

Lectures of the Lamfalussy Conference: Presentation of the Book ‘Alexandre Lamfalussy – Selected Essays’*

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Alexandre Lamfalussy (1929–2015) was a highly influential person in the process of European monetary and financial integration, especially as the Founding President of the European Monetary Institute, the predecessor of the European Central Bank. However, he was also a brilliant intellectual and an eminent academic who published widely. This made for an abundant number of beautiful essays, a selection of which is presented in the book ‘*Alexandre Lamfalussy – Selected Essays*’ (Maes – Szapáry 2017).

Belgium and Hungary were the two countries close to the heart of Alexandre Lamfalussy. Lamfalussy was born on April 26, 1929 in Kapuvar, Hungary. He started his economics studies at the József Nádor University of Technology and Economics in Budapest. In January 1949, he left Hungary and came to Belgium where he continued his studies and where his career took off.

The volume, ‘*Alexandre Lamfalussy – Selected Essays*’, is a compilation of selected articles and speeches by Alexandre Lamfalussy, starting with his first article in 1953 on ‘*The Steel Industry and the European Coal and Steel Community*’ and ending with his last lecture, his ‘*Concluding Remarks*’ delivered at the conference commemorating the 20th anniversary of the European Monetary Institute in February 2014. The volume is divided into four broad parts.

(1) ‘*The Young Lamfalussy*’, covering the period from 1929 to 1975, encompassing his initial work on industrial economics and growth as well as his early writings on monetary and financial issues.

In his early research, Lamfalussy focused on the weak investment and growth performance of Belgian industry (Maes 2009). In the subsequent years, Lamfalussy broadened his research, exploring the topic of why the countries of the European Economic Community had been growing much more strongly than the United

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Kingdom. It led to a short article in *Lloyds Bank Review* (*Chapter III*) and a book, “The United Kingdom and the Six. An Essay on Economic Growth in Western Europe” (*Lamfalussy 1963*). In these publications, Lamfalussy emphasised virtuous (or vicious) circles, in which stronger export growth promotes higher investment, which in turn strengthens productivity and investment, further reinforcing exports. Broadly speaking, Lamfalussy’s analyses fit into the Keynesian tradition. His emphasis on vicious and virtuous circles clearly showed that the free market economy was not stable and self-adjusting.

In 1955, Lamfalussy started working at the Banque de Bruxelles, Belgium’s second commercial bank, becoming Chairman of the Executive Board in 1971. In the 1960s, he was involved in the creation of mutual funds and played a role in international investment banking (*Chapter V*). In 1961, under the influence of Robert Triffin, he went to Yale for a year. He also met James Tobin there, who was already critical of the functioning of the financial system. Whilst at the Banque de Bruxelles, Lamfalussy’s research interests shifted to monetary and financial issues, both national and international. He was very close to the thinking of the Radcliffe Report, emphasising the importance of money substitutes (*Chapter IV*). In the 1960s, Alexandre Lamfalussy was also a member of several committees which investigated the financial system, such as the Segré Committee, which investigated the integration of the capital markets in the EEC. Moreover, he took part in meetings on the reform of the international monetary system, one of the most famous being the Bellagio group together with Sir Roy Harrod, Harry Johnson, Peter Kenen, Fritz Machlup, Robert Mundell, Jacques Rueff and Robert Triffin, among others. In 1969, at the age of forty, he delivered the prestigious Per Jacobsson lecture (*Chapter VII*).

(2) ‘At the Bank for International Settlements’ covering the period from 1976 to 1993 He joined the BIS as its Economic Advisor, becoming General Manager in 1985. During Lamfalussy’s time at the BIS, three topics were predominant: exchange rate instability, inflation and the Latin American debt crisis.

The strong appreciation of the US dollar, resulting from differences in the policy mix between Europe and the US in the early 1980s, would mark Lamfalussy profoundly. He felt this was a clear indication that flexible exchange rates could not be relied on to avoid serious exchange rate misalignments. Moreover, the period showed the dangers of exchange rate misalignments, especially strong protectionist threats (see *Chapter XIX*).

The mid-1970s were the time of the great inflation. Among central bankers, monetary targets were a major issue of discussion. Lamfalussy (*1985, reprinted as Chapter XVI*) took a balanced approach. He emphasised that policy-makers had to avoid succumbing to two opposite temptations. One temptation was to return to complete “ad hoc-ry”. Lamfalussy argued that rules were needed, “to provide

some anchor for the wildly fluctuating expectations of market participants; to make monetary policy-makers accountable for their action... and to give them leverage in their dealings with governments and parliaments” (*Lamfalussy 1985*). However, he also argued against the temptation of retreating into a world of rigid rules. “It is difficult to define such rules; it is sometimes impossible to apply them; and it would often be irresponsible to stick to them. The road to follow is somewhere in between: rules applied with a pragmatic sense of discretion”. For Lamfalussy, monetary policy, notwithstanding thorough research, remained an art, not a science.

Financial stability was always an important topic for Lamfalussy. As early as the mid 1970s, he was warning about the debt build-up in Latin America (*Maes 2010*). He also pointed out the interrelationship with loose US monetary policies and the US balance of payments deficit. In 1976, he proposed to set up a “risk office” at the BIS in order to collect crucial information on a limited number of systemic banks. In 1979-1980, a Working Party which he chaired advanced a “macro-prudential” approach. Later, in the 1980s, Lamfalussy played a significant role in the management of the Latin American debt crisis.

Lamfalussy very quickly took a cautious attitude towards financial innovations. In a certain sense, he always kept a “Keynesian” *Weltanschauung*, with a certain scepticism about the functioning of financial markets. Similar to Tobin, Lamfalussy had questions regarding the efficiency of the financial system and argued in favour of a research programme in the field of “normative financial economics”.

In his (aforementioned) presentation, *Lamfalussy (1985)* focused closely on the accelerating speed of financial innovation. This was leading to a flow of new financial instruments and techniques, as well as the blurring of dividing lines between institutions and between markets, an old concern of Lamfalussy who was steeped in the Radcliffe tradition. After discussing the monetary policy implications, Lamfalussy turned to prudential issues. His fundamental question concerned the effects on financial stability of the redistribution of risk by these new instruments: “You may argue that when risk-averse market participants shift risks associated with unexpected interest and exchange rate developments onto willing risk takers, everybody is going to be better off. This may well be the case, but increased collective happiness does not necessarily mean greater systemic stability. Or does it?” (*Lamfalussy 1985*).

Lamfalussy greatly contributed to the creation of a “BIS atmosphere”, namely that one should be attentive to imbalances, debt build-ups and bubbles, which may sow the seeds of financial crises. Lamfalussy thus became the main architect of the BIS “macro-prudential” approach to financial stability with a focus of the financial system as a whole.

During his time at the BIS, Lamfalussy was also involved in European issues. The highlight was his participation in the Delors Committee a crucial phase in the EMU process. Lamfalussy played an intellectually stimulating role (*Maes 2016*). In his view, the coordination of budgetary policy was a crucial issue. Marked by his experience of the Latin American debt build-up, he questioned whether market forces were enough to ensure fiscal discipline. Lamfalussy advocated an EMU with a significant economic pillar. In his view, fiscal policy coordination “appears to be a vital component of a European EMU” (*Lamfalussy 1989*). He advanced two main reasons. The first one very much reflected his preoccupations with the policy mix on the international monetary scene: “the determination of a global fiscal policy in a way that is sufficiently responsive to evolving domestic and international requirements”. The second reason foreshadowed the “binding rules on budgetary policy” in the Delors Report itself, namely, the need “to avoid tensions arising from excessive differences between public sector borrowing requirements of individual member countries”.

(3) ‘Founding President of the European Monetary Institute’, the period from 1994 to 1997. The main task of Lamfalussy and the EMI was preparing the final stage of European Monetary Union, especially the single monetary policy and the introduction of the euro.

In several speeches and articles, Lamfalussy also discussed the implications of EMU. Here, he was responding to an explicit request from Chancellor Helmut Kohl. As Lamfalussy wrote, Kohl told him: “I know that you have a lot to do, but please go and speak to the Germans. Explain the facts in different places, and especially in Bavaria”. So, Lamfalussy went to Bavaria and, the next day, he got a phone call from Helmut Kohl who said, “You really won over those Bavarians, and they are a difficult lot” (*Lamfalussy, Maes and Péters 2014:147*).

In Lamfalussy’s view, EMU would lead to major benefits. He emphasised that, in order to reap these benefits, countries had to enter EMU in a state of sustainable macroeconomic convergence. Lamfalussy argued that significant policy adjustments were still necessary for EMU to function. One area was budgetary policy. But for Lamfalussy, the greatest challenge concerned the labour market, “I have already noted that wage and price flexibility is essential to facilitate economic adjustment to various kinds of shocks ... With or without EMU, employment policies have to be in the forefront of attention of European policy-makers” (*Lamfalussy 1997*).

Wim Duisenberg, in his address at the occasion of the farewell of Alexandre Lamfalussy as President of the EMI, beautifully summarised Lamfalussy’s contribution: “Things have not always been easy for you when chairing the meetings of the EMI Council. But being a central banker, heart and soul, you have always managed to find compromises. I vividly remember a few meetings of the EMI

Council which you eventually managed to conclude successfully, although they started off as a babel of tongues. ... One of your greatest assets is that you have managed to combine this typical conservative and cautious nature of a central banker, always focused on substance, with your firm belief in European monetary integration. ... You have never believed that a true single market is in the long run compatible with a quasi-floating exchange rate system" (*Duisenberg 1997*).

Very fundamentally, Lamfalussy's advocacy of European monetary integration had its origin in two main sources: a profound European conviction, marked by the devastation of the Second World War and by the Iron Curtain, and a fundamental distrust of systems of floating exchange rates, in line with his general views on the functioning of financial markets. Moreover, he was a strong defender of a symmetric EMU, with a strong economic pillar, and an early advocate of a banking union.

(4) 'Lamfalussy the Elder' covering the final period of his life, from 1997 to 2015, focusing strongly on financial stability.

In his Pierre Werner Lecture in Luxembourg in 2004 (see *Chapter XXXII*), Lamfalussy focused on the organisation of prudential supervision in the European Union, which he described as a "mind-boggling patchwork". Lamfalussy stressed that central banks had a crucial role in the management of financial crises, especially in "preventing a potential crisis from turning into a real one... In such a situation, they should provide liquidity to the system, so as to avoid liquidity shortages pushing otherwise solvent banks into bankruptcy. They also have to care about the smooth functioning of the payments system". Lamfalussy further argued that the timely provision of liquidity was very much a matter of judgment, which implied that central banks had to be intimately familiar with financial institutions. "They must possess direct information on banks' risk-assessment methods and capabilities, on their decision-making processes and control mechanisms and, not least, on their expertise and skills in using innovative financial instruments. Such information cannot be acquired by reading second-hand reports, however lucid and transparent such reports may be." (*Lamfalussy 2004*).

For Lamfalussy the crucial issue was whether one should give some responsibility to the ECB for supervision of the large, systemically important, banks: "I would start from the assumption that the group of financial intermediaries whose regulation and supervision deserves to be reconsidered are a limited number of very large banks which have become actors at the global level and are key players in the European interbank market. Their problems could have directly systemic consequences ... Should one not consider exploring the desirability and the feasibility of entrusting the ECB with an operational responsibility in the supervision of this limited number of banks"? (*Lamfalussy 2004*). An early anticipation of the 2014 establishment of

the Banking Union with the Single Supervisory Mechanism under the European Central Bank.

The financial crisis further induced Lamfalussy to adjust his opinions. In his “Dinner Address” to the Sixth ECB Central Banking Conference (see *Chapter XXXIII*), he “meditated” on his 1997 EMI farewell speech, in which he had warned not to “overburden monetary policy” and to focus on price stability. He now argued that the financial crisis had “confirmed something that was (or should have been) expected: that whether they like it or not, central banks are in the front line when it comes to keeping crisis manifestations under control” (*Lamfalussy 2011*). He then emphasised the severity of the crisis, “What is *new* in the current experience is that central banks have had to carry out their liquidity-boosting operations in an environment where the liquidity shortage turned rather quickly into solvency problems of frightening dimensions – for which there has been no precedent since the 1930’s. Nor has there been any precedent for the speed of contamination at the global level” (*Lamfalussy 2011*).

Given the severity of the crisis, central banks reacted with a variety of “non-standard” measures. This led not only to a spectacular expansion of their balance sheets, but also to a change in the composition of their assets, with more risky assets. “As a result central banks have started navigating in uncharted waters, in terms of both operational techniques and their relations with governments”. Lamfalussy did not expect a quick end to the crisis. Consequently, financial stability should remain an objective for central banks, just as price stability, making life more complex for central bankers.

In 1999, Lamfalussy became the President of the Triffin International Foundation, now called Robert Triffin International, which seeks to enhance the debate on a necessary reform of the international monetary system. Together with Michel Camdessus and Tommaso Padoa-Schioppa, he was also co-chair of the Palais-Royal Initiative, which produced a report “Reform of the International Monetary System: A cooperative approach for the twenty first century”, which was submitted to the French G20 Presidency on 8 February 2011.

Alexandre Lamfalussy died in Ottignies, Belgium, on 9 May 2015, aged 86.

In these times of financial instability and doubts over the European project, it is worth reading, or rereading, Alexandre Lamfalussy’s work. As Jacques de Larosière pointed out, *‘Alexandre Lamfalussy 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.’*

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