” once a bubble bursts represents an asymmetric approach, one that might create moral hazard and over time contribute to ever larger bubbles and collapses (ECB 2005). The question of what to do once the bubble bursts should remain but should come only second.

New research and empirical evidence have delivered strong arguments in favor of the potential effectiveness of using the central bank interest rate to stabilize financial markets (Papademos 2009). The policy of “leaning” against the wind of asset price booms must be based on a reliable assessment of substantial misalignments. The ECB’s monetary pillar draws attention to rising imbalances in the monetary sector which are well-correlated with financial imbalances.

The discussion is whether and to what extent central banks should be made responsible for preserving financial stability. There are (at least) two dimensions to this problem.

Full responsibility for financial stability would imply that the central bank is provided with additional tools from the area of regulation and supervision. This however would challenge the independence of a central bank for the reason that too much political responsibility is given to such an institution. A clear mandate to maintain price stability to be delivered by an independent central bank is the nominal anchor in a paper standard system. With the removal of the precondition of independence, inflation expectations would be deprived of this anchor and over time the period of low inflation would remain a rather short lived episode.

This, however, does not imply that central banks should be completely excluded from responsibility – formally or informally. There are strong arguments why central banks should have all the information they need and might contribute or take responsibility for macro-prudential supervision. The “line in the sand” should be drawn where the intrinsic goal of the central bank – maintaining price stability – is endangered.

Reputation at risk

In the sovereign debt crisis central banks were seen as “savior” of last resort. In providing liquidity at zero or close to zero interest rates against collateral which hardly qualifies as “good securities” a number of central banks have gone far beyond Bagehot’s famous principle. This is an inappropriate extension of the role of lender of last resort.

Solvency of a sovereign debtor is traditionally defined as a state being able to service its debt by collecting taxes. Bringing this responsibility into the domain of the central bank means transferring an obligation of public finance into a monetary phenomenon. The dividing line between monetary and fiscal policy is crossed and the central bank becomes part of politics.

In this context a discussion concerning the acceptance of a higher inflation rate by central banks triggers additional pressure. There are two strands of arguments why currently central banks should tolerate higher inflation: One is derived from the problem of the zero bound for nominal central bank interest rates, the other argument is based on the idea that higher inflation would facilitate the service on public debt. Another concerns the coordination – explicitly or implicitly – of monetary policy and fiscal policy, in the belief that policymakers can maximize economic welfare by choosing the optimal mix of monetary and fiscal stimulus.

Once a central bank would accept higher inflation and engage in games of “give and take”, its reputation and credibility would be at stake and its independence de facto would be lost. Central banks might be blamed for all the negative consequences which will be attributed to them for their resistance to participate in the “coordination game”. In the longer term such firmness might turn out as the best contribution central banks can make for the welfare of society.

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Central banks should demonstrate modesty in what they promise to deliver, explain convincingly what they have no competence for, be transparent on their actions, but firm in their determination to preserve the value of money which is the final anchor in a paper standard.

Click **here** to read the Working Paper from the CFS Website

Staff Member Profile

Laura Moretti
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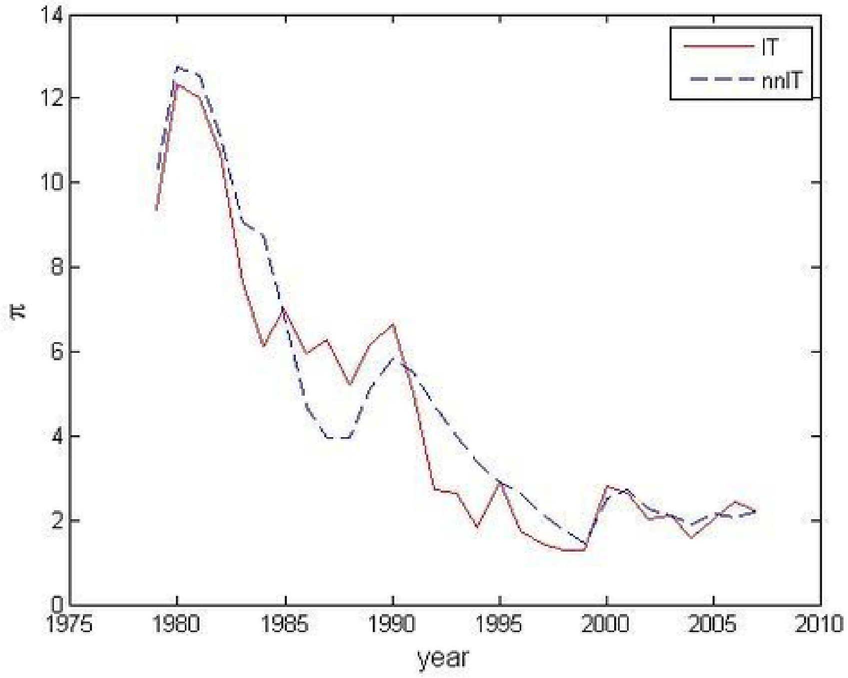

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The ECB and Its Watchers XIV

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THE ECB AND ITS WATCHERS

The ECB and Its Watchers XIV
15 June 2012

Frankfurt am Main

This conference series brings together “The ECB and its Watchers” since 1999. This year, the Center for Financial Studies is joined by the Institute of Monetary and Financial Stability as co-sponsor of the event. Both institutes are located in the House of Finance of Goethe University Frankfurt.

On June 15, ECB President Draghi and Board Member Peter Praet met with ECB watchers from academia, media and the financial community on at a dramatic confluence of events concerning European Monetary Union. Several EMU members’ commitment to the type of policies that are required to maintain stability in a monetary union continues to be challenged by financial market participants. In some cases, electoral support for such policies is highly questionable.

At the same time, European Union leaders are considering to augment monetary union with banking union, debtor’s union and fiscal union. Such changes would bring us much closer to political union. They would involve a substantial shift of power from the national to the supra-national level.


Volker Wieland, Mario Draghi

The hope is that supra-national institutions would perform better than national governments in terms of committing to and implementing the type of policies that are required to maintain stability in a monetary union.

Surely, the analysis, criticism and advice of ECB watchers is needed more than ever by policy makers, financial market participants and euro area citizens. Conference speakers included government and central bank officials such as the Finance Minister of Portugal, Vitor Gaspar, the Deputy Governor of the Central Bank of Ireland, Stefan Gerlach, and Lucio Pench from the European Commission, influential academics such as Lucrezia Reichlin, John Vickers, Jose Campa and Hans-Werner Sinn, and economists from financial firms such as Willem Buiter.

This year’s meeting, organized again by Volker Wieland (CFS & IMFS) marked a record number of more than 300 registered participants, among them 70 media and press representatives. As in the past, it was partly covered live by CNBC, Bloomberg and Reuters TV. In addition, President Draghi’s speech and conference discussions were reported on in the news of the major German television channels, ARD and ZDF.

Debates and speeches at the conference focused on urgent questions in the current policy debate. Three areas received much attention, banking regulation, monetary policy,

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and economic adjustment in the euro area.

On banking, it was discussed what regulatory structure would be appropriate for managing systemic risk in the sector and whether a form of banking union was needed. Regarding monetary policy speakers debated whether ECB liquidity provision was insufficient, appropriate or excessive, and whether the ECB had dealt effectively with the challenges arising from the heterogeneous economic situation in the euro area.

This was followed by in-depth reviews of divergences and needs for economic adjustment in the euro area. Progress on the adjustment path was evaluated and diverse visions of the future of euro area governance and the make-up of the monetary union were presented.

The following presentations are available for download:

Introductory Remarks: Volker Wieland
Presentation: John Vickers
Presentation: José Campa
Presentation: Peter Praet
Presentation: Lucrezia Reichlin
Presentation: Vítor Gaspar
Presentation: Lucio Pench
Hans Werner Sinn: please visit the website of the institute
Presentation: Stefan Gerlach

The Conference website with all links can be found here.

The ECB and Its Watchers

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Greece: Getting Here and Moving Forward

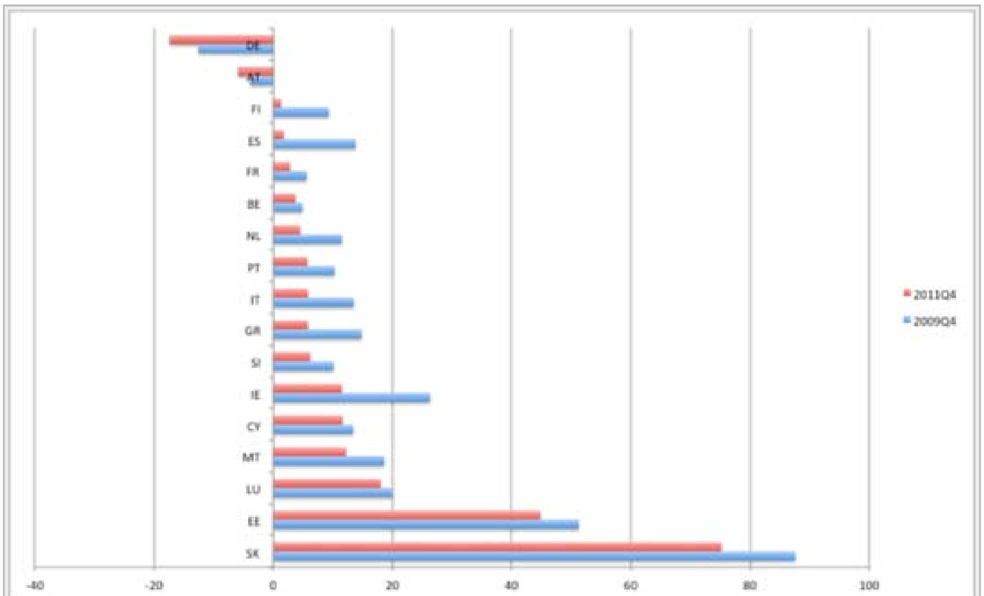
Greece: Getting Here and Moving Forward

Lecture by Professor Michael Haliassos
5 June 2012


Michael Haliassos

The talk by CFS Director Michael Haliassos focused on key factors that have brought Greece to its present state and on prospects for getting on a sustainable growth path in the euro area.

He argued that the factors contributing to Greece's predicament represent an interplay of economic and political processes that have led to a bad equilibrium. Although it would have been difficult to escape this equilibrium without an external coordination mechanism, the intervention of the IMF-ECB-EU has so far focused mainly on austerity measures and has failed to provide the necessary impetus for most essential structural reforms. This is partly the fault of the troika, which appears to have given up on reforms occurring or has pushed for hasty, horizontal measures; and partly the fault of Greek politicians and powerful pressure groups, which have resisted reforms. This has caused the Greek people to identify the memorandum with cuts rather than improved competitiveness and growth, and to oppose the memorandum while firmly supporting Greece's membership of the Eurozone.



Change in Harmonized Competitiveness Indicators Based on Unit Labor Costs, Percentage change since 1991:Q1. Observation points: 2009:Q4 and 2011:Q4 (Source

ECB)

Greece developed an inflated and inefficient public sector over the past 30 years because political parties used appointments and then creation of unwarranted wage differentials within it as a means to create loyal political clienteles. The creation of a slimmer, efficient, growth- and productivity-oriented public sector requires severing these ties and linking appointments, promotions, and pay to effort of public sector employees and to efficiency of public sector entities. European partners can be instrumental in this effort, not only by exerting the necessary pressure but also by sharing valuable expertise and international best practices.

The much discussed option of making Greece drop out of the euro zone would not provide a viable solution for Greece and could endanger the future of the euro zone itself. Returning to the drachma would mean a substantial devaluation that would raise the value of debt but also the cost of necessary imports, while failing to deliver substantial import substitution or increases in export revenue. The current lack of a wide productive base and the difficulties in starting new businesses, partly due to the poor state of the public sector, mean that production is unlikely to rise sufficiently in order to solve the current account problems. For those who did not send their money abroad, exit from the euro would consequently bring poverty. Additionally, there would be a danger of hyperinflation, as the central bank would regain access to the printing press in the midst of public protests against huge increases in the cost of living and considerable unemployment.

Moving forward within the euro zone will require cutting the Gordian knot. Given that Greece has corrected most of its loss of competitiveness in unit labor costs since the start of 1999, reforms rather than further salary cuts and tax increases are now needed. These reforms should include measures fostering a more efficient, smaller public sector and the establishment of dynamic, innovative, export-oriented private firms; labor reforms to enhance flexibility; reforms of the justice system to enhance investor protection and contract enforcement; and increased price transparency to promote and monitor competition. A number of success stories in Greek industry and of sectors that have been identified as promising for future development suggest that targeted investments, as opposed to general provision of liquidity, are both necessary and fruitful in the effort to put Greece back on a growth path.

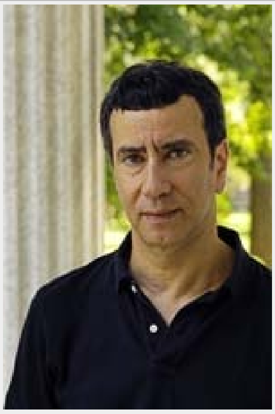
Beyond Our Means: Why America Spends While the World Saves

Beyond Our Means: Why America Spends While the World Saves

Lecture by Sheldon Garon

(Princeton University)

11 June 2012



Sheldon Garon

On June 11^{th}, Professor Sheldon Garon (the Nissan Professor of History and East Asian Studies in the Department of History at Princeton University) gave a lecture on the different cultures of consumption and saving in various parts of the world, thereby referring to his book published last year:"Beyond our means: Why America Spends while the World Saves".

Garon presented an overview of the net household saving rates in different countries and explained the disparities through differences in national attitudes towards small savings. Historically, the US has had significantly lower household saving rates than continental European countries (Germany, France, Italy) or Japan. Many American households lack the basic savings to deal with unemployment, medical emergencies, home foreclosures,and retirement. In fact, 43% of American households have little or no savings. Theoretically, Garon stated, Americans should have *higher* saving rates than Europeans because the US welfare system is relatively weak.

Garon argued that the disparities in household saving rates are based on differences in the histories of saving: East Asian and European states have promoted and effectively implemented a culture of saving over the last two centuries. He gave an overview of institutions and campaigns that fostered the culture of thrift in these societies.

The savings banks in Germany – the Sparkassen – have a long history going back to the early 19^{th} century. After a major reform effort in the beginning of that century, communities and states in Europe aimed to bring financial stability to the working class, reduce crime and create“prudent citizens”. Such institutions also existed in the US: mutual savings banks were well established in the Northeast, Midwest, and the Pacific Coast. However, as Garon noted, due to the decentralization of the country, people in the South and West had little or no access to such savings banks: While in New England in 1910, 53.5% of the population had a savings account, in the South, it was only 3.4% – and in Texas only 0.9%. (as a reference: Germany 33.4%, Japan 34.9%)

The second type of institution that encouraged small savings in Europe was the postal savings bank – in Germany known as Postbank. Governments established postal savings banks in the late 19th century to enable the majority of the people to save small amounts. The importance of these institutions can be understood by looking at their stunning architecture. The US government also tried to promote small savings but Congress opposed postal savings legislation for several decades. Finally, in 1910 a very weak postal savings system was enacted but abolished in 1966.

In order to stimulate saving habits from an early age, many societies successfully implemented school savings banks, which became particularly popular in Belgium,

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France, and Japan in the late 19th century. In the US, these institutions appeared in some school districts, but failed to reach most schoolchildren. Since schools had to cooperate with savings banks, many American schools could not offer such a program, due to the lack of savings banks.

One of the greatest transnational successes in promoting savings was the campaign for war savings. By showing examples of campaigns, Garon illustrated how governments mobilized their populations to invest in small savings institutions, in order to support the financing of the war. Some of these posters show how women were bombarded with messages to save whilst demonizing money wasting. After World War II, many European countries continued to promote saving, thus financing post-war reconstruction. Not only did the existing systems of savings banks and postal savings continue, but they were extended with innovative methods to promote savings and to bring children into contact with saving at an early age.

The US, however, pursued a different policy. US savings rates remained within a moderate range from the 1950s to the early 1980s (between 7 and11%) but dropped significantly afterwards, fallingbelow 2% in 2005. According to Garon, declining saving reflected in part the growing consensus amongst Americans that consumption, rather than saving, is the key to economic growth. Recent developments, such as the deregulation of credit cards, the encouragement of home equity loans after the 1986 tax reform, subprime mortgages after 2000, and growing income inequality have led to a further decline in American saving rates.

Garon concluded his presentation with a number of recommendations for reviving saving in the US. Improved access to banking for lower-income households would be a first step in that direction. He also favors a change in tax laws, in order to incentivize lower-income households to save for retirement and daily needs. Secondly, tax incentives to over-invest in housing and home equity loans should be reduced, and so-called “predatory lending” should be regulated. Finally, Garon suggests that Americans begin to promote “financial inclusion” as a national priority and a civil right.

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03 New Senior Fellows at CFS

How can Macro-Prudential Regulation be Effective?

How can Macro-Prudential Regulation be Effective?

Lecture by Vítor Constâncio
28 March 2012

On March 28th 2012, Vítor Constâncio, Vice President of the European Central Bank, gave a lecture on the effectiveness of macro-prudential regulation as part of the CFS Colloquium series entitled “Mission completed? Consequences of regulatory change on the financial industry?” The lecture attracted a large audience.


Vítor Constâncio

Constâncio argued that the recent financial crisis was triggered by a combination of excessive growth of credit, increases in leverage in the financial system, and the expansion of a shadow banking sector. From a macroeconomic perspective, the demand for safe assets was boosted by both the so called “savings glut” -- the very high level of saving in oil producing countries and in East Asia, partially as a reaction to the Asian Financial Crisis in the late 1990s -- and expansionary monetary policy in the US and elsewhere from the early 2000 onwards. Combined with financial deregulation, perhaps best illustrated by the repeal of the Glass-Steagall Act, these factors caused the financial imbalances that set the stage for the crisis.

Low interest rates led to rising leverage and to a search for yield, while financial innovation and deregulation led to a more interconnected and complex financial system in which contagion risk was pronounced. Moreover, the growing importance of the shadow banking sector contributed to the opaqueness of the system and rendered it difficult to monitoring the growing systemic risk, especially in the absence of a macro-prudential policy framework.

The surveillance of institutions and markets, in order to identify the vulnerabilities and the building up of risk that can lead to system risk, and the assessment of their possible impact on the financial sector and the whole economy are the two tasks of macroprudential oversight. The identification of systemic risk is important for central banks, Constâncio noted, mainly because a stable financial system is needed for the effective transmission of monetary policy.

In guarding against financial instability, monetary policy has a crucial role to play since interest rates affect asset prices and the value of collateral, and consequently the level of leverage and risk taking by banks. While policy had been focused mainly on ensuring price stability, particularly in inflation targeting regimes, central banks have acted as lender of last resorts since the 19th century. Thus, financial stability considerations were not new concerns to monetary policy makers.

A specific problem noted by Constâncio was that monetary policy tends to be asymmetric, with central banks intervening strongly only during downturns but ignoring the risks accumulating in booms. This behavior was usually rationalized by the difficulty of identifying bubbles or in the danger associated with pricking bubbles. However, the recent development of macro models with financial frictions provides additional guidance

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for monetary policy even though the models are not mature yet. Similarly, central banks already oversee market infrastructures, implement prudential supervision and conduct financial stability analysis; much analysis was thus already devoted to the identification of bubbles and the risks they entail. Nevertheless, macro-prudential oversight should be expanded to the whole financial sector.

Regarding macro-prudential instruments, there is much international agreement that counter-cyclical capital buffers can play a key role and are to be implemented in the Basel III framework. All the indications are that they can substantially improve the resilience of the banking sector, thus contributing to the smooth provision of financial services throughout the business cycle. If they had been in place before the recent financial crisis, banks' needs for capital would have fallen by perhaps as much as half.

Constâncio also discussed dynamic provisioning, which was introduced by Spanish regulators before the crisis to enhance the resilience of the banking sector in a period of strong lending growth and rising house prices. It involves building up provisions for potential losses in order to smooth the credit cycle. The Spanish experience showed that dynamic provisioning did improve bank resilience in the downturn but, nevertheless, proved insufficient to prevent the build up of imbalances. Other measures such as maximum loan-to-value, and debt-to-income, ratios were potential instruments and had proven to be effective in the Korean case.

Constâncio also considered the highly pro-cyclical and reinforcing nature of fair value accounting and loan loss provisions. While fair value accounting could not be considered the root of the imbalances that led to the crisis, it had fed the boom and leverage, and acted as an amplifier, via “fire sales”, in the downturn.

To conclude, Constâncio noted that financial instability disrupted the real economy and a new macro-prudential regulatory regime, combining macro and micro prudential policies, should be developed to limit excessive risk taking and imbalances and enhance the resilience of the financial system.

for Finance in Europe"

03 New Senior Fellows at CFS

Globalization and Pluralization of States. Why there will be no “United States of Europe”

Globalization and Pluralization of States. Why there will be no “United States of Europe”

Original Title: "Globalisierung und Pluralisierung der Staatenwelt. Wieso es 'Vereinigte Staaten von Europa' nicht geben wird"

Professor Hermann Lübbe

(Honorary professor for Philosophy and Political Theory at the University of Zurich)

8 March 2012

The first talk this year in the CFS Presidential Lectures series was given by the philosopher and political scientist Professor Hermann Lübbe. He gave his view on the future development of the European Union. According to his main thesis, European states have no intention of moving to a “United States of Europe”, analogue to the USA, but will, quite the contrary, increasingly emphasize their regional sovereignty. Lübbe presented his arguments by outlining the historical development of the EU, and then pointing at current pluralistic tendencies among the European states.

Lübbe began his speech by referring to a discussion he had in the aftermath of the Maastricht Treaty on the aims of the European unification process. German officials tend to present this process as a converging of European states, with the aim to overcome Europe's regionalism and small-state mentality in order to raise global political importance. However, he noted, rather than unification, a diversification of states is the case in recent European history. In order to illustrate this tendency of pluralization, Lübbe named two underlying factors. First, the irreversible process of decolonization in the years after World War II detached major parts of Africa and South East Asia from their European dependence, and second, the downfall and division of large territorial states – such as the Soviet Union, the Austrian-Hungarian and the Ottoman Empire – led to a remarkable number of newly created sovereign states. This is an ongoing trend that does not only apply to Eastern Europe and the Balkans. Lübbe cited by way of example the independency movements in Belgium, Catalonia, Corsica, and Scotland, and the trend towards regionalization and increasing autonomy of local authorities in countries as France and Spain. According to him, Germans tend to disregard such tendencies, since they, due to their history, usually give low attention to national and regional consciousness.

Lübbe argued against German elites who refuse to acknowledge the importance of

distinct regional values and just see these as a backward-looking attitude by isolationist groups. In his view, pluralization is a complementary phenomenon to globalization on the economic as well the political side, meaning that by rising globalization, pluralistic tendencies will rise equally. In this context, he gave his definition of globalization, namely a process whereby social and regional areas become more and more dependent on each other, especially meaning that an increasing number of goods (including services) will either be accessible only in mutual accordance or not at all. There are plenty of examples, such as radio frequencies, or air or sea traffic control. International agreements ensure the mutual abidance by the rules, being controlled by supranational organizations – not by a unified nation state.
Lübbe sees a significant proof for this complementarity in the demand for more self-determination by the individual when the influence of authorities in privacy intrusive processes rises. He used the example of the improved medical care and increased impact of doctors in our lives, as being complementary to our claim for more involvement in medical decisions. According to Lübbe, this can be transmitted from the individual level to the collective, i.e. regional groups. The competences that supranational organizations have acquired over the recent past are not necessarily competences that have been taken away at the local level, but are rather complementary to meet requirements of modern life that were non-existent before.

To transpose these ideas to the Europe, Lübbe argues that the European Union is first and foremost a common market of continental reach. He dismisses the argument of a European community of values as being meaningless, and asserts that the peace in Europe today is not the result of the European integration but rather the opposite. Referring to a statement by Bundeskanzler a.D. Helmut Kohl "Der Euro sei eine Frage von Krieg und Frieden", Lübbe points to the fact that the European Union has never possessed the ability to maintain and build peace (due to the failure to establish a European Defence Community).

Lübbe concluded with a statement that the European sovereign debt crisis is not primarily a consequence of a fundamental euro problem but rather of a large-scale process in many parts of the world. It is a crisis of democracy and the growing disability of political parties to contribute to stipulating a political line. He concluded his speech by presenting direct democracy as an instrument to bring political parties back to a political and economic order that resists the temptation to run up more government debt.

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Deutsche Bank Prize in Financial Economics 2013: Preview

Deutsche Bank Prize in Financial Economics 2013: Preview

2013 marks the academic award's 5th edition. The CFS, in partnership with Goethe University Frankfurt, has been awarding the DB Prize biannually since 2005. The award honors internationally renowned researchers whose work has significantly influenced financial economics, and has led to fundamental advances in economic theory and practice.

The winner of the forthcoming DB Prize will be **announced in February 2013**. The award itself is accompanied by a monetary sum of 50,000 euro, donated by the Stiftungsfonds Deutsche Bank im Stifterverband für die Deutsche Wissenschaft* and will be **presented on September 26, 2013** by the CEO of Deutsche Bank AG. The award ceremony takes place as part of an international academic symposium in honor of the award winner, which encourages a fruitful dialogue between academics, policy makers, and financial practitioners.

Nomination Process

The pool of invaluable nominations provided by an international network of distinguished academics guides the Jury's award winner selection process and ensures that it reflects, in part, the winner's stand within the scientific community. From the end of September 2012 onwards 3,800 academics, who are from around 60 countries all over the world and whose own research focuses on this field of expertise, will be called upon to take part in the nomination procedure until the end of November, 2012.

Jury 2013

Since 2005, the groups of Jury members have consisted of over 30 distinguished professors with backgrounds from Europe, North America, Latin America, Asia and the South Pacific. Members of the international Jury for the upcoming award in 2013 include the professors **Ricardo Caballero** (Massachusetts Institute of Technology), **David Folkerts-Landau** (Deutsche Bank's Group Chief Economist, Global Head of Market Research and member of the Group Executive Committee), **Nicola Fuchs-Schündeln** (Goethe University Frankfurt) and CFS Director **Michael Haliassos** (Goethe University Frankfurt). Also representing the Goethe University are the professors **Otmar Issing** (CFS President) and **Jan Pieter Krahnen** (CFS Director). Furthermore, the Jury includes Professor **Robert Merton** (Nobel Prize Winner; Massachusetts Institute of Technology) and the award winner of the DB Prize 2011, Professor **Kenneth Rogoff** (Harvard University). Professor **Raman Uppal** (EDHEC Business School) as well as CFS Director Professor **Uwe Walz** (Goethe University Frankfurt) are also acting as Jury members.

For further information on the Jury please click on the following link:
www.ifk-cfs.de/dbprize/2013/jury

Former Award Winners

The rapid growth of the prize's reputation has been primarily due to the consistently and exceptionally high level of achievement characterizing each awardee, as well as to the openness to alternative points of view.
In 2005, the DB Prize has honored **Eugene Fama**'s fruitful insistence on individual

rationality in financial market behavior, as well as **Robert Shiller**'s constructive challenge of rationality and promotion of behavioral considerations in 2009. In 2007, it has recognized **Michael Woodford**'s pathbreaking redefinition of monetary analysis, as well as in 2011, **Kenneth Rogoff**'s insightful diagnosis of what can persistently go wrong during financial crises, preventing us from learning how to avoid or handle future ones.

The DB Prize has created a unique platform over the past eight years for renowned international financial economists, together with participants from politics, academia, press, central banks, private institutions and banks to exchange ideas and discuss the award winner's research and the light it can shed on current developments. The award ceremony and symposium represent the culmination of significant efforts undertaken by distinguished members of the worldwide academic community.

The prize is a decisive contribution to strengthening Frankfurt's role as a center for both research and financial markets. The prize holder will be appointed "Distinguished Fellow" of the CFS.

** Deutsche Bank Donation Fund in the Donor's Association for German Science*

For further information on the DB Prize please click on the following link:
www.db-prize.org

Sabine Kimmel (CFS)

for Finance in Europe"

03 New Senior Fellows at CFS

Christian Leuz will visit Frankfurt with Humboldt Research Award

Christian Leuz, Joseph Sondheimer Professor of International Economics, Finance and Accounting at the University of Chicago Booth School of Business, has received the **Humboldt Research Award**.


Christian Leuz

This Award will now enable Christian Leuz to put his cooperation with CFS and Goethe University on a more solid basis. The Award comes with an invitation of the researcher to Germany and it is Christian's intention to spend several months during the academic year 2012/2013 at Goethe University in Frankfurt, where he had earned his doctorate degree in 1996 and a habilitation (German postdoctoral lecture qualification) in 2000. In cooperation with researchers from the Center for Financial Studies and Goethe University's House of Finance, Leuz will do research and also support Goethe University in its efforts to create a research group focusing on empirical accounting and capital-market research. Leuz' influence and guidance to establish an "Empirical Accounting and Finance Group" with an impact on the academic, regulatory, and practicing worlds of financial reporting will be a major contribution that is enabled by the Humboldt Research Award.

Christian Leuz has accumulated an impressive body of research on the role of corporate disclosures, accounting transparency and disclosure regulation in capital markets and in corporate financing. His study on the U.S. OTC market, co-authored by Brian Bushee, is one of the first to provide evidence on the existence of disclosure externalities, which are commonly viewed as a justification for regulation. Leuz was one of two economists who were asked by the Financial Accounting Standards Board to produce an independent research report on the pros and cons of adopting International Financial Reporting Standards (IFRS) in the United States. In one of his latest studies, he looks at the economic consequences of securities regulation in the EU context.

Christian Leuz is one of the most frequently cited authors in the field of finance and accounting, and he has won several awards and prizes, including the 2010 Notable Contribution Award and the 2011 AAA/Deloitte Wildman Medal for his work on international accounting.

The Center for Financial Studies and the House of Finance are up to exciting changes and we look forward to welcoming Christian and to working with him on common research projects.

for Finance in Europe"

03 New Senior Fellows at CFS

LOEWE center "Sustainable Architecture for Finance in Europe"

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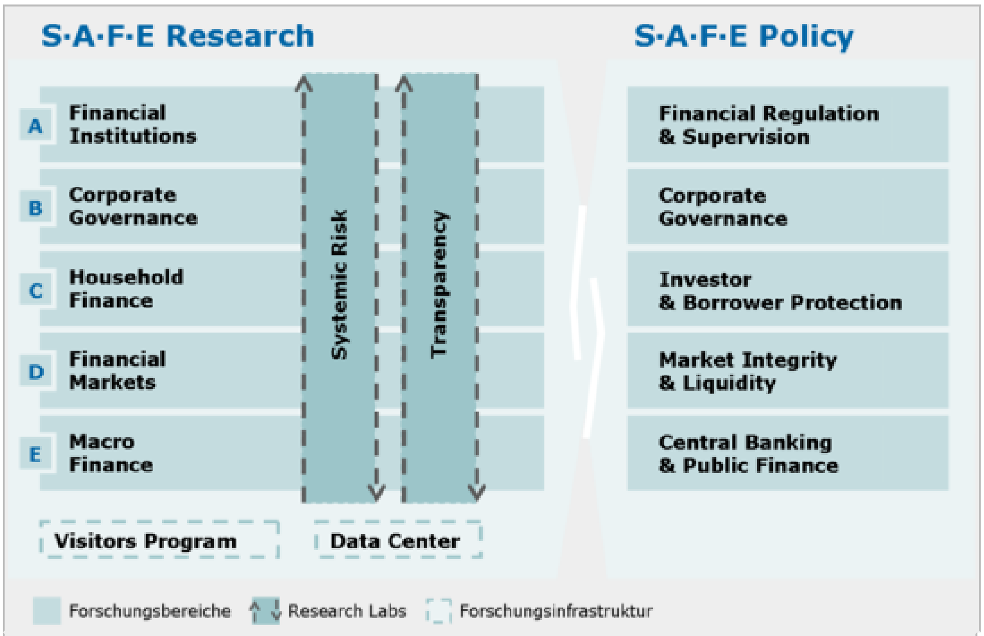
S·A·F·E

We are happy to announce today the approval of our application to the excellence initiative of the State of Hessen under the acronym 'LOEWE' . The support of the State Government of Hessen through this program will allow CFS, in collaboration with Goethe University Frankfurt, to set up a LOEWE research center called S▪A▪F▪E "Sustainable Architecture for Finance in Europe", dedicated to top-level scientific research and research-based policy advice. Over the next years, the LOEWE Center will receive significant funding to pursue a comprehensive research agenda on the changing role of financial markets and institutions, and to contribute research-based policy advice with a view to meeting the politico-economic challenges in the design of a sustainable financial system in Europe and the world. The new Center will conduct research, train young professionals, and reach out into the community by creating a platform for dynamic interaction between academics and policy makers.

The new research center S▪A▪F▪E will promote research and policy advice in five key areas capturing the behavior of households, financial institutions, markets, policy makers and regulators, but will also emphasize projects that cut across these five areas. Topical issues, such as the current fiscal imbalances and the challenges they pose for a common currency, will be combined with topics of longer-standing, such as technological progress, the global imbalances induced by the process of economic development, and the challenges on old-age provision posed by the demographic transition. The Center's design is intended to benefit from, and contribute to the dynamic interaction between researchers, economic actors, and policy makers and regulators.



Structure of S▪A▪F▪E

The new center will have a strong European orientation, contributing to a balance with

similar endeavors on the other side of the Atlantic, and will have a number of key features that will be highly beneficial to European policy makers and supervisors, as well as to the academic and financial practitioner community in Hessen and in Germany at large. S▪A▪F▪E intends to introduce new concepts for sharing knowledge, which will offer students, policy makers, and financial practitioners the opportunity to acquire first-hand knowledge on specific, often technical subjects. A newly designed Visitors Program will contribute to these objectives, as well as to international visibility of the project. The Center will also be involved in collecting unique data sets on the changing behavior of banks, households, firms, and policy institutions, focusing on the differences between optimal and actual behavior, and on their potential costs and remedies.

Located in Goethe University's House of Finance, the center can use as a stepping stone existing relations, events or networks. S▪A▪F▪E will open its doors in January 2013 and we look forward to working on the challenges we face.

More can be found on the website of **Hessisches Ministerium für Wissenschaft und Kunst**

The ECB and Its Watchers XIV

The ECB and Its Watchers XIV

THE ECB AND ITS WATCHERS

The ECB and Its Watchers XIV
15 June 2012

Frankfurt am Main

This conference series brings together “The ECB and its Watchers” since 1999. This year, the Center for Financial Studies is joined by the Institute of Monetary and Financial Stability as co-sponsor of the event. Both institutes are located in the House of Finance of Goethe University Frankfurt.

On June 15, ECB President Draghi and Board Member Peter Praet met with ECB watchers from academia, media and the financial community on at a dramatic confluence of events concerning European Monetary Union. Several EMU members’ commitment to the type of policies that are required to maintain stability in a monetary union continues to be challenged by financial market participants. In some cases, electoral support for such policies is highly questionable.

At the same time, European Union leaders are considering to augment monetary union with banking union, debtor’s union and fiscal union. Such changes would bring us much closer to political union. They would involve a substantial shift of power from the national to the supra-national level.


Volker Wieland, Mario Draghi

The hope is that supra-national institutions would perform better than national governments in terms of committing to and implementing the type of policies that are required to maintain stability in a monetary union.

Surely, the analysis, criticism and advice of ECB watchers is needed more than ever by policy makers, financial market participants and euro area citizens. Conference speakers included government and central bank officials such as the Finance Minister of Portugal, Vitor Gaspar, the Deputy Governor of the Central Bank of Ireland, Stefan Gerlach, and Lucio Pench from the European Commission, influential academics such as Lucrezia Reichlin, John Vickers, Jose Campa and Hans-Werner Sinn, and economists from financial firms such as Willem Buiter.

This year’s meeting, organized again by Volker Wieland (CFS & IMFS) marked a record number of more than 300 registered participants, among them 70 media and press representatives. As in the past, it was partly covered live by CNBC, Bloomberg and Reuters TV. In addition, President Draghi’s speech and conference discussions were reported on in the news of the major German television channels, ARD and ZDF.

Debates and speeches at the conference focused on urgent questions in the current policy debate. Three areas received much attention, banking regulation, monetary policy,

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02 LOEWE center "Sustainable Architecture

and economic adjustment in the euro area.

On banking, it was discussed what regulatory structure would be appropriate for managing systemic risk in the sector and whether a form of banking union was needed. Regarding monetary policy speakers debated whether ECB liquidity provision was insufficient, appropriate or excessive, and whether the ECB had dealt effectively with the challenges arising from the heterogeneous economic situation in the euro area.

This was followed by in-depth reviews of divergences and needs for economic adjustment in the euro area. Progress on the adjustment path was evaluated and diverse visions of the future of euro area governance and the make-up of the monetary union were presented.

The following presentations are available for download:

Introductory Remarks: Volker Wieland
Presentation: John Vickers
Presentation: José Campa
Presentation: Peter Praet
Presentation: Lucrezia Reichlin
Presentation: Vítor Gaspar
Presentation: Lucio Pench
Hans Werner Sinn: please visit the website of the institute
Presentation: Stefan Gerlach

The Conference website with all links can be found here.


The ECB and Its Watchers

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The ECB and Its Watchers

for Finance in Europe"

03 New Senior Fellows at CFS

Greece: Getting Here and Moving Forward

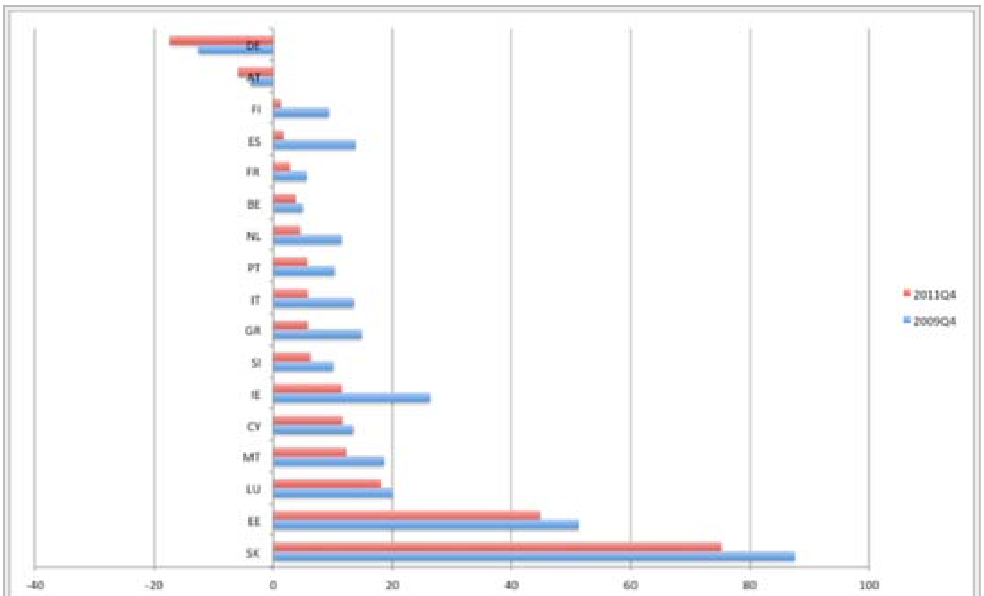
Greece: Getting Here and Moving Forward

Lecture by Professor Michael Haliassos
5 June 2012


Michael Haliassos

The talk by CFS Director Michael Haliassos focused on key factors that have brought Greece to its present state and on prospects for getting on a sustainable growth path in the euro area.

He argued that the factors contributing to Greece's predicament represent an interplay of economic and political processes that have led to a bad equilibrium. Although it would have been difficult to escape this equilibrium without an external coordination mechanism, the intervention of the IMF-ECB-EU has so far focused mainly on austerity measures and has failed to provide the necessary impetus for most essential structural reforms. This is partly the fault of the troika, which appears to have given up on reforms occurring or has pushed for hasty, horizontal measures; and partly the fault of Greek politicians and powerful pressure groups, which have resisted reforms. This has caused the Greek people to identify the memorandum with cuts rather than improved competitiveness and growth, and to oppose the memorandum while firmly supporting Greece's membership of the Eurozone.



Change in Harmonized Competitiveness Indicators Based on Unit Labor Costs, Percentage change since 1991:Q1. Observation points: 2009:Q4 and 2011:Q4 (Source

ECB)

Greece developed an inflated and inefficient public sector over the past 30 years because political parties used appointments and then creation of unwarranted wage differentials within it as a means to create loyal political clienteles. The creation of a slimmer, efficient, growth- and productivity-oriented public sector requires severing these ties and linking appointments, promotions, and pay to effort of public sector employees and to efficiency of public sector entities. European partners can be instrumental in this effort, not only by exerting the necessary pressure but also by sharing valuable expertise and international best practices.

The much discussed option of making Greece drop out of the euro zone would not provide a viable solution for Greece and could endanger the future of the euro zone itself. Returning to the drachma would mean a substantial devaluation that would raise the value of debt but also the cost of necessary imports, while failing to deliver substantial import substitution or increases in export revenue. The current lack of a wide productive base and the difficulties in starting new businesses, partly due to the poor state of the public sector, mean that production is unlikely to rise sufficiently in order to solve the current account problems. For those who did not send their money abroad, exit from the euro would consequently bring poverty. Additionally, there would be a danger of hyperinflation, as the central bank would regain access to the printing press in the midst of public protests against huge increases in the cost of living and considerable unemployment.

Moving forward within the euro zone will require cutting the Gordian knot. Given that Greece has corrected most of its loss of competitiveness in unit labor costs since the start of 1999, reforms rather than further salary cuts and tax increases are now needed. These reforms should include measures fostering a more efficient, smaller public sector and the establishment of dynamic, innovative, export-oriented private firms; labor reforms to enhance flexibility; reforms of the justice system to enhance investor protection and contract enforcement; and increased price transparency to promote and monitor competition. A number of success stories in Greek industry and of sectors that have been identified as promising for future development suggest that targeted investments, as opposed to general provision of liquidity, are both necessary and fruitful in the effort to put Greece back on a growth path.

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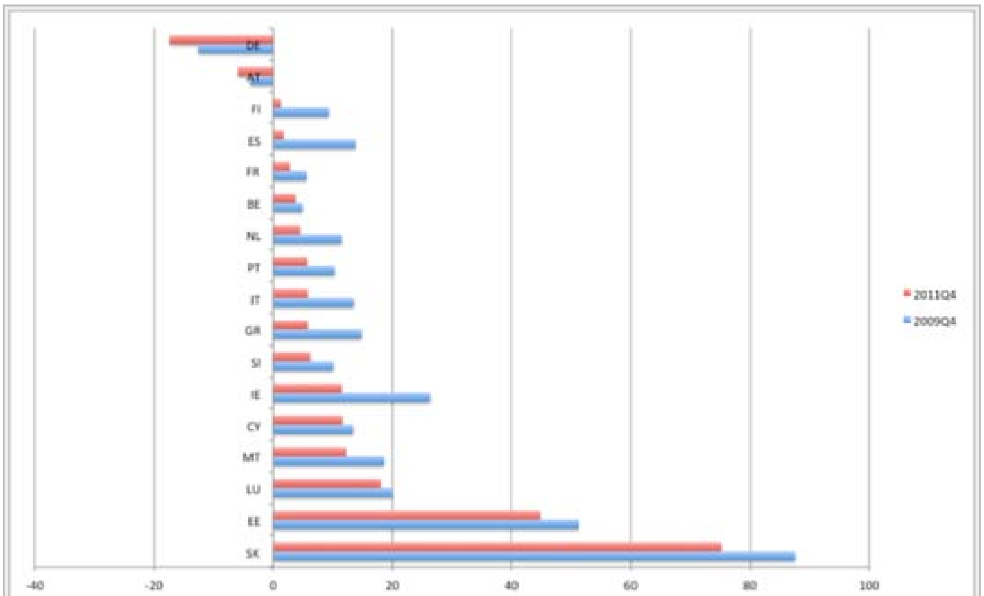

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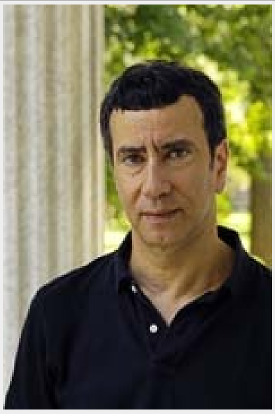
Beyond Our Means: Why America Spends While the World Saves

Beyond Our Means: Why America Spends While the World Saves

Lecture by Sheldon Garon

(Princeton University)

11 June 2012


Sheldon Garon

On June 11th, Professor Sheldon Garon (the Nissan Professor of History and East Asian Studies in the Department of History at Princeton University) gave a lecture on the different cultures of consumption and saving in various parts of the world, thereby referring to his book published last year:"Beyond our means: Why America Spends while the World Saves".

Garon presented an overview of the net household saving rates in different countries and explained the disparities through differences in national attitudes towards small savings. Historically, the US has had significantly lower household saving rates than continental European countries (Germany, France, Italy) or Japan. Many American households lack the basic savings to deal with unemployment, medical emergencies, home foreclosures,and retirement. In fact, 43% of American households have little or no savings. Theoretically, Garon stated, Americans should have *higher* saving rates than Europeans because the US welfare system is relatively weak.

Garon argued that the disparities in household saving rates are based on differences in the histories of saving: East Asian and European states have promoted and effectively implemented a culture of saving over the last two centuries. He gave an overview of institutions and campaigns that fostered the culture of thrift in these societies.

The savings banks in Germany – the Sparkassen – have a long history going back to the early 19th century. After a major reform effort in the beginning of that century, communities and states in Europe aimed to bring financial stability to the working class, reduce crime and create“prudent citizens”. Such institutions also existed in the US: mutual savings banks were well established in the Northeast, Midwest, and the Pacific Coast. However, as Garon noted, due to the decentralization of the country, people in the South and West had little or no access to such savings banks: While in New England in 1910, 53.5% of the population had a savings account, in the South, it was only 3.4% – and in Texas only 0.9%. (as a reference: Germany 33.4%, Japan 34.9%)

The second type of institution that encouraged small savings in Europe was the postal savings bank – in Germany known as Postbank. Governments established postal savings banks in the late 19th century to enable the majority of the people to save small amounts. The importance of these institutions can be understood by looking at their stunning architecture. The US government also tried to promote small savings but Congress opposed postal savings legislation for several decades. Finally, in 1910 a very weak postal savings system was enacted but abolished in 1966.

In order to stimulate saving habits from an early age, many societies successfully implemented school savings banks, which became particularly popular in Belgium,

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France, and Japan in the late 19th century. In the US, these institutions appeared in some school districts, but failed to reach most schoolchildren. Since schools had to cooperate with savings banks, many American schools could not offer such a program, due to the lack of savings banks.

One of the greatest transnational successes in promoting savings was the campaign for war savings. By showing examples of campaigns, Garon illustrated how governments mobilized their populations to invest in small savings institutions, in order to support the financing of the war. Some of these posters show how women were bombarded with messages to save whilst demonizing money wasting. After World War II, many European countries continued to promote saving, thus financing post-war reconstruction. Not only did the existing systems of savings banks and postal savings continue, but they were extended with innovative methods to promote savings and to bring children into contact with saving at an early age.

The US, however, pursued a different policy. US savings rates remained within a moderate range from the 1950s to the early 1980s (between 7 and11%) but dropped significantly afterwards, fallingbelow 2% in 2005. According to Garon, declining saving reflected in part the growing consensus amongst Americans that consumption, rather than saving, is the key to economic growth. Recent developments, such as the deregulation of credit cards, the encouragement of home equity loans after the 1986 tax reform, subprime mortgages after 2000, and growing income inequality have led to a further decline in American saving rates.

Garon concluded his presentation with a number of recommendations for reviving saving in the US. Improved access to banking for lower-income households would be a first step in that direction. He also favors a change in tax laws, in order to incentivize lower-income households to save for retirement and daily needs. Secondly, tax incentives to over-invest in housing and home equity loans should be reduced, and so-called “predatory lending” should be regulated. Finally, Garon suggests that Americans begin to promote “financial inclusion” as a national priority and a civil right.

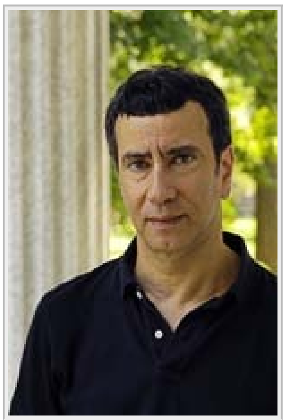
Beyond Our Means: Why America Spends While the World Saves

Beyond Our Means: Why America Spends While the World Saves

Lecture by Sheldon Garon

(Princeton University)

11 June 2012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How can Macro-Prudential Regulation be Effective?

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Lecture by Vítor Constâncio
28 March 2012

On March 28th 2012, Vítor Constâncio, Vice President of the European Central Bank, gave a lecture on the effectiveness of macro-prudential regulation as part of the CFS Colloquium series entitled "Mission completed? Consequences of regulatory change on the financial industry?" The lecture attracted a large audience.


Vítor Constâncio

Constâncio argued that the recent financial crisis was triggered by a combination of excessive growth of credit, increases in leverage in the financial system, and the expansion of a shadow banking sector. From a macroeconomic perspective, the demand for safe assets was boosted by both the so called "savings glut" -- the very high level of saving in oil producing countries and in East Asia, partially as a reaction to the Asian Financial Crisis in the late 1990s -- and expansionary monetary policy in the US and elsewhere from the early 2000 onwards. Combined with financial deregulation, perhaps best illustrated by the repeal of the Glass-Steagall Act, these factors caused the financial imbalances that set the stage for the crisis.

Low interest rates led to rising leverage and to a search for yield, while financial innovation and deregulation led to a more interconnected and complex financial system in which contagion risk was pronounced. Moreover, the growing importance of the shadow banking sector contributed to the opaqueness of the system and rendered it difficult to monitoring the growing systemic risk, especially in the absence of a macro-prudential policy framework.

The surveillance of institutions and markets, in order to identify the vulnerabilities and the building up of risk that can lead to system risk, and the assessment of their possible impact on the financial sector and the whole economy are the two tasks of macroprudential oversight. The identification of systemic risk is important for central banks, Constâncio noted, mainly because a stable financial system is needed for the effective transmission of monetary policy.

In guarding against financial instability, monetary policy has a crucial role to play since interest rates affect asset prices and the value of collateral, and consequently the level of leverage and risk taking by banks. While policy had been focused mainly on ensuring price stability, particularly in inflation targeting regimes, central banks have acted as lender of last resorts since the 19th century. Thus, financial stability considerations were not new concerns to monetary policy makers.

A specific problem noted by Constâncio was that monetary policy tends to be asymmetric, with central banks intervening strongly only during downturns but ignoring the risks accumulating in booms. This behavior was usually rationalized by the difficulty of identifying bubbles or in the danger associated with pricking bubbles. However, the recent development of macro models with financial frictions provides additional guidance

for monetary policy even though the models are not mature yet. Similarly, central banks already oversee market infrastructures, implement prudential supervision and conduct financial stability analysis; much analysis was thus already devoted to the identification of bubbles and the risks they entail. Nevertheless, macro-prudential oversight should be expanded to the whole financial sector.

Regarding macro-prudential instruments, there is much international agreement that counter-cyclical capital buffers can play a key role and are to be implemented in the Basel III framework. All the indications are that they can substantially improve the resilience of the banking sector, thus contributing to the smooth provision of financial services throughout the business cycle. If they had been in place before the recent financial crisis, banks' needs for capital would have fallen by perhaps as much as half.

Constâncio also discussed dynamic provisioning, which was introduced by Spanish regulators before the crisis to enhance the resilience of the banking sector in a period of strong lending growth and rising house prices. It involves building up provisions for potential losses in order to smooth the credit cycle. The Spanish experience showed that dynamic provisioning did improve bank resilience in the downturn but, nevertheless, proved insufficient to prevent the build up of imbalances. Other measures such as maximum loan-to-value, and debt-to-income, ratios were potential instruments and had proven to be effective in the Korean case.

Constâncio also considered the highly pro-cyclical and reinforcing nature of fair value accounting and loan loss provisions. While fair value accounting could not be considered the root of the imbalances that led to the crisis, it had fed the boom and leverage, and acted as an amplifier, via “fire sales”, in the downturn.

To conclude, Constâncio noted that financial instability disrupted the real economy and a new macro-prudential regulatory regime, combining macro and micro prudential policies, should be developed to limit excessive risk taking and imbalances and enhance the resilience of the financial system.

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Globalization and Pluralization of States. Why there will be no “United States of Europe”

Original Title: "Globalisierung und Pluralisierung der Staatenwelt. Wieso es 'Vereinigte Staaten von Europa' nicht geben wird"

Professor Hermann Lübbe
(Honorary professor for Philosophy and Political Theory at the University of Zurich)

8 March 2012


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The first talk this year in the CFS Presidential Lectures series was given by the philosopher and political scientist Professor Hermann Lübbe. He gave his view on the future development of the European Union. According to his main thesis, European states have no intention of moving to a “United States of Europe”, analogue to the USA, but will, quite the contrary, increasingly emphasize their regional sovereignty. Lübbe presented his arguments by outlining the historical development of the EU, and then pointing at current pluralistic tendencies among the European states.

Lübbe began his speech by referring to a discussion he had in the aftermath of the Maastricht Treaty on the aims of the European unification process. German officials tend to present this process as a converging of European states, with the aim to overcome Europe's regionalism and small-state mentality in order to raise global political importance. However, he noted, rather than unification, a diversification of states is the case in recent European history. In order to illustrate this tendency of pluralization, Lübbe named two underlying factors. First, the irreversible process of decolonization in the years after World War II detached major parts of Africa and South East Asia from their European dependence, and second, the downfall and division of large territorial states – such as the Soviet Union, the Austrian-Hungarian and the Ottoman Empire – led to a remarkable number of newly created sovereign states. This is an ongoing trend that does not only apply to Eastern Europe and the Balkans. Lübbe cited by way of example the independency movements in Belgium, Catalonia, Corsica, and Scotland, and the trend towards regionalization and increasing autonomy of local authorities in countries as France and Spain. According to him, Germans tend to disregard such tendencies, since they, due to their history, usually give low attention to national and regional consciousness.

Lübbe argued against German elites who refuse to acknowledge the importance of

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distinct regional values and just see these as a backward-looking attitude by isolationist groups. In his view, pluralization is a complementary phenomenon to globalization on the economic as well the political side, meaning that by rising globalization, pluralistic tendencies will rise equally. In this context, he gave his definition of globalization, namely a process whereby social and regional areas become more and more dependent on each other, especially meaning that an increasing number of goods (including services) will either be accessible only in mutual accordance or not at all. There are plenty of examples, such as radio frequencies, or air or sea traffic control. International agreements ensure the mutual abidance by the rules, being controlled by supranational organizations – not by a unified nation state.
Lübbe sees a significant proof for this complementarity in the demand for more self-determination by the individual when the influence of authorities in privacy intrusive processes rises. He used the example of the improved medical care and increased impact of doctors in our lives, as being complementary to our claim for more involvement in medical decisions. According to Lübbe, this can be transmitted from the individual level to the collective, i.e. regional groups. The competences that supranational organizations have acquired over the recent past are not necessarily competences that have been taken away at the local level, but are rather complementary to meet requirements of modern life that were non-existent before.

To transpose these ideas to the Europe, Lübbe argues that the European Union is first and foremost a common market of continental reach. He dismisses the argument of a European community of values as being meaningless, and asserts that the peace in Europe today is not the result of the European integration but rather the opposite. Referring to a statement by Bundeskanzler a.D. Helmut Kohl "Der Euro sei eine Frage von Krieg und Frieden", Lübbe points to the fact that the European Union has never possessed the ability to maintain and build peace (due to the failure to establish a European Defence Community).

Lübbe concluded with a statement that the European sovereign debt crisis is not primarily a consequence of a fundamental euro problem but rather of a large-scale process in many parts of the world. It is a crisis of democracy and the growing disability of political parties to contribute to stipulating a political line. He concluded his speech by presenting direct democracy as an instrument to bring political parties back to a political and economic order that resists the temptation to run up more government debt.

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New Senior Fellows at CFS

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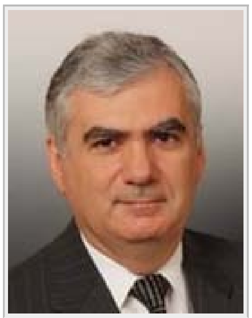
CFS is very happy to report that **Thomas Mayer** and **Athanasios Orphanides** have accepted to become Senior Fellow at CFS.

Thomas Mayer

Thomas Mayer

Thomas Mayer will be involved in research on European financial integration and current financial market issues. He is currently a senior advisor to Deutsche Bank's management and key clients. Previously, he was Chief Economist of Deutsche Bank Group and Head of Deutsche Bank Research, and before that Chief European Economist at Deutsche Bank in London and co-head of the Bank's Global Economics Group. Before joining Deutsche Bank in 2002, he worked for Goldman Sachs in Frankfurt and London, and for Salomon Brothers in London. In the early stages of his career, he held positions at the International Monetary Fund and at the Kiel Institute for the World Economy. He received a Ph.D. in economics from the University of Kiel and is a CFA Charterholder since 2002. Thomas Mayer has published numerous articles on international and European economic issues in professional journals and has commented on these issues in the media.


Athanasios Orphanides

Athanasios Orphanides will be involved in research activities in the area of monetary economics and financial stability, as well as in policy debates regarding monetary policy and financial stability. Orphanides has been Governor of the Central Bank of Cyprus from May 2007 to May 2012. During his term, he oversaw the introduction of the euro in Cyprus and subsequently served as member of the Governing Council of the European Central Bank between January 2008 and May 2012. Following the creation of the European Systemic Risk Board in 2010, he was elected a member of its inaugural Steering Committee. Prior to his appointment as Governor, Orphanides was a Senior Adviser at the Federal Reserve Board in the USA, where he had started his professional career as an economist. While at the Federal Reserve he taught undergraduate and graduate courses in macroeconomics and monetary economics at Georgetown University and Johns Hopkins University. Orphanides obtained his undergraduate degrees in mathematics and economics as well as Ph.D. in economics from the Massachusetts Institute of Technology.

Deutsche Bank Prize in Financial Economics 2013: Preview

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2013 marks the academic award's 5th edition. The CFS, in partnership with Goethe University Frankfurt, has been awarding the DB Prize biannually since 2005. The award honors internationally renowned researchers whose work has significantly influenced financial economics, and has led to fundamental advances in economic theory and practice.

The winner of the forthcoming DB Prize will be **announced in February 2013**. The award itself is accompanied by a monetary sum of 50,000 euro, donated by the Stiftungsfonds Deutsche Bank im Stifterverband für die Deutsche Wissenschaft* and will be **presented on September 26, 2013** by the CEO of Deutsche Bank AG. The award ceremony takes place as part of an international academic symposium in honor of the award winner, which encourages a fruitful dialogue between academics, policy makers, and financial practitioners.

Nomination Process

The pool of invaluable nominations provided by an international network of distinguished academics guides the Jury's award winner selection process and ensures that it reflects, in part, the winner's stand within the scientific community. From the end of September 2012 onwards 3,800 academics, who are from around 60 countries all over the world and whose own research focuses on this field of expertise, will be called upon to take part in the nomination procedure until the end of November, 2012.

Jury 2013

Since 2005, the groups of Jury members have consisted of over 30 distinguished professors with backgrounds from Europe, North America, Latin America, Asia and the South Pacific. Members of the international Jury for the upcoming award in 2013 include the professors **Ricardo Caballero** (Massachusetts Institute of Technology), **David Folkerts-Landau** (Deutsche Bank's Group Chief Economist, Global Head of Market Research and member of the Group Executive Committee), **Nicola Fuchs-Schündeln** (Goethe University Frankfurt) and CFS Director **Michael Haliassos** (Goethe University Frankfurt). Also representing the Goethe University are the professors **Otmar Issing** (CFS President) and **Jan Pieter Krahnen** (CFS Director). Furthermore, the Jury includes Professor **Robert Merton** (Nobel Prize Winner; Massachusetts Institute of Technology) and the award winner of the DB Prize 2011, Professor **Kenneth Rogoff** (Harvard University). Professor **Raman Uppal** (EDHEC Business School) as well as CFS Director Professor **Uwe Walz** (Goethe University Frankfurt) are also acting as Jury members.

For further information on the Jury please click on the following link:
www.ifk-cfs.de/dbprize/2013/jury

Former Award Winners

The rapid growth of the prize's reputation has been primarily due to the consistently and exceptionally high level of achievement characterizing each awardee, as well as to the openness to alternative points of view.
In 2005, the DB Prize has honored **Eugene Fama**'s fruitful insistence on individual

rationality in financial market behavior, as well as **Robert Shiller**'s constructive challenge of rationality and promotion of behavioral considerations in 2009. In 2007, it has recognized **Michael Woodford**'s pathbreaking redefinition of monetary analysis, as well as in 2011, **Kenneth Rogoff**'s insightful diagnosis of what can persistently go wrong during financial crises, preventing us from learning how to avoid or handle future ones.

The DB Prize has created a unique platform over the past eight years for renowned international financial economists, together with participants from politics, academia, press, central banks, private institutions and banks to exchange ideas and discuss the award winner's research and the light it can shed on current developments. The award ceremony and symposium represent the culmination of significant efforts undertaken by distinguished members of the worldwide academic community.

The prize is a decisive contribution to strengthening Frankfurt's role as a center for both research and financial markets. The prize holder will be appointed "Distinguished Fellow" of the CFS.

** Deutsche Bank Donation Fund in the Donor's Association for German Science*

For further information on the DB Prize please click on the following link:
www.db-prize.org

Sabine Kimmel (CFS)

Deutsche Bank Prize in Financial Economics 2013: Preview

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2013 marks the academic award's 5th edition. The CFS, in partnership with Goethe University Frankfurt, has been awarding the DB Prize biannually since 2005. The award honors internationally renowned researchers whose work has significantly influenced financial economics, and has led to fundamental advances in economic theory and practice.

The winner of the forthcoming DB Prize will be **announced in February 2013**. The award itself is accompanied by a monetary sum of 50,000 euro, donated by the Stiftungsfonds Deutsche Bank im Stifterverband für die Deutsche Wissenschaft* and will be **presented on September 26, 2013** by the CEO of Deutsche Bank AG. The award ceremony takes place as part of an international academic symposium in honor of the award winner, which encourages a fruitful dialogue between academics, policy makers, and financial practitioners.

Nomination Process

The pool of invaluable nominations provided by an international network of distinguished academics guides the Jury's award winner selection process and ensures that it reflects, in part, the winner's stand within the scientific community. From the end of September 2012 onwards 3,800 academics, who are from around 60 countries all over the world and whose own research focuses on this field of expertise, will be called upon to take part in the nomination procedure until the end of November, 2012.

Jury 2013

Since 2005, the groups of Jury members have consisted of over 30 distinguished professors with backgrounds from Europe, North America, Latin America, Asia and the South Pacific. Members of the international Jury for the upcoming award in 2013 include the professors **Ricardo Caballero** (Massachusetts Institute of Technology), **David Folkerts-Landau** (Deutsche Bank's Group Chief Economist, Global Head of Market Research and member of the Group Executive Committee), **Nicola Fuchs-Schündeln** (Goethe University Frankfurt) and CFS Director **Michael Haliassos** (Goethe University Frankfurt). Also representing the Goethe University are the professors **Otmar Issing** (CFS President) and **Jan Pieter Krahnen** (CFS Director). Furthermore, the Jury includes Professor **Robert Merton** (Nobel Prize Winner; Massachusetts Institute of Technology) and the award winner of the DB Prize 2011, Professor **Kenneth Rogoff** (Harvard University). Professor **Raman Uppal** (EDHEC Business School) as well as CFS Director Professor **Uwe Walz** (Goethe University Frankfurt) are also acting as Jury members.

For further information on the Jury please click on the following link:
www.ifk-cfs.de/dbprize/2013/jury

Former Award Winners

The rapid growth of the prize's reputation has been primarily due to the consistently and exceptionally high level of achievement characterizing each awardee, as well as to the openness to alternative points of view.
In 2005, the DB Prize has honored **Eugene Fama**'s fruitful insistence on individual

rationality in financial market behavior, as well as **Robert Shiller**'s constructive challenge of rationality and promotion of behavioral considerations in 2009. In 2007, it has recognized **Michael Woodford**'s pathbreaking redefinition of monetary analysis, as well as in 2011, **Kenneth Rogoff**'s insightful diagnosis of what can persistently go wrong during financial crises, preventing us from learning how to avoid or handle future ones.

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Christian Leuz will visit Frankfurt with Humboldt Research Award

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Christian Leuz

Christian Leuz, Joseph Sondheimer Professor of International Economics, Finance and Accounting at the University of Chicago Booth School of Business, has received the **Humboldt Research Award**.

This Award will now enable Christian Leuz to put his cooperation with CFS and Goethe University on a more solid basis. The Award comes with an invitation of the researcher to Germany and it is Christian's intention to spend several months during the academic year 2012/2013 at Goethe University in Frankfurt, where he had earned his doctorate degree in 1996 and a habilitation (German postdoctoral lecture qualification) in 2000. In cooperation with researchers from the Center for Financial Studies and Goethe University's House of Finance, Leuz will do research and also support Goethe University in its efforts to create a research group focusing on empirical accounting and capital-market research. Leuz' influence and guidance to establish an "Empirical Accounting and Finance Group" with an impact on the academic, regulatory, and practicing worlds of financial reporting will be a major contribution that is enabled by the Humboldt Research Award.

Christian Leuz has accumulated an impressive body of research on the role of corporate disclosures, accounting transparency and disclosure regulation in capital markets and in corporate financing. His study on the U.S. OTC market, co-authored by Brian Bushee, is one of the first to provide evidence on the existence of disclosure externalities, which are commonly viewed as a justification for regulation. Leuz was one of two economists who were asked by the Financial Accounting Standards Board to produce an independent research report on the pros and cons of adopting International Financial Reporting Standards (IFRS) in the United States. In one of his latest studies, he looks at the economic consequences of securities regulation in the EU context.

Christian Leuz is one of the most frequently cited authors in the field of finance and accounting, and he has won several awards and prizes, including the 2010 Notable Contribution Award and the 2011 AAA/Deloitte Wildman Medal for his work on international accounting.

The Center for Financial Studies and the House of Finance are up to exciting changes and we look forward to welcoming Christian and to working with him on common research projects.

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LOEWE center "Sustainable Architecture for Finance in Europe"

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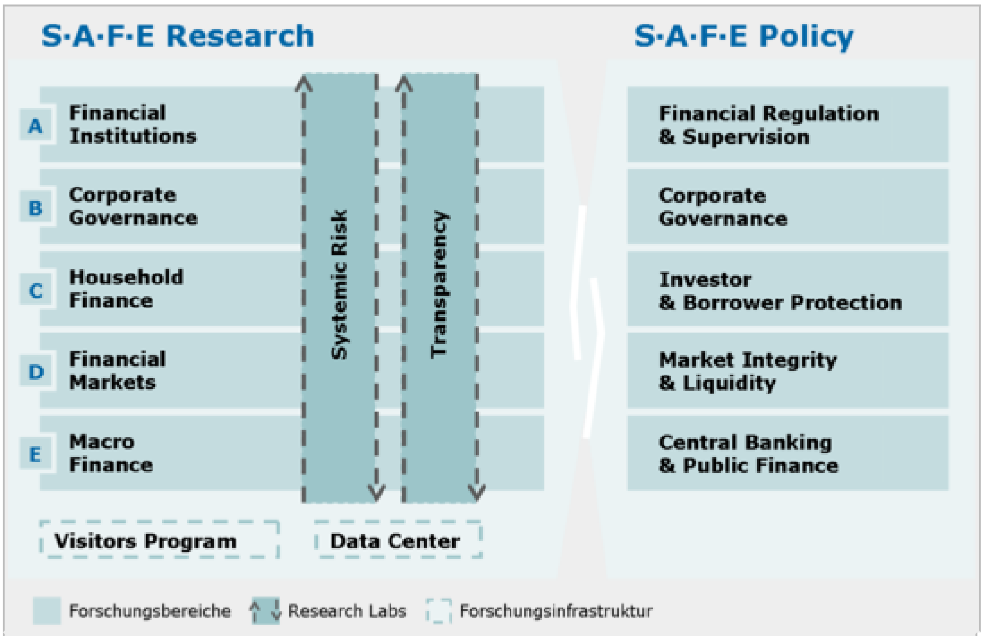
S·A·F·E

We are happy to announce today the approval of our application to the excellence initiative of the State of Hessen under the acronym 'LOEWE' . The support of the State Government of Hessen through this program will allow CFS, in collaboration with Goethe University Frankfurt, to set up a LOEWE research center called S▪A▪F▪E "Sustainable Architecture for Finance in Europe", dedicated to top-level scientific research and research-based policy advice. Over the next years, the LOEWE Center will receive significant funding to pursue a comprehensive research agenda on the changing role of financial markets and institutions, and to contribute research-based policy advice with a view to meeting the politico-economic challenges in the design of a sustainable financial system in Europe and the world. The new Center will conduct research, train young professionals, and reach out into the community by creating a platform for dynamic interaction between academics and policy makers.

The new research center S▪A▪F▪E will promote research and policy advice in five key areas capturing the behavior of households, financial institutions, markets, policy makers and regulators, but will also emphasize projects that cut across these five areas. Topical issues, such as the current fiscal imbalances and the challenges they pose for a common currency, will be combined with topics of longer-standing, such as technological progress, the global imbalances induced by the process of economic development, and the challenges on old-age provision posed by the demographic transition. The Center's design is intended to benefit from, and contribute to the dynamic interaction between researchers, economic actors, and policy makers and regulators.



Structure of S▪A▪F▪E

The new center will have a strong European orientation, contributing to a balance with

similar endeavors on the other side of the Atlantic, and will have a number of key features that will be highly beneficial to European policy makers and supervisors, as well as to the academic and financial practitioner community in Hessen and in Germany at large. S▪A▪F▪E intends to introduce new concepts for sharing knowledge, which will offer students, policy makers, and financial practitioners the opportunity to acquire first-hand knowledge on specific, often technical subjects. A newly designed Visitors Program will contribute to these objectives, as well as to international visibility of the project. The Center will also be involved in collecting unique data sets on the changing behavior of banks, households, firms, and policy institutions, focusing on the differences between optimal and actual behavior, and on their potential costs and remedies.

Located in Goethe University's House of Finance, the center can use as a stepping stone existing relations, events or networks. S▪A▪F▪E will open its doors in January 2013 and we look forward to working on the challenges we face.

More can be found on the website of **Hessisches Ministerium für Wissenschaft und Kunst**

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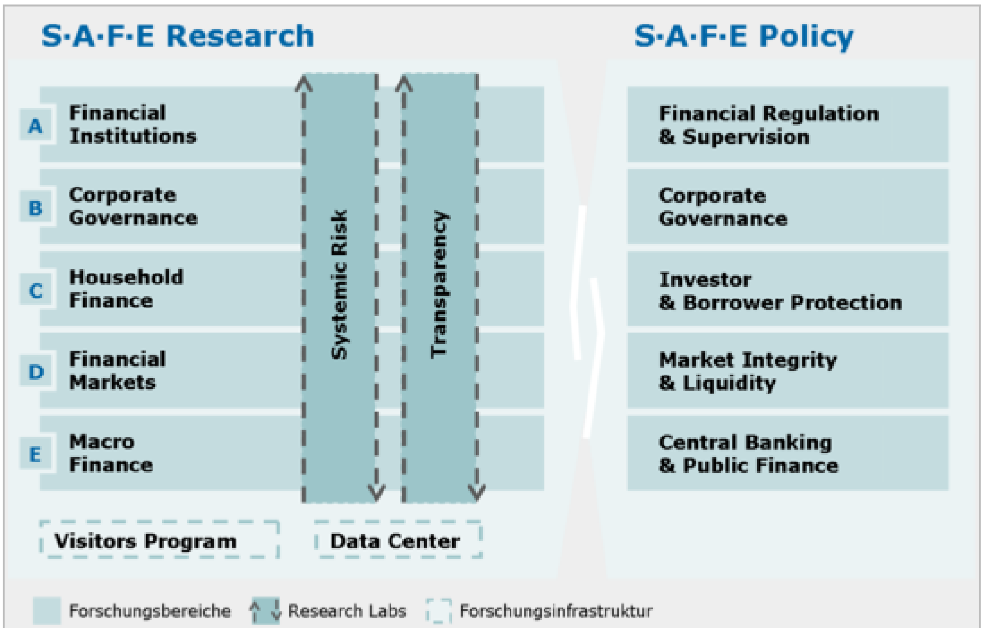

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New Senior Fellows at CFS

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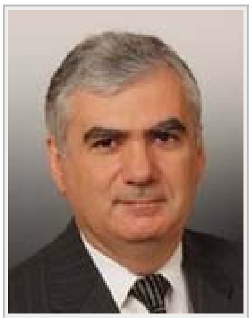
CFS is very happy to report that **Thomas Mayer** and **Athanasios Orphanides** have accepted to become Senior Fellow at CFS.

Thomas Mayer

Thomas Mayer

Thomas Mayer will be involved in research on European financial integration and current financial market issues. He is currently a senior advisor to Deutsche Bank's management and key clients. Previously, he was Chief Economist of Deutsche Bank Group and Head of Deutsche Bank Research, and before that Chief European Economist at Deutsche Bank in London and co-head of the Bank's Global Economics Group. Before joining Deutsche Bank in 2002, he worked for Goldman Sachs in Frankfurt and London, and for Salomon Brothers in London. In the early stages of his career, he held positions at the International Monetary Fund and at the Kiel Institute for the World Economy. He received a Ph.D. in economics from the University of Kiel and is a CFA Charterholder since 2002. Thomas Mayer has published numerous articles on international and European economic issues in professional journals and has commented on these issues in the media.


Athanasios Orphanides

Athanasios Orphanides will be involved in research activities in the area of monetary economics and financial stability, as well as in policy debates regarding monetary policy and financial stability. Orphanides has been Governor of the Central Bank of Cyprus from May 2007 to May 2012. During his term, he oversaw the introduction of the euro in Cyprus and subsequently served as member of the Governing Council of the European Central Bank between January 2008 and May 2012. Following the creation of the European Systemic Risk Board in 2010, he was elected a member of its inaugural Steering Committee. Prior to his appointment as Governor, Orphanides was a Senior Adviser at the Federal Reserve Board in the USA, where he had started his professional career as an economist. While at the Federal Reserve he taught undergraduate and graduate courses in macroeconomics and monetary economics at Georgetown University and Johns Hopkins University. Orphanides obtained his undergraduate degrees in mathematics and economics as well as Ph.D. in economics from the Massachusetts Institute of Technology.

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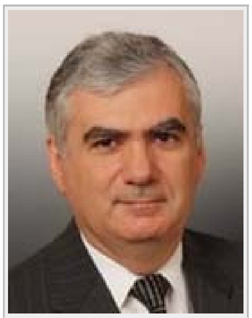

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Foreword

Foreword


Uwe Walz

In its 45 years of existence, CFS has built up a strong reputation as independent and internationally-oriented research institute in Frankfurt. From the outset, CFS was simultaneously committed to a broad research agenda directed at gaining new insights in the field of finance, and to an array of supportive activities directed at sharing these insights with academics, policy makers and also with the general public.

Since its move to the House of Finance at Goethe University's Campus Westend in 2008, CFS has been able to cooperate more closely with researchers from other research institutes and departments at Goethe University. The bundling of strengths in the field of finance, economics and law within the House of Finance has opened many new opportunities for CFS. This is reflected in the Development Plan that was set up in 2010 by the then new team of directors. The activities that are presented in this 2011 report prove that major steps have been accomplished in realizing this plan.

In the context of its 2010 Development Plan, CFS has set up a number of activities that claim to be a catalyst for research. These activities now start to bear fruits. For example, with the Research Visitors Program, CFS could invite very renowned international researchers to Frankfurt. Furthermore, CFS has worked on several applications in the past year. The most notable application has been for a research center S▪A▪F▪E -- Sustainable Architecture for Finance in Europe -- in the excellence initiative of the State of Hessen under the acronym 'LOEWE'. The proposal was created in close cooperation with many researchers of Goethe University.

We are very happy to announce the approval of this application. The support of the State Government of Hessen through this program will allow CFS, in collaboration with Goethe University Frankfurt, to set up a LOEWE research center dedicated to top-level scientific research and research-based policy advice. Over the next six years, the LOEWE Center will receive significant funding to pursue a comprehensive research agenda on the changing role of financial markets and institutions, and to contribute research-based policy advice to meet the politico-economic challenges in the design of a sustainable financial system in Europe and the world. The new Center will conduct research, train young professionals, and reach out to academics and policy makers by creating a platform for dynamic interaction.

Located in Goethe University's House of Finance, the center can use existing relations, events or networks as a stepping stone. S▪A▪F▪E will open its doors in January 2013 and we look forward to working on the challenges we face.

I would like to thank the staff team at CFS and its financial supporters for making this possible. I trust that readers will find all our activities as inspiring as we do.

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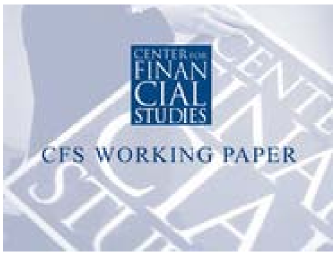
WP 12 / 06: Central Banks - Paradise Lost

WP 12/06: Central Banks - Paradise Lost

Working Paper by Otmar Issing (CFS President)



The main focus of the paper is to analyze how the philosophy behind central bank policy developed over time and how the crisis and its consequences will have an influence on this institution.

The Heyday of Central Banks

The paper begins with a short description of how the reputation of central banks evolved during the last 60 years and how it peaked around the turn of the last century.

In the post-war period, there was a reliance on administrative measures such as credit ceilings or other types of quantitative controls. They proved, however, increasingly ineffective and incompatible with free-market conditions causing central banks to abolish such instruments and to rely increasingly on open market operations.

The 1970s had a fundamental impact on concepts of monetary policy. The “great inflation” in the US was identified as a consequence of a discretionary monetary policy misguided by unreliable indicators. When this policy ended in stagflation, the Fed under chairman Volcker reoriented its policy in the direction of pragmatic monetarism.

Theory and practice have discarded the option of a purely discretionary monetary policy. On the other extreme, strict rules did not stand the test in theory either. However, the discussion on rules has delivered many useful insights, namely that central banks should adapt a kind of rule-based behavior as embodied e.g. in the commitment to an explicit monetary policy strategy.

The 1990s generated a huge bulk of literature discussing the optimal institutional arrangement for central banks. There is a broad consensus that a central bank, especially one endowed with independence in its monetary policy decision must be given a clear mandate and that the mandate must include price stability in the form of low inflation. However, the discussion of a single versus a dual or even more-dimensional mandate is ongoing.

As a result of this literature but also practical experience one could conclude that an optimal institutional arrangement for a central bank should include three principles: independence in the conduct of monetary policy, a clear mandate, and prohibition of monetary financing. This consensus is reflected in the statute of the European Central Bank (ECB) which was agreed on in Maastricht in 1991.

Inflation Targeting

In the 1990s, central banks around the world seemed to have reached a general consensus on the optimal monetary policy strategy. Inflation Targeting was identified as state of the art of monetary policy, and proponents still see it as the best-practice

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strategy, even after the crisis. According to Issing, it is hard to see how inflation targeting can deal with the fundamental flaw which is the neglect of money and credit as sources of risk for price stability. It is mainly for this reason that the ECB adopted a two pillar strategy giving money and credit an important role.

A widespread consensus among central banks is based on the principle of price stability or rather low and stable inflation as monetary policy objective and pursues a strategy comprising a number of elements:
a) A quantitative definition of the objective of price stability
b) A forward-looking monetary policy
c) Transparency of the decision-making process and communication with the public.

The crucial element of divergence however remains the issue if monetary policy decisions are based on an inflation forecast derived from a real economy model or on a strategy which gives money a prominent role.

Lessons from the financial market crisis

Before the crisis, the dominant view was that central banks should not target asset prices and not try to prick bubbles but should rather follow a “clean-up” strategy in the aftermath of events (what Issing calls the “Jackson Hole” consensus). Considerable flaws characterize this consensus, with the unfolding of the financial crisis being only the most recent and prominent manifestation of those flaws. This passive role together with the preannouncement of the bank’s function as a “savior” once a bubble bursts represents an asymmetric approach, one that might create moral hazard and over time contribute to ever larger bubbles and collapses (ECB 2005). The question of what to do once the bubble bursts should remain but should come only second.

New research and empirical evidence have delivered strong arguments in favor of the potential effectiveness of using the central bank interest rate to stabilize financial markets (Papademos 2009). The policy of “leaning” against the wind of asset price booms must be based on a reliable assessment of substantial misalignments. The ECB’s monetary pillar draws attention to rising imbalances in the monetary sector which are well-correlated with financial imbalances.

The discussion is whether and to what extent central banks should be made responsible for preserving financial stability. There are (at least) two dimensions to this problem.

Full responsibility for financial stability would imply that the central bank is provided with additional tools from the area of regulation and supervision. This however would challenge the independence of a central bank for the reason that too much political responsibility is given to such an institution. A clear mandate to maintain price stability to be delivered by an independent central bank is the nominal anchor in a paper standard system. With the removal of the precondition of independence, inflation expectations would be deprived of this anchor and over time the period of low inflation would remain a rather short lived episode.

This, however, does not imply that central banks should be completely excluded from responsibility – formally or informally. There are strong arguments why central banks should have all the information they need and might contribute or take responsibility for macro-prudential supervision. The “line in the sand” should be drawn where the intrinsic goal of the central bank – maintaining price stability – is endangered.

Reputation at risk

In the sovereign debt crisis central banks were seen as “savior” of last resort. In providing liquidity at zero or close to zero interest rates against collateral which hardly qualifies as “good securities” a number of central banks have gone far beyond Bagehot’s famous principle. This is an inappropriate extension of the role of lender of last resort.

Solvency of a sovereign debtor is traditionally defined as a state being able to service its debt by collecting taxes. Bringing this responsibility into the domain of the central bank means transferring an obligation of public finance into a monetary phenomenon. The dividing line between monetary and fiscal policy is crossed and the central bank becomes part of politics.

In this context a discussion concerning the acceptance of a higher inflation rate by central banks triggers additional pressure. There are two strands of arguments why currently central banks should tolerate higher inflation: One is derived from the problem of the zero bound for nominal central bank interest rates, the other argument is based on the idea that higher inflation would facilitate the service on public debt. Another concerns the coordination – explicitly or implicitly – of monetary policy and fiscal policy, in the belief that policymakers can maximize economic welfare by choosing the optimal mix of monetary and fiscal stimulus.

Once a central bank would accept higher inflation and engage in games of “give and take”, its reputation and credibility would be at stake and its independence de facto would be lost. Central banks might be blamed for all the negative consequences which will be attributed to them for their resistance to participate in the “coordination game”. In the longer term such firmness might turn out as the best contribution central banks can make for the welfare of society.

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Central banks should demonstrate modesty in what they promise to deliver, explain convincingly what they have no competence for, be transparent on their actions, but firm in their determination to preserve the value of money which is the final anchor in a paper standard.

Click **here** to read the Working Paper from the CFS Website

Staff Member Profile

Staff Member Profile

Laura Moretti
Post-Doctoral Researcher at CFS since October 2010

My research interests range from Macroeconomics and International Finance to Political Economy. I am particularly interested in the role of institutions and in policy questions, and have a preference for empirical work.

Laura Moretti

Following the debate over the role of transparency in financial markets, the paper **"Transparency and Government Bond Spreads"** analyzes the impact of enhancing transparency on government bond spreads of emerging markets economies (EME). The International Monetary Fund (IMF) offered member countries after 1999 the opportunity to publish the Article IV reports, prepared by the IMF staff during their regular country visits, and the Report on Observance of Standards and Codes, which contains the IMFs' assessment of the country's compliance with internationally recognized standards and codes. These initiatives were prompted by the widely shared view that the EME crises in the 1990s were partly due to the lack of reliable information. Using a sample of 18 EMEs for the period 1999-2007, I find that the effect of the publication of Article IV is negligible, while the publication of ROSC matters, leading to a decline in the spreads of 15%. I am currently extending the analysis to verify whether those EMEs that become more transparent have been more resilient during the recent financial crisis.

My interest in transparency led to a joint paper with Toru Suzuki (Max Planck Institute of Economics, Jena) on "**Strategic Transparency and Political Competition**", in which we analyze the strategic decision of an incumbent politician to raise transparency in order to increase his chances of reelection. We are particular interested in the endogenous choice of disclosing information given incumbents' power to legislate and the fact that imposed rules are not always effective.

Returning to macroeconomic issues, the paper "**Inflation Targeting and Product Market Deregulation**" analyzes the effect of the adoption of inflation targeting (IT) on the inflation rate directly and indirectly through its interaction with product market deregulation in a sample of OECD countries. It has been noticed that the decline in inflation experienced in the 1990s was mainly driven by institutional reforms within central banks and by improvements in monetary policy, but other factors such as the increased competition due to globalization and product market deregulation played an important role. The results show that the effect of IT is large and statistically significant, but there is an important interaction effect between product market deregulation and the adoption of IT. I am currently working on the analysis of the effect of deregulation on the inflation rate in the euro area where the institutional reform of the central bank occurred at the same time in contrast to reforms regarding competition that were implemented at different points in time.

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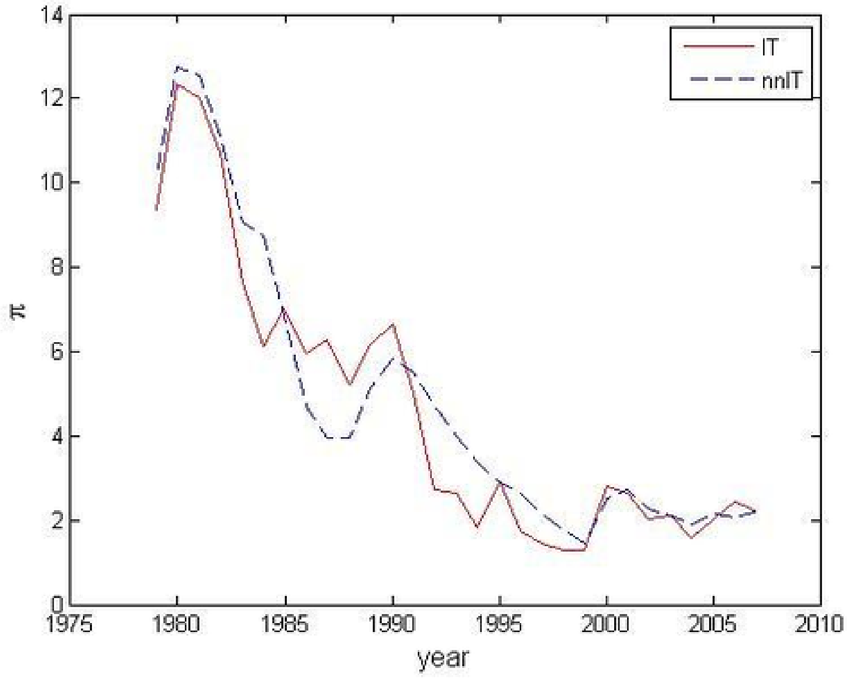

Average Inflation Rate for IT and non-IT Countries Quarterly data, 1985-2007

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Following the recent macroeconomic developments and the observation of the dramatic decline in the US long term real interest rates before the recent financial crisis prompted the paper with Stefan Gerlach (Central Bank of Ireland) on "**Monetary Policy and TIPS Yields before the Crisis**". We investigate whether excessively expansionary monetary policy caused the financial crisis. We conclude that, even though the nominal interest rates were low in the years that have preceded the crisis, they were not inconsistent with macroeconomic conditions. A summary of the study appeared in a VoxEU column, "Monetary Policy before the Crisis", last August. Since the same phenomenon was common in all industrialized countries, we are extending the analysis to a sample of 8 OECD economies.

Finally, I recently analyzed the informational content of the CFS Financial Index. The index, which surveys managers in the financial industry in Germany, provides a measure of confidence of the financial sector. It is available quarterly since 2009, but due to the limited time series availability it has not been possible to investigate it extensively. I find that the CFS index is a leading indicator of German GDP growth and of the loan supply for Germany as captured by the European Central Bank's Bank Lending Survey.

My future project is to analyze the interbank lending structure in Germany and the effect of the recent unconventional monetary policy measures adopted by the ECB during the financial crisis.

The ECB and Its Watchers XIV

The ECB and Its Watchers XIV

THE ECB AND ITS WATCHERS

The ECB and Its Watchers XIV
15 June 2012

Frankfurt am Main

This conference series brings together “The ECB and its Watchers” since 1999. This year, the Center for Financial Studies is joined by the Institute of Monetary and Financial Stability as co-sponsor of the event. Both institutes are located in the House of Finance of Goethe University Frankfurt.

On June 15, ECB President Draghi and Board Member Peter Praet met with ECB watchers from academia, media and the financial community on at a dramatic confluence of events concerning European Monetary Union. Several EMU members' commitment to the type of policies that are required to maintain stability in a monetary union continues to be challenged by financial market participants. In some cases, electoral support for such policies is highly questionable.

At the same time, European Union leaders are considering to augment monetary union with banking union, debtor's union and fiscal union. Such changes would bring us much closer to political union. They would involve a substantial shift of power from the national to the supra-national level.


Volker Wieland, Mario Draghi

The hope is that supra-national institutions would perform better than national governments in terms of committing to and implementing the type of policies that are required to maintain stability in a monetary union.

Surely, the analysis, criticism and advice of ECB watchers is needed more than ever by policy makers, financial market participants and euro area citizens. Conference speakers included government and central bank officials such as the Finance Minister of Portugal, Vitor Gaspar, the Deputy Governor of the Central Bank of Ireland, Stefan Gerlach, and Lucio Pench from the European Commission, influential academics such as Lucrezia Reichlin, John Vickers, Jose Campa and Hans-Werner Sinn, and economists from financial firms such as Willem Buiter.

This year's meeting, organized again by Volker Wieland (CFS & IMFS) marked a record number of more than 300 registered participants, among them 70 media and press representatives. As in the past, it was partly covered live by CNBC, Bloomberg and Reuters TV. In addition, President Draghi's speech and conference discussions were reported on in the news of the major German television channels, ARD and ZDF.

Debates and speeches at the conference focused on urgent questions in the current policy debate. Three areas received much attention, banking regulation, monetary policy,

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and economic adjustment in the euro area.

On banking, it was discussed what regulatory structure would be appropriate for managing systemic risk in the sector and whether a form of banking union was needed. Regarding monetary policy speakers debated whether ECB liquidity provision was insufficient, appropriate or excessive, and whether the ECB had dealt effectively with the challenges arising from the heterogeneous economic situation in the euro area.

This was followed by in-depth reviews of divergences and needs for economic adjustment in the euro area. Progress on the adjustment path was evaluated and diverse visions of the future of euro area governance and the make-up of the monetary union were presented.

The following presentations are available for download:

Introductory Remarks: Volker Wieland
Presentation: John Vickers
Presentation: José Campa
Presentation: Peter Praet
Presentation: Lucrezia Reichlin
Presentation: Vítor Gaspar
Presentation: Lucio Pench
Hans Werner Sinn: please visit the website of the institute
Presentation: Stefan Gerlach

The Conference website with all links can be found here.

The ECB and Its Watchers

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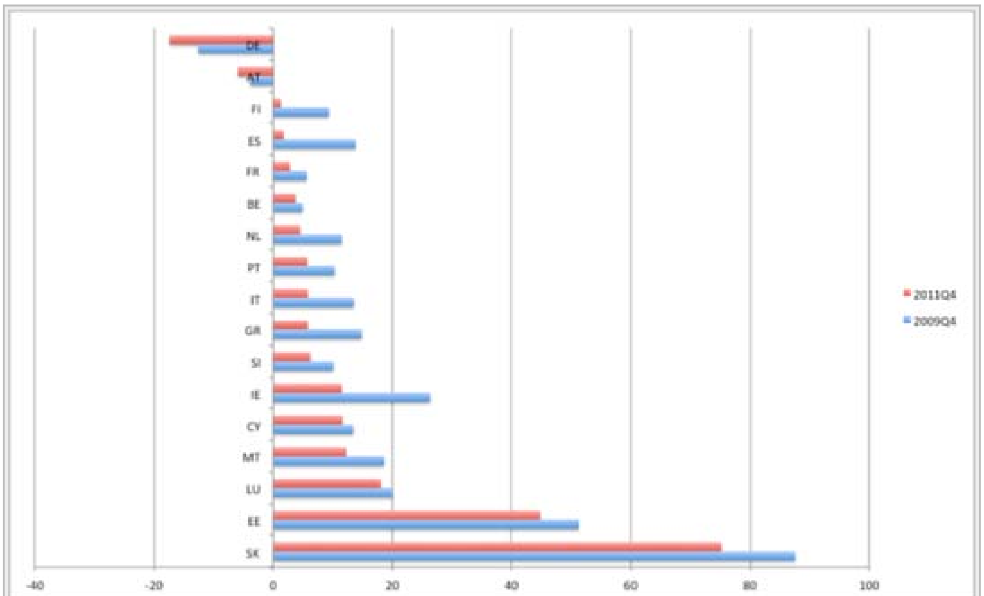
Greece: Getting Here and Moving Forward

Lecture by Professor Michael Haliassos
5 June 2012


Michael Haliassos

The talk by CFS Director Michael Haliassos focused on key factors that have brought Greece to its present state and on prospects for getting on a sustainable growth path in the euro area.

He argued that the factors contributing to Greece's predicament represent an interplay of economic and political processes that have led to a bad equilibrium. Although it would have been difficult to escape this equilibrium without an external coordination mechanism, the intervention of the IMF-ECB-EU has so far focused mainly on austerity measures and has failed to provide the necessary impetus for most essential structural reforms. This is partly the fault of the troika, which appears to have given up on reforms occurring or has pushed for hasty, horizontal measures; and partly the fault of Greek politicians and powerful pressure groups, which have resisted reforms. This has caused the Greek people to identify the memorandum with cuts rather than improved competitiveness and growth, and to oppose the memorandum while firmly supporting Greece's membership of the Eurozone.



Change in Harmonized Competitiveness Indicators Based on Unit Labor Costs, Percentage change since 1991:Q1. Observation points: 2009:Q4 and 2011:Q4 (Source

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Greece developed an inflated and inefficient public sector over the past 30 years because political parties used appointments and then creation of unwarranted wage differentials within it as a means to create loyal political clienteles. The creation of a slimmer, efficient, growth- and productivity-oriented public sector requires severing these ties and linking appointments, promotions, and pay to effort of public sector employees and to efficiency of public sector entities. European partners can be instrumental in this effort, not only by exerting the necessary pressure but also by sharing valuable expertise and international best practices.

The much discussed option of making Greece drop out of the euro zone would not provide a viable solution for Greece and could endanger the future of the euro zone itself. Returning to the drachma would mean a substantial devaluation that would raise the value of debt but also the cost of necessary imports, while failing to deliver substantial import substitution or increases in export revenue. The current lack of a wide productive base and the difficulties in starting new businesses, partly due to the poor state of the public sector, mean that production is unlikely to rise sufficiently in order to solve the current account problems. For those who did not send their money abroad, exit from the euro would consequently bring poverty. Additionally, there would be a danger of hyperinflation, as the central bank would regain access to the printing press in the midst of public protests against huge increases in the cost of living and considerable unemployment.

Moving forward within the euro zone will require cutting the Gordian knot. Given that Greece has corrected most of its loss of competitiveness in unit labor costs since the start of 1999, reforms rather than further salary cuts and tax increases are now needed. These reforms should include measures fostering a more efficient, smaller public sector and the establishment of dynamic, innovative, export-oriented private firms; labor reforms to enhance flexibility; reforms of the justice system to enhance investor protection and contract enforcement; and increased price transparency to promote and monitor competition. A number of success stories in Greek industry and of sectors that have been identified as promising for future development suggest that targeted investments, as opposed to general provision of liquidity, are both necessary and fruitful in the effort to put Greece back on a growth path.

for Finance in Europe"

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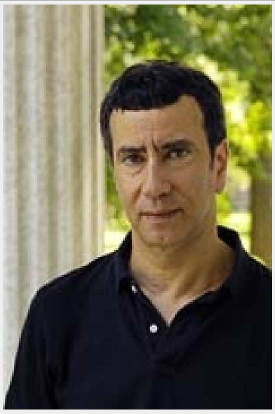
Beyond Our Means: Why America Spends While the World Saves

Lecture by Sheldon Garon

(Princeton University)

11 June 2012


Sheldon Garon

On June 11th, Professor Sheldon Garon (the Nissan Professor of History and East Asian Studies in the Department of History at Princeton University) gave a lecture on the different cultures of consumption and saving in various parts of the world, thereby referring to his book published last year:"Beyond our means: Why America Spends while the World Saves".

Garon presented an overview of the net household saving rates in different countries and explained the disparities through differences in national attitudes towards small savings. Historically, the US has had significantly lower household saving rates than continental European countries (Germany, France, Italy) or Japan. Many American households lack the basic savings to deal with unemployment, medical emergencies, home foreclosures,and retirement. In fact, 43% of American households have little or no savings. Theoretically, Garon stated, Americans should have *higher* saving rates than Europeans because the US welfare system is relatively weak.

Garon argued that the disparities in household saving rates are based on differences in the histories of saving: East Asian and European states have promoted and effectively implemented a culture of saving over the last two centuries. He gave an overview of institutions and campaigns that fostered the culture of thrift in these societies.

The savings banks in Germany – the Sparkassen – have a long history going back to the early 19th century. After a major reform effort in the beginning of that century, communities and states in Europe aimed to bring financial stability to the working class, reduce crime and create"prudent citizens". Such institutions also existed in the US: mutual savings banks were well established in the Northeast, Midwest, and the Pacific Coast. However, as Garon noted, due to the decentralization of the country, people in the South and West had little or no access to such savings banks: While in New England in 1910, 53.5% of the population had a savings account, in the South, it was only 3.4% – and in Texas only 0.9%. (as a reference: Germany 33.4%, Japan 34.9%)

The second type of institution that encouraged small savings in Europe was the postal savings bank – in Germany known as Postbank. Governments established postal savings banks in the late 19th century to enable the majority of the people to save small amounts. The importance of these institutions can be understood by looking at their stunning architecture. The US government also tried to promote small savings but Congress opposed postal savings legislation for several decades. Finally, in 1910 a very weak postal savings system was enacted but abolished in 1966.

In order to stimulate saving habits from an early age, many societies successfully implemented school savings banks, which became particularly popular in Belgium,

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France, and Japan in the late 19th century. In the US, these institutions appeared in some school districts, but failed to reach most schoolchildren. Since schools had to cooperate with savings banks, many American schools could not offer such a program, due to the lack of savings banks.

One of the greatest transnational successes in promoting savings was the campaign for war savings. By showing examples of campaigns, Garon illustrated how governments mobilized their populations to invest in small savings institutions, in order to support the financing of the war. Some of these posters show how women were bombarded with messages to save whilst demonizing money wasting. After World War II, many European countries continued to promote saving, thus financing post-war reconstruction. Not only did the existing systems of savings banks and postal savings continue, but they were extended with innovative methods to promote savings and to bring children into contact with saving at an early age.

The US, however, pursued a different policy. US savings rates remained within a moderate range from the 1950s to the early 1980s (between 7 and11%) but dropped significantly afterwards, fallingbelow 2% in 2005. According to Garon, declining saving reflected in part the growing consensus amongst Americans that consumption, rather than saving, is the key to economic growth. Recent developments, such as the deregulation of credit cards, the encouragement of home equity loans after the 1986 tax reform, subprime mortgages after 2000, and growing income inequality have led to a further decline in American saving rates.

Garon concluded his presentation with a number of recommendations for reviving saving in the US. Improved access to banking for lower-income households would be a first step in that direction. He also favors a change in tax laws, in order to incentivize lower-income households to save for retirement and daily needs. Secondly, tax incentives to over-invest in housing and home equity loans should be reduced, and so-called “predatory lending” should be regulated. Finally, Garon suggests that Americans begin to promote “financial inclusion” as a national priority and a civil right.

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How can Macro-Prudential Regulation be Effective?

How can Macro-Prudential Regulation be Effective?

Lecture by Vítor Constâncio
28 March 2012

On March 28th 2012, Vítor Constâncio, Vice President of the European Central Bank, gave a lecture on the effectiveness of macro-prudential regulation as part of the CFS Colloquium series entitled “Mission completed? Consequences of regulatory change on the financial industry?” The lecture attracted a large audience.


Vítor Constâncio

Constâncio argued that the recent financial crisis was triggered by a combination of excessive growth of credit, increases in leverage in the financial system, and the expansion of a shadow banking sector. From a macroeconomic perspective, the demand for safe assets was boosted by both the so called “savings glut” -- the very high level of saving in oil producing countries and in East Asia, partially as a reaction to the Asian Financial Crisis in the late 1990s -- and expansionary monetary policy in the US and elsewhere from the early 2000 onwards. Combined with financial deregulation, perhaps best illustrated by the repeal of the Glass-Steagall Act, these factors caused the financial imbalances that set the stage for the crisis.

Low interest rates led to rising leverage and to a search for yield, while financial innovation and deregulation led to a more interconnected and complex financial system in which contagion risk was pronounced. Moreover, the growing importance of the shadow banking sector contributed to the opaqueness of the system and rendered it difficult to monitoring the growing systemic risk, especially in the absence of a macro-prudential policy framework.

The surveillance of institutions and markets, in order to identify the vulnerabilities and the building up of risk that can lead to system risk, and the assessment of their possible impact on the financial sector and the whole economy are the two tasks of macroprudential oversight. The identification of systemic risk is important for central banks, Constâncio noted, mainly because a stable financial system is needed for the effective transmission of monetary policy.

In guarding against financial instability, monetary policy has a crucial role to play since interest rates affect asset prices and the value of collateral, and consequently the level of leverage and risk taking by banks. While policy had been focused mainly on ensuring price stability, particularly in inflation targeting regimes, central banks have acted as lender of last resorts since the 19th century. Thus, financial stability considerations were not new concerns to monetary policy makers.

A specific problem noted by Constâncio was that monetary policy tends to be asymmetric, with central banks intervening strongly only during downturns but ignoring the risks accumulating in booms. This behavior was usually rationalized by the difficulty of identifying bubbles or in the danger associated with pricking bubbles. However, the recent development of macro models with financial frictions provides additional guidance

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for monetary policy even though the models are not mature yet. Similarly, central banks already oversee market infrastructures, implement prudential supervision and conduct financial stability analysis; much analysis was thus already devoted to the identification of bubbles and the risks they entail. Nevertheless, macro-prudential oversight should be expanded to the whole financial sector.

Regarding macro-prudential instruments, there is much international agreement that counter-cyclical capital buffers can play a key role and are to be implemented in the Basel III framework. All the indications are that they can substantially improve the resilience of the banking sector, thus contributing to the smooth provision of financial services throughout the business cycle. If they had been in place before the recent financial crisis, banks' needs for capital would have fallen by perhaps as much as half.

Constâncio also discussed dynamic provisioning, which was introduced by Spanish regulators before the crisis to enhance the resilience of the banking sector in a period of strong lending growth and rising house prices. It involves building up provisions for potential losses in order to smooth the credit cycle. The Spanish experience showed that dynamic provisioning did improve bank resilience in the downturn but, nevertheless, proved insufficient to prevent the build up of imbalances. Other measures such as maximum loan-to-value, and debt-to-income, ratios were potential instruments and had proven to be effective in the Korean case.

Constâncio also considered the highly pro-cyclical and reinforcing nature of fair value accounting and loan loss provisions. While fair value accounting could not be considered the root of the imbalances that led to the crisis, it had fed the boom and leverage, and acted as an amplifier, via “fire sales”, in the downturn.

To conclude, Constâncio noted that financial instability disrupted the real economy and a new macro-prudential regulatory regime, combining macro and micro prudential policies, should be developed to limit excessive risk taking and imbalances and enhance the resilience of the financial system.

Globalization and Pluralization of States. Why there will be no “United States of Europe”

Globalization and Pluralization of States. Why there will be no “United States of Europe”

Original Title: "Globalisierung und Pluralisierung der Staatenwelt. Wieso es 'Vereinigte Staaten von Europa' nicht geben wird"

Professor Hermann Lübbe

(Honorary professor for Philosophy and Political Theory at the University of Zurich)

8 March 2012


© European Community

The first talk this year in the CFS Presidential Lectures series was given by the philosopher and political scientist Professor Hermann Lübbe. He gave his view on the future development of the European Union. According to his main thesis, European states have no intention of moving to a “United States of Europe”, analogue to the USA, but will, quite the contrary, increasingly emphasize their regional sovereignty. Lübbe presented his arguments by outlining the historical development of the EU, and then pointing at current pluralistic tendencies among the European states.

Lübbe began his speech by referring to a discussion he had in the aftermath of the Maastricht Treaty on the aims of the European unification process. German officials tend to present this process as a converging of European states, with the aim to overcome Europe's regionalism and small-state mentality in order to raise global political importance. However, he noted, rather than unification, a diversification of states is the case in recent European history. In order to illustrate this tendency of pluralization, Lübbe named two underlying factors. First, the irreversible process of decolonization in the years after World War II detached major parts of Africa and South East Asia from their European dependence, and second, the downfall and division of large territorial states – such as the Soviet Union, the Austrian-Hungarian and the Ottoman Empire – led to a remarkable number of newly created sovereign states. This is an ongoing trend that does not only apply to Eastern Europe and the Balkans. Lübbe cited by way of example the independency movements in Belgium, Catalonia, Corsica, and Scotland, and the trend towards regionalization and increasing autonomy of local authorities in countries as France and Spain. According to him, Germans tend to disregard such tendencies, since they, due to their history, usually give low attention to national and regional consciousness.

Lübbe argued against German elites who refuse to acknowledge the importance of

distinct regional values and just see these as a backward-looking attitude by isolationist groups. In his view, pluralization is a complementary phenomenon to globalization on the economic as well the political side, meaning that by rising globalization, pluralistic tendencies will rise equally. In this context, he gave his definition of globalization, namely a process whereby social and regional areas become more and more dependent on each other, especially meaning that an increasing number of goods (including services) will either be accessible only in mutual accordance or not at all. There are plenty of examples, such as radio frequencies, or air or sea traffic control. International agreements ensure the mutual abidance by the rules, being controlled by supranational organizations – not by a unified nation state.
Lübbe sees a significant proof for this complementarity in the demand for more self-determination by the individual when the influence of authorities in privacy intrusive processes rises. He used the example of the improved medical care and increased impact of doctors in our lives, as being complementary to our claim for more involvement in medical decisions. According to Lübbe, this can be transmitted from the individual level to the collective, i.e. regional groups. The competences that supranational organizations have acquired over the recent past are not necessarily competences that have been taken away at the local level, but are rather complementary to meet requirements of modern life that were non-existent before.

To transpose these ideas to the Europe, Lübbe argues that the European Union is first and foremost a common market of continental reach. He dismisses the argument of a European community of values as being meaningless, and asserts that the peace in Europe today is not the result of the European integration but rather the opposite. Referring to a statement by Bundeskanzler a.D. Helmut Kohl "Der Euro sei eine Frage von Krieg und Frieden", Lübbe points to the fact that the European Union has never possessed the ability to maintain and build peace (due to the failure to establish a European Defence Community).

Lübbe concluded with a statement that the European sovereign debt crisis is not primarily a consequence of a fundamental euro problem but rather of a large-scale process in many parts of the world. It is a crisis of democracy and the growing disability of political parties to contribute to stipulating a political line. He concluded his speech by presenting direct democracy as an instrument to bring political parties back to a political and economic order that resists the temptation to run up more government debt.

for Finance in Europe"

03 New Senior Fellows at CFS

Deutsche Bank Prize in Financial Economics 2013: Preview

Deutsche Bank Prize in Financial Economics 2013: Preview

2013 marks the academic award's 5th edition. The CFS, in partnership with Goethe University Frankfurt, has been awarding the DB Prize biannually since 2005. The award honors internationally renowned researchers whose work has significantly influenced financial economics, and has led to fundamental advances in economic theory and practice.

The winner of the forthcoming DB Prize will be **announced in February 2013**. The award itself is accompanied by a monetary sum of 50,000 euro, donated by the Stiftungsfonds Deutsche Bank im Stifterverband für die Deutsche Wissenschaft* and will be **presented on September 26, 2013** by the CEO of Deutsche Bank AG. The award ceremony takes place as part of an international academic symposium in honor of the award winner, which encourages a fruitful dialogue between academics, policy makers, and financial practitioners.

Nomination Process

The pool of invaluable nominations provided by an international network of distinguished academics guides the Jury's award winner selection process and ensures that it reflects, in part, the winner's stand within the scientific community. From the end of September 2012 onwards 3,800 academics, who are from around 60 countries all over the world and whose own research focuses on this field of expertise, will be called upon to take part in the nomination procedure until the end of November, 2012.

Jury 2013

Since 2005, the groups of Jury members have consisted of over 30 distinguished professors with backgrounds from Europe, North America, Latin America, Asia and the South Pacific. Members of the international Jury for the upcoming award in 2013 include the professors **Ricardo Caballero** (Massachusetts Institute of Technology), **David Folkerts-Landau** (Deutsche Bank's Group Chief Economist, Global Head of Market Research and member of the Group Executive Committee), **Nicola Fuchs-Schündeln** (Goethe University Frankfurt) and CFS Director **Michael Haliassos** (Goethe University Frankfurt). Also representing the Goethe University are the professors **Otmar Issing** (CFS President) and **Jan Pieter Krahnen** (CFS Director). Furthermore, the Jury includes Professor **Robert Merton** (Nobel Prize Winner; Massachusetts Institute of Technology) and the award winner of the DB Prize 2011, Professor **Kenneth Rogoff** (Harvard University). Professor **Raman Uppal** (EDHEC Business School) as well as CFS Director Professor **Uwe Walz** (Goethe University Frankfurt) are also acting as Jury members.

For further information on the Jury please click on the following link:
www.ifk-cfs.de/dbprize/2013/jury

Former Award Winners

The rapid growth of the prize's reputation has been primarily due to the consistently and exceptionally high level of achievement characterizing each awardee, as well as to the openness to alternative points of view.
In 2005, the DB Prize has honored **Eugene Fama**'s fruitful insistence on individual

rationality in financial market behavior, as well as **Robert Shiller**'s constructive challenge of rationality and promotion of behavioral considerations in 2009. In 2007, it has recognized **Michael Woodford**'s pathbreaking redefinition of monetary analysis, as well as in 2011, **Kenneth Rogoff**'s insightful diagnosis of what can persistently go wrong during financial crises, preventing us from learning how to avoid or handle future ones.

The DB Prize has created a unique platform over the past eight years for renowned international financial economists, together with participants from politics, academia, press, central banks, private institutions and banks to exchange ideas and discuss the award winner's research and the light it can shed on current developments. The award ceremony and symposium represent the culmination of significant efforts undertaken by distinguished members of the worldwide academic community.

The prize is a decisive contribution to strengthening Frankfurt's role as a center for both research and financial markets. The prize holder will be appointed "Distinguished Fellow" of the CFS.

** Deutsche Bank Donation Fund in the Donor's Association for German Science*

For further information on the DB Prize please click on the following link:
www.db-prize.org

Sabine Kimmel (CFS)

Christian Leuz will visit Frankfurt with Humboldt Research Award

Christian Leuz will visit Frankfurt with Humboldt Research Award


Christian Leuz

Christian Leuz, Joseph Sondheimer Professor of International Economics, Finance and Accounting at the University of Chicago Booth School of Business, has received the **Humboldt Research Award**.

This Award will now enable Christian Leuz to put his cooperation with CFS and Goethe University on a more solid basis. The Award comes with an invitation of the researcher to Germany and it is Christian's intention to spend several months during the academic year 2012/2013 at Goethe University in Frankfurt, where he had earned his doctorate degree in 1996 and a habilitation (German postdoctoral lecture qualification) in 2000. In cooperation with researchers from the Center for Financial Studies and Goethe University's House of Finance, Leuz will do research and also support Goethe University in its efforts to create a research group focusing on empirical accounting and capital-market research. Leuz' influence and guidance to establish an "Empirical Accounting and Finance Group" with an impact on the academic, regulatory, and practicing worlds of financial reporting will be a major contribution that is enabled by the Humboldt Research Award.

Christian Leuz has accumulated an impressive body of research on the role of corporate disclosures, accounting transparency and disclosure regulation in capital markets and in corporate financing. His study on the U.S. OTC market, co-authored by Brian Bushee, is one of the first to provide evidence on the existence of disclosure externalities, which are commonly viewed as a justification for regulation. Leuz was one of two economists who were asked by the Financial Accounting Standards Board to produce an independent research report on the pros and cons of adopting International Financial Reporting Standards (IFRS) in the United States. In one of his latest studies, he looks at the economic consequences of securities regulation in the EU context.

Christian Leuz is one of the most frequently cited authors in the field of finance and accounting, and he has won several awards and prizes, including the 2010 Notable Contribution Award and the 2011 AAA/Deloitte Wildman Medal for his work on international accounting.

The Center for Financial Studies and the House of Finance are up to exciting changes and we look forward to welcoming Christian and to working with him on common research projects.

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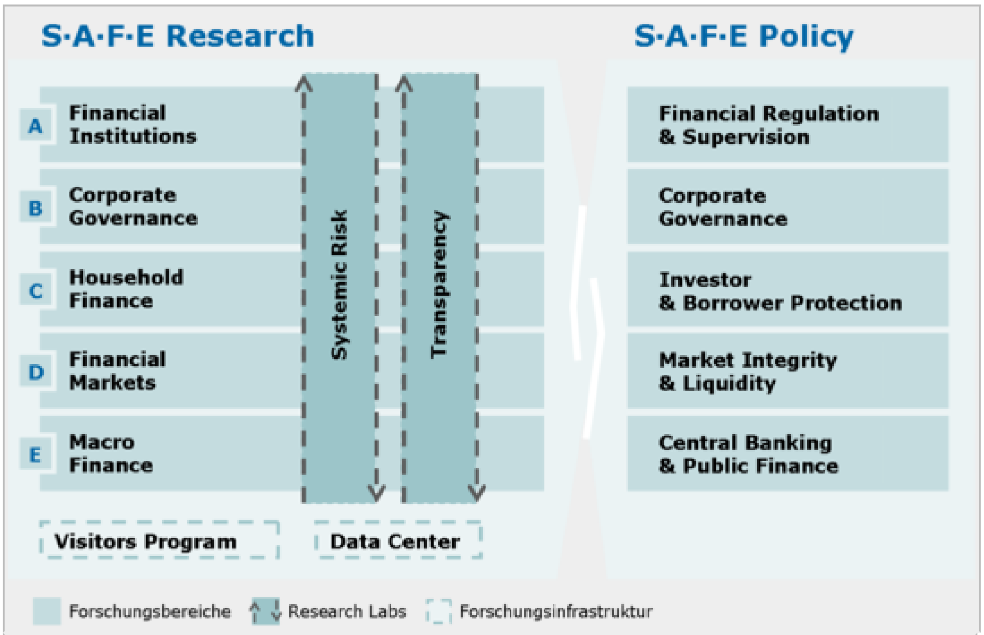
LOEWE center "Sustainable Architecture for Finance in Europe"

LOEWE center "Sustainable Architecture for Finance in Europe"

S·A·F·E

We are happy to announce today the approval of our application to the excellence initiative of the State of Hessen under the acronym 'LOEWE' . The support of the State Government of Hessen through this program will allow CFS, in collaboration with Goethe University Frankfurt, to set up a LOEWE research center called S▪A▪F▪E "Sustainable Architecture for Finance in Europe", dedicated to top-level scientific research and research-based policy advice. Over the next years, the LOEWE Center will receive significant funding to pursue a comprehensive research agenda on the changing role of financial markets and institutions, and to contribute research-based policy advice with a view to meeting the politico-economic challenges in the design of a sustainable financial system in Europe and the world. The new Center will conduct research, train young professionals, and reach out into the community by creating a platform for dynamic interaction between academics and policy makers.

The new research center S▪A▪F▪E will promote research and policy advice in five key areas capturing the behavior of households, financial institutions, markets, policy makers and regulators, but will also emphasize projects that cut across these five areas. Topical issues, such as the current fiscal imbalances and the challenges they pose for a common currency, will be combined with topics of longer-standing, such as technological progress, the global imbalances induced by the process of economic development, and the challenges on old-age provision posed by the demographic transition. The Center's design is intended to benefit from, and contribute to the dynamic interaction between researchers, economic actors, and policy makers and regulators.



Structure of S▪A▪F▪E

The new center will have a strong European orientation, contributing to a balance with

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similar endeavors on the other side of the Atlantic, and will have a number of key features that will be highly beneficial to European policy makers and supervisors, as well as to the academic and financial practitioner community in Hessen and in Germany at large. S▪A▪F▪E intends to introduce new concepts for sharing knowledge, which will offer students, policy makers, and financial practitioners the opportunity to acquire first-hand knowledge on specific, often technical subjects. A newly designed Visitors Program will contribute to these objectives, as well as to international visibility of the project. The Center will also be involved in collecting unique data sets on the changing behavior of banks, households, firms, and policy institutions, focusing on the differences between optimal and actual behavior, and on their potential costs and remedies.

Located in Goethe University's House of Finance, the center can use as a stepping stone existing relations, events or networks. S▪A▪F▪E will open its doors in January 2013 and we look forward to working on the challenges we face.

More can be found on the website of **Hessisches Ministerium für Wissenschaft und Kunst**

New Senior Fellows at CFS

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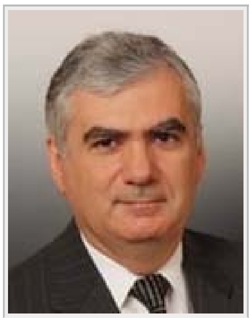
CFS is very happy to report that **Thomas Mayer** and **Athanasios Orphanides** have accepted to become Senior Fellow at CFS.

Thomas Mayer

Thomas Mayer

Thomas Mayer will be involved in research on European financial integration and current financial market issues. He is currently a senior advisor to Deutsche Bank's management and key clients. Previously, he was Chief Economist of Deutsche Bank Group and Head of Deutsche Bank Research, and before that Chief European Economist at Deutsche Bank in London and co-head of the Bank's Global Economics Group. Before joining Deutsche Bank in 2002, he worked for Goldman Sachs in Frankfurt and London, and for Salomon Brothers in London. In the early stages of his career, he held positions at the International Monetary Fund and at the Kiel Institute for the World Economy. He received a Ph.D. in economics from the University of Kiel and is a CFA Charterholder since 2002. Thomas Mayer has published numerous articles on international and European economic issues in professional journals and has commented on these issues in the media.


Athanasios Orphanides

Athanasios Orphanides will be involved in research activities in the area of monetary economics and financial stability, as well as in policy debates regarding monetary policy and financial stability. Orphanides has been Governor of the Central Bank of Cyprus from May 2007 to May 2012. During his term, he oversaw the introduction of the euro in Cyprus and subsequently served as member of the Governing Council of the European Central Bank between January 2008 and May 2012. Following the creation of the European Systemic Risk Board in 2010, he was elected a member of its inaugural Steering Committee. Prior to his appointment as Governor, Orphanides was a Senior Adviser at the Federal Reserve Board in the USA, where he had started his professional career as an economist. While at the Federal Reserve he taught undergraduate and graduate courses in macroeconomics and monetary economics at Georgetown University and Johns Hopkins University. Orphanides obtained his undergraduate degrees in mathematics and economics as well as Ph.D. in economics from the Massachusetts Institute of Technology.

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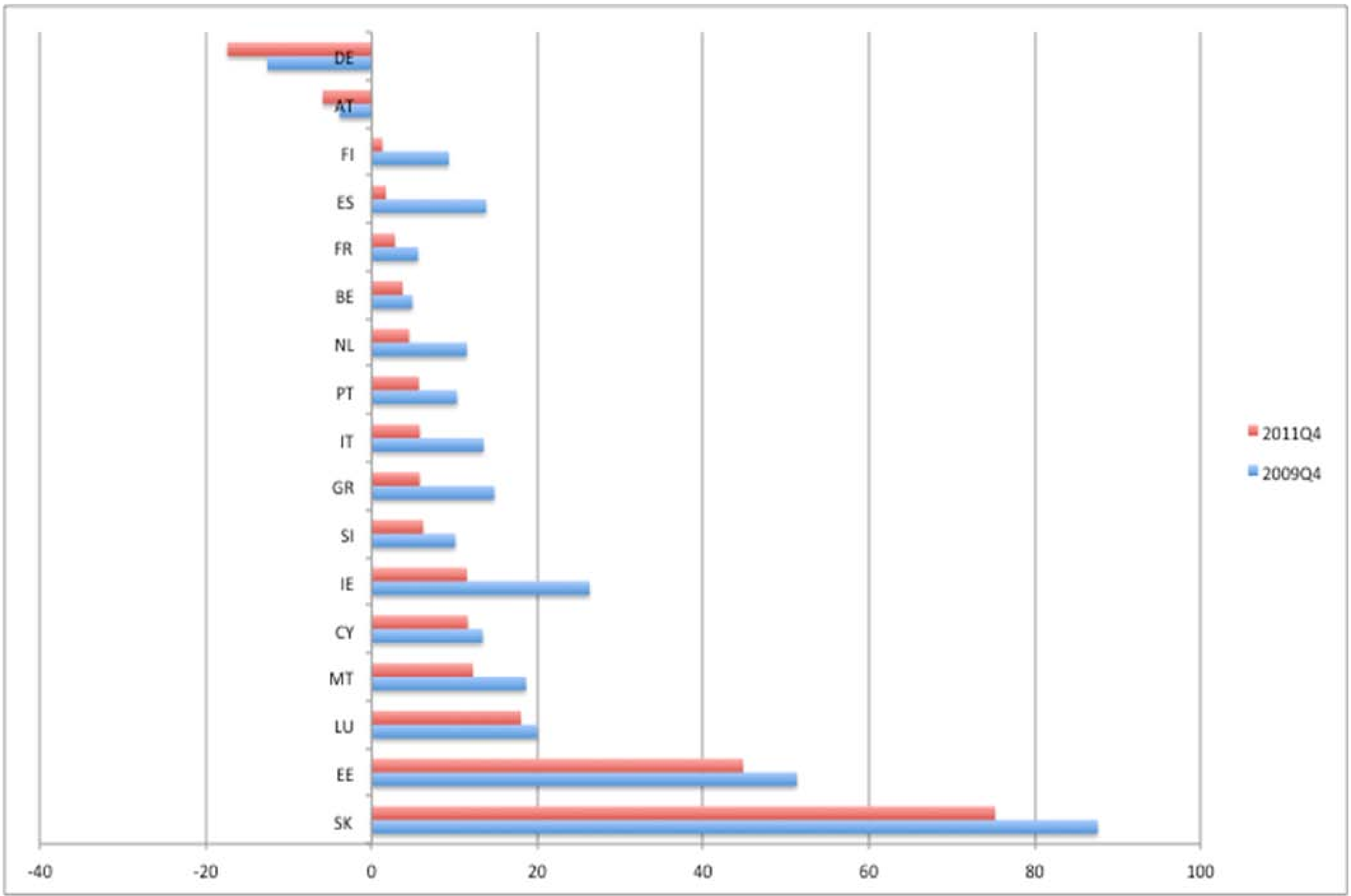
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