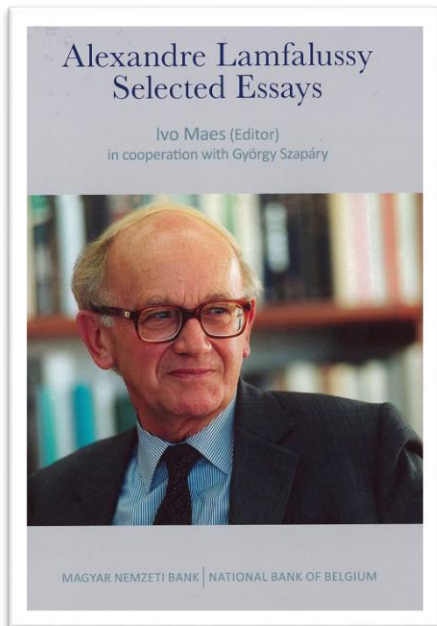


Book Review: Alexandre Lamfalussy Selected Essays

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Thanks to the joint initiative of the Central Banks of Hungary and Belgium, a book with a selection of 35 essays allows to illustrate the exceptional career of Alexandre Baron Lamfalussy, who died in 2015, at the age of 86; and to fathom his judicious opinions about the international monetary scene, of which he was a privileged observer and also a first-range architect. These essays reproduce his addresses to various sophisticated audiences.

We are lucky that Alexandre could be convinced towards the end of his life, to enter into a 'dialogue' (as we call it hereafter) with an economist, a historian and his eldest son. This text, presented in 2014 at the National Bank of Belgium, when the 20th anniversary of the European Monetary Institute was commemorated, allows us to reconstitute his early years in Hungary, his escape a few days before the Iron Curtain was effectively installed, and the various stages of his stupendous career.



Overview of his curriculum

The young Alexandre was able to reach Belgium, where he studied economics, with outstanding results, at the Catholic University of Louvain; he proceeded with a PhD degree at Oxford. He entered the (then) Banque de Bruxelles as an economist, and became a member of the (top) Management Committee, which he headed from 1971.¹ In 1961-62 he had been invited to teach at Yale University. In October 1974, a loss at the Banque, resulting from uncovered foreign exchange transactions, led him to resign.

Soon afterwards he was solicited to become the economic advisor of the Bank for International Settlements (BIS) and head of its Monetary and Economic Department, where he acceded to the top position of General Manager in 1985. In 1994, he accepted the exacting task of establishing and managing a new institution, the European Monetary Institute (EMI), which had to prepare the launch of the European Central Bank (ECB), and of a new currency, the EURO. As agreed upon with the EU leadership, Lamfalussy directed the EMI during 3 years and may be regarded as a primary originator of the EURO.

Those who are interested in hearing more about such an outstanding career, are referred to the 'Dialogue', which also contains several worthwhile anecdotes about the background of the Euro, such as the involvement of top leaders as Jacques Delors and Helmut Kohl. I must naturally focus here on the 'Selected Essays', which contains a brief introduction by Ivo Maes about Lamfalussy's career, and whose selections are rubricated over the main periods of the author's career. Yet, I can obviously only refer to a few of the 35 'selected essays'.

In his successive positions, Lamfalussy has naturally been a much-solicited speaker. He took care in writing out his addresses, when they were slated for publication, as was most often the case. His papers share a few characteristics. Firstly, his opinions were expressed with great clarity, careful nuancing and within a well-designed lay-out. Secondly, he was not interested in surveying the whole course of a given problem – in fact still evolving – but rather in identifying new developments in the international financial arena, which then became topical, and to scrutinize them systematically, even if he had not yet ready answers but could solely adduce some elements to the analysis. Depending on

¹ In 1961-62 he had been invited to teach at Yale University where he prepared a book on "The United Kingdom and the Six".



their particular interests, and the length of their retrospection, the readers of the 'Selected essays' will find authoritative views on the many problems which have plagued the field of international finance.

Indeed, during the long span of Lamfalussy's career, that area has almost never been peaceful. Let me recall the dispute about the Bretton Woods mechanism and its replacement in 1973 by a floating-rate system; as well as the search for a stable relationship between European currencies.

His training in economics

His outstanding scores in economics at the University of Louvain predestined the young Alexandre for a doctoral follow-up. He got a scholarship for Oxford, where from 1953 to 1955 he prepared a Ph D thesis directed by Prof. Philip Andrews (Industrial Economics), while Prof. John Hicks (the future Nobel laureate in 1972) acted as chief reader. The Macmillan editing house was interested in a printed version of the thesis. The book, entitled "Investment and Growth in Mature Economies. The Case of Belgium" was published in 1961 and quickly established the reputation of Lamfalussy as an outstanding economist. His main message was that the weak performance of the industry in Belgium, and of similar countries, was attributable to their addiction to 'defensive investments', whereby firms in the traditional heavy industry sectors, such as steel, stuck to expand their output along traditional lines, instead of attempting new products. These views have been vindicated by the deep crisis that afflicted the heavy industry in Belgium, a few years later.

In his management role at the Banque de Bruxelles

Having joined the Banque de Bruxelles, as from 1955, he became a member of the Management Board, and then its chairman in 1971. Apart from his assignment as Economic Counselor and directing the expanding 'investment banking' activities, he was also tasked with the supervision of the Banks' branches in its Walloon region, thus familiarizing him with the panoply of typically commercial banking operations.

During the span of his career in commercial banking he has written a fair number of essays. Amongst those that are retained in the 'Selected Essays', one should mention his address at the IMF, in 1969, in the prestigious Per Jacobsson Lecture on the 'Role of monetary gold over the next ten years'. The role of gold as a reserve asset was then declining, and heavily criticized; in August 1971, President



Nixon ended the convertibility of the US dollar into gold. This was a period of turbulence in the financial world: I remember having read then in 'The Economist', that "it would be unthinkable that the dollar could be devalued", and yet this happened soon afterwards, in 1973 and signalled the end of the fixed-exchange regimes. In his address in Washington, the speaker drew attention to the deep structural changes in the international economy, and pleaded for more flexibility in the exchange markets and for the dethroning of gold in its monetary role.

The "Selected Essays" also contains two articles about the Euro-bond market and its rapid development as from 1968, according to a formula, concocted by Anglosaxon merchant banks: to circumvent the imposition of a withholding tax on the coupons of such bonds, the latter were issued formally by a thinly capitalized subsidiary in a tax-free jurisdiction, typically in Luxembourg, but under the guarantee by the parent company. A host of American firms, constrained in their ability to export capital, have accessed that new international market, often by way of convertible bonds. As most major banks in Europe, the Banque de Bruxelles was involved in placing bonds, and sometimes in co-managing them, as well as participating in large so-called Euro-currency consortia loans in US dollars.

At the helm of the Bank for International Settlements 1976-1993

In a rapidly globalizing world, beset by monetary turmoil, the role of the BIS has become more involved and focal. This is not at all surprising: Its staff is renowned for its analytical acumen and the depth of its research; the BIS has also become the instigator of worldwide monetary statistics; it is the regular meeting place for the world's top leaders in monetary matters, allowing the BIS experts to sharply observe the world's financial scene. The BIS is called upon to coordinate actions by central banks and national authorities. The BIS can properly be viewed as the symposium of Central Banks. Thus, soon after Lamfalussy had joined, the BIS became a main actor in the currency crises, that were hitting Mexico and other Latin American countries, and which, to an extent, were the result of the recycling of the surpluses of the OPEC countries, deposited in the major banks; but the floating interest rates, which they carried, strangled the borrowing countries, once the drastic anti-inflation measures in the USA in 1979, had driven up the interest rate charges.

During his long association with the BIS, Lamfalussy's authority was widely and increasingly respected. Under his governance, the BIS has strengthened its reputation of excellence. The annual report of the



BIS, in which those familiar with Lamfalussy's style, recognize his stamp, was hailed as a highly authoritative source of insights.

Amongst the addresses during his governance at the BIS, let me refer to two of them. In December 1994, he spoke at a joint luncheon of the American Economic Association and the American Finance Association about "The Changing Environment of Central Bank Policy". He drew attention to four interconnected "evolutionary processes" viz. disinflation (then a major concern, as just reminded), internationalization, innovation and deregulation. In this succinct, but profound text, the speaker warns against the negative impacts which such newly emerging tendencies exert on the stability of international finance. Let me only cite three sentences, which revealed his growing concerns and somewhat foreshadowed the global 2007-08 financial tsunami.

- "In general, financial impulses emanating from the United States are transmitted remarkably quickly to other financial centres, despite fairly generalized floating" (p. 213).
- "This process (of financial innovations) is fuelled by market participants' desire to hedge against the uncertainty generated by interest and exchange rate volatility (and is thus partly a reflection of inflationary developments) to circumvent regulations or to avoid taxes, to take up opportunities offered by deregulation or new technology, or simply to respond to market pressures" (p. 215).
- And thirdly - this appropriate comment by an accomplished macro-economist "Economic analysis should concern itself with the process of change, with its succession of cumulative or compensating imbalances, rather than with movement around some identifiable state of equilibrium" (p.217).

The other address I like to remind was pronounced in 1988 at the famous Jackson Hole annual conference, convened by the Federal Reserve Bank of Kansas City. It dealt with "Globalization of Financial Markets, International and Regulatory Issues". He drew attention to the disruptive impacts of the new developments in the financial markets, and advanced a strong plea for supervision and, to the extent possible, for international cooperation, on account of "the worldwide character of financial markets and the geographical mobility of both financial transactions and financial institutions (p. 243).

The book with essays also contains two texts of addresses in Hungary, Alexandre's home country. One in 1991, following close upon the collapse of the Iron Curtain, looked at "Priorities for Eastern Europe";



in the essay, while rejoicing about the turn of events in the Eastern Bloc, but acknowledging that Hungary had in 1968 already taken some steps towards a market economy, his address conveys a sober analysis of the challenges still awaiting the new EU member states. The other address, upon the 10th anniversary of the new banking system in Hungary in 1997, looked ahead at the problems that would confront the banking system, on account of the innovations that occurred already in Western Europe, including the impact of digitalization.

The European exchange rate predicament

At the BIS, the fate of the foreign exchange relations between the EU member states remained a problem of constant attention. The concept of a common EU currency had already been aired much earlier, and had been attempted in various variants of the so-called 'European Monetary System' but which were not particularly successful. Monetary stability was only achieved when a profoundly revolutionary solution, that of a really unified currency became a possibility, when it was strongly pushed by Delors, President of the Commission and by Chancellor Kohl. In June 1988, the so-called Delors Committee was set up to investigate its feasibility and shape. Aside from Delors himself, Lamfalussy was one of the few members. He apparently was initially not a staunch supporter of the common currency, realizing that the prospective Euro was weak on its fiscal (= budgetary) flank, with the EU budget barely reaching 1 % of the overall GDP of the prospective members and with the chances for substantial own revenues for the EU being blocked by the unanimity rule in tax matters. Lamfalussy was tasked with the analysis of that fiscal side of an 'optimal currency area', under reference to existing federal states. His 1989 text is reproduced in the 'Selected Essays'. He duly drew attention to the fiscal deficiency in the EU-currency project, and the need for "appropriate arrangements" (p. 264). In hindsight, he may have been more demanding, but as he has noticed in the 'Dialogue' (p. 170), the two main member states Germany and France did not respect the 3 % ceiling on budget deficits, and the financial tsunami of 2008-09 was ignited by US financial institutions and their unrestrained subprime lending. One may add, that the early years of the new century were tainted by widespread optimism about the world's financial stance; it was erroneously claimed that, according to the theory of 'efficient markets', financial markets were capable of self-correcting. Moreover, the Greek tragedy has been basically caused by the top politicians of that country.



So, the Maastricht Treaty (1993) decided to introduce the European monetary union and thereto to create a European Central Bank. A European Monetary Institute (EMI) would prepare the launch of the European common currency. That Euro currency should become reality not later than January 1, 1999. After much prodding, Lamfalussy, then 65 years old, accepted to direct the EMI, during a period of 3 years, a rather 'barbaric but efficient' time limit, as Lamfalussy has called it.

This was, on all counts, a daunting challenge. Lamfalussy had to start his work with a small staff; he took care to select the other staff members himself, up to 300 all in all, but had obtained the assurance not to be encumbered by national quotas. The logistical problems to be solved were staggering: not only the policy tools which the ECB should apply, had to be designed, but the technicalities of setting up a new central bank, including the interconnecting of the digital information systems of the participating central banks, had to be efficiently implanted. In this connection, he had to convince a large number of banks to install such costly equipment. He also had to overcome the widespread aversion of the German banking community vis-à-vis the Euro. But thanks to the group spirit he was able to instill in his staff, eager to participate in an exciting novel project, and a real diplomatic talent, the Euro banknotes were delivered, on schedule, into the pockets of the citizens of the Euro-member states on January 1, 1999. The conversion of the former national currencies into the Euro occurred in a smooth way, and the money and bond markets were also run in the new currency. An outstanding technical feat, indeed.

After his retirement from the EMI

Lamfalussy, invoking his age of over 70 years, declined the suggestion by some member states to act as the first governor of the ECB. Yet, subsequently, he has still become embarked in a major European project: in 2000 he was asked to chair a 'committee of wise men', tasked with achieving a more efficient and integrated system of supervision of the European Securities markets, which hitherto was a "mind –boggling patchwork" (of differentiated national rules) (p. 386). He undertook this analysis with a small group of self-selected experts. The report has allowed to derive general principles, that have greatly contributed to a more uniform regulation of securities markets; it has acted as a stepping stone to the creation, after the 2008-09 financial crisis, of European supervisory authorities, in the securities area but also in the banking field. The 'Selected Essays' contain a detailed paper on the



objectives of this committee, and its main proposals. Central banks, and in the Eurozone the ECB, are now exercising the supervision over the large, systemically important banks— a proposal which Lamfalussy has long defended.

Conclusion

The ‘Selected Essays’ are a fitting homage to a top-level artisan of the art of central banking in an almost constantly perturbed environment. Lamfalussy had a brilliant and clear mind. I remember that, already in his younger years, Albert Kervyn, his predecessor as economic advisor at the Banque de Bruxelles, himself a reputed economist, confided that, when economists met, the views expressed by the young Alexandre Lamfalussy carried most weight. Yet, they were conveyed in a quiet, unassuming manner; this modesty has not impeded - or perhaps has cemented? - his successful stewardship of teams of outstanding financial economists, particularly at the BIS and the EMI. The testimony of Jacques de Larosière, former Managing Director of the IMF, aptly portrayed Alexandre Lamfalussy as somebody “who expressed himself with lucidity and often adopted controversial positions. In the light of subsequent events, we are compelled to acknowledge that his assessments were generally correct and far-sighted”.