
Ivo Maes (ed.), in cooperation with G. Szapáry, *Alexandre Lamfalussy. Selected Essays*, Magyar Nemzeti Bank and National Bank of Belgium, Budapest 2017, pp. 405.

The timeless essays in this inspiring book present many of the best thoughts of a most thoughtful and likeable man, Alexander Lamfalussy. The topics covered include virtually every aspect of the conduct of domestic monetary policy, the pursuit of monetary and financial stability, the pros and cons of different exchange rate arrangements and the changing nature of the international monetary system. Students of

post-war economic history, the history of economic thought, or the origins of the euro will clearly find it fascinating. Yet, it is also likely to evoke a similar response among a broader circle of readers. The major problems Lamfalussy confronted during a professional career spanning more than six decades remain unresolved, not least the issues of ever mounting debt levels and financial fragility. Thus, his analytical insights remain as relevant as ever. Central bankers and other policymakers today could learn a great deal by treating it as a reference book and dipping into it from time to time as the circumstances demand.

The essays are arranged in chronological order but divided into four periods: the Young Lamfalussy (1929-1975), at the Bank for International Settlements (1976-1993), Founding President of the European Monetary Institute (1994-1997) and the Elder Lamfalussy (1997-2015). They are introduced by a highly useful general discussion by the book's editor, Ivo Maes, who also provides equally useful overviews to each individual chapter. It is, indeed, a book that rewards being "dipped into." The chronological arrangement also reminds us of the enormous practical contributions that Lamfalussy made at various stages of his career. He was throughout a doer as well as a thinker, and, rightly, he is remembered as "the father of the euro."

The chronological approach helps the reader track the evolution of events and various schools of thought over the period covered. Perhaps most important, it reveals the development of Lamfalussy's own thought. He was, I believe, the first to reflect seriously on the potential usefulness of a "macroprudential" policy framework and also to see its limitations. And he was certainly among the first to see the merits of a single European currency and to recommend that the European Central Bank should play an important role in banking supervision. After the onslaught of the financial crisis of 2007, he was also well advanced among central bankers in saying explicitly that "financial stability should remain an objective for central banks, just like price stability", noting as well that this might have implications for the conduct of monetary policy. This was a major shift from the position he had taken

earlier, when he was at the European Monetary Institute. But he felt such a shift was totally justified given the length and severity of the crisis. As Keynes famously said, "When my information changes, I alter my conclusions. What do you do, Sir?". The only downside of a chronological approach, for this reviewer at least, is the discovery that some of my best "original" thoughts had occurred to Lamfalussy twenty years before they occurred to me.

In reading these essays one is struck by the similarities between Lamfalussy's analytical framework and that of Schumpeter. Indeed, Lamfalussy explicitly refers to Schumpeter's work in a number of these essays. Both economists begin with the assumption that the economy is an evolving system, complex and adaptive, in which highly non-linear outcomes (crises) are entirely possible. From the very earliest of Lamfalussy's essays, one gets the clear impression that he believes that neither the financial system nor the real economy is inherently stable and self-adjusting. Subsequently, many central bankers came to espouse totally opposing views, influenced by prevailing academic theories. Nevertheless, Lamfalussy (and his ideological successors at the Bank for International Settlements) never ceased to express vigorously and courageously his contrarian views, which were increasingly supported by evidence arising from the financial crisis itself.

For Lamfalussy, it is the interactions within the economy, in particular the interplay between macroeconomic "imbalances" and financial stability, which generate the most interesting and often the costliest economic outcomes. Constant adaptation of economic agents to changing circumstances (often endogenous innovation) is another part of Lamfalussy's assumed reality. In several essays, he notes how financial innovation laid waste to the "monetarist" doctrine of a stable money demand function. In a later essay, he lays out the dynamics of how the possibility of depositor "runs" on banks requires safety nets, which in turn leads to regulation, which in turn leads to avoidance and evasion, and then the possibility of runs elsewhere, in a never-ending process. Moreover, in a late essay he recognized how positive global supply

shocks might have interacted with inflation targeting to produce credit booms and busts. These joint themes of complex interaction and change, with important and often unexpected implications for the dynamics of the system as a whole, motivate many of the essays in this book.

This way of thinking also had significant effects on Lamfalussy's policy advice. First, a profound humility shines through. It reflects his explicit recognition of how little anyone really knows, or indeed can know, about how the economy works and how it might evolve. Only a very wise man could say, as he often does in these essays, "I do not know the answer. Nevertheless, I might spell out very shortly, my own prejudices or policy preferences." Second, in doing this "spelling out," he invariably lays out both sides of the argument. In referring explicitly to the costs and benefits of alternative courses of action, he not only justifies the choice he has made "on balance," but also alerts policymakers as to how the costs might be mitigated. He stresses repeatedly, for example, how the costs of restrictive monetary policy (to deliver price stability) might be reduced by labour market reforms and a more prudent fiscal stance – nowhere more than in the euro zone. Third, his advice is always to be prudent in making policy changes. In complex systems, even small changes can alter systemic properties and unleash unintended consequences. Similarly, organic innovations in the system should be monitored very closely and, if necessary, their downsides mitigated.

Finally, his policy advice was always pragmatic. At one point he says, "I think, by necessity, we will be drawn to a solution of this kind." By this he meant that policy advice based on good analytics will always have to be tempered by political and other realities. In this context, it is also worth mentioning that Lamfalussy had expressed, decades ago, an early awareness that the objective of macroeconomic policies should not only be strong growth but also sustainable and inclusive growth. In turn, he also understood that multidimensional objectives imply the need to address trade-offs. While economists can evaluate the size and

nature of the trade-offs available, Lamfalussy felt that political judgement is still required in making a final choice between the alternatives available. His deep respect and support for the democratic process also emerge in a number of essays which touch upon the "independence" of central banks. They make a useful, and typically sensible, contribution to a debate which has recently been generating more heat than light. The notion of total "independence" for a central bank in a democratic society is a total chimera.

Many of these essays also concern international questions. Lamfalussy recognized the reality of financial globalization and asked, again characteristically, how the benefits of increased competition might be maintained while minimizing the costs. He was particularly concerned about international capital flows. These could hurt recipient countries, both on the way in (fostering "imbalances") and on the way out ("sudden stops"). But they could hurt lenders too if the loans were "imprudent" and thus eventually unserviceable. His warnings prior to the Latin American debt crisis of the 1980s were clear and prescient.

As for solutions, he strongly supported the introduction of the euro system in Europe. Unfortunately, like most others, he failed to see that imprudent private sector flows within an immutable exchange rate system could still culminate in a counterparty crisis of potentially existential proportions. At the global level, he always supported international cooperation strongly when it bore on the regulation of the financial services industry or on balance of payments problems. In contrast, Lamfalussy remained sceptical to the end about global cooperation with respect to monetary policy. In a nutshell, there was no institutional framework to support such cooperation and no political will to put such a framework in place.

Sadly, with the passing of Alexandre Lamfalussy, the persuasive voice that might have mustered such a will, and the brilliant mind that might have helped devise such a framework, are no longer available to us. We shall also have to simply wait and see to assess the actual and ultimate dangers of having an International Monetary (Non) System

since the demise of Bretton Woods. Fortunately, what does remain available to us today is the wisdom contained in this book. It deserves many readers.

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