

About the Study Center Gerzensee

The central bankers courses, doctoral courses and academic conferences occupy nearly half of the seminar and hotel capacity of the Study Center Gerzensee. The remainder of the time, the facilities are available to external groups of private corporations, and federal or cantonal governments. Thanks to the relatively large room offering and the efficient staff, the Study Center has developed into a favored conference place. Far away from the noise and everyday hectic life, only a half-hour trip from the center of Berne, the Study Center offers an ideal place for seminars and conferences. The course rooms are modern and the participants can gather their thoughts and reflect in the quiet corners of the beautiful castle gardens. The day's themes can also be discussed in close companionship with the accompaniment of delicious meals in the restaurant. All our computers offer speedy internet access which brings the outside world closer. Our fitness room and the many hiking trails of the beautiful countryside enable further chances to relax after weighty discussions.

If you are interested in utilizing our facilities for your conference needs, please reserve early (see address on the reverse side). We would be pleased to provide you with professional support during your conference or seminar.

Editorial

The revolution in information technology and the expanding use of the internet in the last few years is greatly facilitating communication among people and is changing the meaning of distance. While virtual communication has been dramatically enhanced, there is a growing need for meetings to foster individual interactions. Even at the professional level, human contact has enormous value and in many cases will improve productivity. The environment provided by Study Center Gerzensee, combining a relaxing atmosphere in a beautiful landscape with comfortable facilities is ideal to encourage these contacts.

In this respect, the central bankers courses organized by the Study Center allow participants from almost a hundred countries to learn from each other and to establish networks that are likely to be useful after they leave Switzerland. The doctoral courses also promote these interactions among Swiss students and put them in contact with internationally famous lecturers. The international conferences allow academics from the most prestigious institutions in the world to meet in a stimulating atmosphere, present their recent findings and brainstorm about new ideas.

Some of the recent activities of the Study Center are reviewed in this newsletter. In addition to several central bankers courses, we hosted a conference on the taxation of financial income. We also include an enlightening interview of Professor Frederic S. Mishkin who talks in particular about the relationship between policy making and economic research.

Philippe Bacchetta, Director

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Interview

The title of the course you are teaching at the Study Center, "Monetary Theory", is very broad. What is your goal for the course?

Well, there are several goals. One is that I want to get the students to understand how difficult it is to actually understand what's going on in the economy and understand what we think we need to know from the data. A key theme of the course is how difficult it is to do identification in macro time series. I try to illustrate to the students that no matter what approach we take we will come up squarely to face this identification problem. We never can be sure we can get it right. If we use econometrics we always make identifying assumptions and always find problems with them. The famous critique that particularly exclusion restrictions can be "incredible" applies not only to the simultaneous equation approach (Cowles commission), but also importantly to the structural vector autoregression approach. We can never be sure about identification. In terms of understanding the data, it means there is no "right" way. In the course I show time series techniques that require certain identifying assumptions, but say that other ways are possible. In particular we can use history to provide us with controlled experiments. We can use a model to tell us which variables are exogenous and which aren't. But since we find we cannot fully believe those restrictions, we can try another approach. For example to look at times when extreme changes occur that we believe could not be related to the variables investigated. The change could be



due to serendipity or cases where someone very different came on board. Then we see what happened afterward. So in fact we establish exogeneity by history. There are two approaches: to use econometrics once we establish the exogeneity or to actually do history, i.e. case studies. And I emphasize this in the class.

Do you find it difficult to teach to central bank researchers from all over the world, do their experience levels and their outlooks complicate matters for you?

In one sense yes but in another sense no. It's actually a big plus to teach to people from central banks all over the world. Although the people frequently have different levels of training, the big benefit is that they have a wealth of experience. What they bring into class then enhances the material. From my perspective, not everyone will be able to follow the material in the same way, but that doesn't mean they won't all get some value from it. And the classroom dynamics are actually better because people have such interesting experiences. So I talk about something and they say well, yes, but did you know that what goes on in my country... and that helps broaden both myself and the other students. And in particular because in the course I focus on the issue that if you're looking at history one

Frederic S. Mishkin is the A. Barton Hepburn Professor of Economics at the Graduate School of Business, Columbia University. Since receiving his Ph.D. from M.I.T. in 1976, he has taught at the University of Chicago, and Northwestern, Princeton and Columbia Universities. From 1994-1997 he was an executive vice-president and director of research at the Federal Reserve Bank of New York and an associate economist to the Federal Open Market Committee. He is author of many research articles and the best-selling textbook "The Economics of Money, Banking and Financial Markets". In May he spent one week at Gerzensee teaching in the central bankers' "Advanced Course for Research Economists".

of the reasons why it is important is to look at other experiences than the current one. The reason I use case studies is looking at current events but at different countries. So from my viewpoint it enhances the course rather than detracts from it.

Do you prefer to teach the central bankers or undergraduates at Columbia?

I teach MBA students, which is a little different, and Ph.D. students. The Ph.D. teaching is fairly similar to what I am doing here. However they are not as worldly as the central bankers. And in fact the central bankers also have actually been doing research for a while. So my feeling is that it adds to the quality of what goes on in the classroom. MBA and undergraduate teaching are very different. For example, when you teach people to do research, it is very important to confuse them. It is very important for people to understand in terms of policy advice how uncertain our evidence always is. Good empirical work can only change your priors, it can never settle any issues. To me, good Ph.D. teaching is to confuse them, to show them a

paper, a great paper but in fact we cannot trust the results for the following reasons. You don't want to confuse MBAs, you want to give them something they will have confidence in and can use. And so you simplify, you don't tell them all the things that might be wrong. Because for researchers, we actually say look, we know a lot of things are wrong but we have to make the best guess. So by confusing them, you are not being destructive in terms of their output. For MBAs you say economics is useful, you don't give all the nuances. So it's a very different style MBAs versus researchers.

Don't you find that being destructive in some sense is counterproductive? I mean when they institute policies they are not going to be sure of...

But in fact to me it is incredibly important in terms of getting good policies to admit what we don't know and the degree of uncertainty. And in fact when I was policy advisor at the Federal Reserve one of my roles was to in fact say "we don't know". And that was extremely important because frequently very bad

THE INTERACTION BETWEEN ECONOMIC RESEARCH AND ECONOMIC POLICY: THE PERSPECTIVE OF FREDERIC S. MISHKIN

policy occurs when people think they know more than they do. And indeed, one of the advantages to be in a central bank versus the private sector is that you can be honest. The president of the Federal Reserve Bank of New York who I worked for used to say it's good I have a humble economist, he tells me all the time what he doesn't know.

But President Truman always said he wanted a one-handed economist.

But in fact for good policy advice we have to tell people what we know and what we don't and the degree of uncertainty. So a good policy maker is someone who takes that information and finally makes the decision. In fact, a good policy-making institution is where there is active debate, people understand what they know and don't. Then you make the decision and the institution marches forward. Frequently institutions always debate and never decide (I could name names but I won't). Equally bad is when the institutions don't allow debate. They are very good at deciding, but they are ill-informed ones (I could also name names but I won't). The key is that good policy-making really requires people to understand what they don't know. And that's why being destructive is the best you can do. We frequently had to tell the president "our research tells us that you think that is true but we don't know well enough". That affects the way you conduct policy. We also might say "look, we cannot be sure that is true, but it is 60 percent likely: the best guess has to be this and we have to do something". It is critical to understand what you know

and what you don't. And that is an important part of what research departments in central banks should be doing. It's what I tried to get my N.Y. Fed research department to do, and in fact one of the things that I try to transmit to the participants here as well.

Tell me, you mentioned you were an associated economist at the Federal Open Market Committee (FOMC). What were your duties there?

In one sense one has no duties. Your job is to listen and answer questions from the person you work for. I was the chief policy advisor for the president of the Federal Reserve of New York. Sometimes he would pass me a note and I would provide him with information. As an associate economist you never speak a word in the FOMC meetings because that's the job of the policy-makers, the twelve Bank presidents and seven members of the Board of Governors. However, your real role is to listen so you know what issues will be important in next meeting's decisions. You must know the key issues that the decision makers need to be informed about so they can make informed decisions the next time around. So, in that sense, you're basically finding out the essential issues. And that's really your role in the FOMC.

What gives you so much energy to keep on going and to do so many different things?

I think it is just my personality. My wife always says to me "you live to work". I think it

is also very important particularly for someone doing research that you never want to be completely grown up. Sometimes my wife criticizes me, saying sometimes you have to behave like a grown-up. I tell her no, it is no good for my activities. I think actually it is also very important for someone doing research to always keep your mind open, always want to learn. And learn from everything. And it doesn't apply just in terms of research...my time at the Fed was very exciting, because I was not only learning to be a policy maker, but also a manager.

So your family plays a big role?

Of course, my family plays a very big role. My father, who is deceased close to ten years ago, was somebody who respected my intellect at an early age. At the age of 11, we started sitting and talking all the time. And he very much encouraged me to pursue intellectual...

What profession did he...

He was a businessman. He didn't know that I would become an academic, but he suspected so. We'd have debates about everything at the dinner table... When I was the head of research at the New York Fed, one of things I said in the management committee is "you don't understand, the right way to run a research group is you have a bunch of children and the research director should be the head child". I actually thought that it was very effective in terms of getting the research group to be productive at the New York Fed.

What projects are you working on now?

One of the areas I mentioned is I'm doing research on looking at monetary policy strategies for emerging market countries, so that's become a major interest. Also, my work on financial crises has led me to financial sector reform, and so I'm doing research on that, and in fact I was asked to serve on an international advisory board for the Korean financial supervisory agency. I'm still doing research on basic issues in monetary policy. My focus is very policy oriented; I got interested in financial sector reform because it is important for monetary policy. So my research program is very policy-oriented, that's what really drives it.

And so you're happy in academia with a foot in policy?

Yes, I love policy work and enjoyed very much doing it at the New York Fed. But one of the nice things about being a professor is that you have freedom to go wherever you'll be most needed and where you have the highest value-added. So I also get called on for policy advising. I talk with many central banks about monetary policy issues, so it's a very exciting life and one where you work hard but you control your time so it's not a bad way to live.

This is an edited interview conducted by Jeffrey Nilsen. The full version is available on our homepage.



Professor Alex Cukierman from the University of Tel Aviv

Central Banker's Courses

Course for high-ranking central bank managers

The first central bankers course at Study Center Gerzensee for the new millennium was led by Professor Alex Cukierman of the University of Tel Aviv in Israel and Tilburg University in the Netherlands. The course on "Central Bank Strategy, Credibility and Independence" took place for two weeks starting on February 7, 2000. Professor Cukierman is well-known as author of over seventy scientific articles and four books, including "Central Bank Strategy, Credibility and Independence; Theory and Evidence".

As with most courses at the Study Center, the total experience depends to a large extent on who the participants are and how well they interact. In this course, we had an excellent group of central bankers. For example, a wide range of nations were represented (e.g. Armenia, China, Malawi, Peru, the Philippines, Poland), the participants attained high educational

achievement (seven were PhDs, and another twelve had Masters degrees from European or American universities), and finally the experience level was quite high. Of the twenty-five participants over 50% were involved in policy making. Seven members of the monetary boards of their respective nations took part in the course.

The fundamental idea of the course is that inflation, the devaluation of a currency's value in terms of the goods it can buy, is the essential responsibility and also primarily controlled by the central bank. The puzzle is then if the central bank so dislikes inflation, why is it such a persistent phenomenon? The public's distrust of the central bank's motives can often lead to a long run inflation bias. How central banks should deal with the bias was a focus of class discussions. One method, inflation targeting, is an operational procedure recently implemented by many central banks. Professor Cukierman discussed this procedure in detail and in particular the role of private information.

If policymakers do have an information advantage, it is difficult for them to convince the public that they will commit to a specific target.

Most of our courses include reviews about computers, software and exercises the participants solve using real-world data. For this course, though, intense discussions on policy making continued into the afternoon (and informal discussions continued late in the evening). The only respite to this plethora of policy percussions came when several participants presented policy case studies about their respective countries.

Professor Cukierman's discussions led this group of policy makers to win a deeper understanding of the concepts underlying frequently heard central bank buzzwords, including independence, credibility, transparency, commitment, etc. The policymakers also built up networks with influential policy makers in other nations, valuable assets in the new situation of interdependent central banks in a one-world economy.

Monetary Theory and Monetary Policy

In April the Study Center hosted its bread-and-butter course for central bank middle managers. The participants are treated to an expansion of their economic knowledge through a review of the latest theoretical and empirical advances. Professor Jeffrey Nilsen led the group through a review of, among other things, money demand empirical work and introduced them to VARs. In the second week, Professor Harris Dellas of the University of Bern presented the recent developments in international macroeconomics. Professor and Director Philippe Bacchetta discussed the current hot topic of currency crises and utilized the Study Center's computer game to examine more directly the motives of investors and how they can evoke a crisis. At the end of the course, participants used their acquired knowledge in group presentations dealing with several current topics in monetary policy.



Academic Conferences

Taxation of Financial Income

On May 22 - 24, the Study Center Gerzensee organized, jointly with the National Bureau of Economic Research, USA, the 2000 edition of **TAPES**. This stands for "Trans-Atlantic Public Economics Seminar" and is a bi-annual event that takes place at various institutions in Europe. The organizers of the conference were Roger Gordon (University of Michigan) and Philippe Bacchetta, who selected ten papers to be presented. Half were written by North American authors and the other half by Europeans.

The issue of taxation of financial income ranks high on the current economic policy debate in many countries, in particular because of the increase in capital mobility and the recent development of new technologies and in financial markets. The program shows the various themes examined during the conference and the high quality of the participants. Four of the papers presented at the conference dealt directly with the issue of capital mobility and potential tax competition. Three of these were empirical and found a significant effect of corporate tax rates on the

allocation of capital. They found evidence of the tax effect on the location of firms in Swiss cantons; on various schemes followed by US multinationals with subsidiaries in both low and high tax countries and on the location of assets in financial subsidiaries by US multinationals after the Tax Reform Act of 1986. Finally, a fourth paper examined the recent proposal of the European Union to choose between withholding taxes and information exchange among tax authorities.

Another set of papers examine the interaction of financial markets structure and taxation. An empirical paper finds that dividends are responsive to cash flow, investment and debt, which implies that investment is at least partially determined by retained earnings. Three theoretical papers examine the optimal taxation policies in presence of asymmetric information in capital markets; with venture capital; and with heterogeneous traders in financial markets. The last two papers of the conference study the impact of taxation on household portfolios in the US.

A selection of the papers will be published in the Journal of Public Economics.

Program

Lars Feld and **Gerhard Kirchgässner**, Universität St. Gallen, "The Impact of Corporate Income Taxes on Employment: Some Panel Evidence for Swiss Cantons"
Discussants: James Poterba, MIT and Lans Bovenberg, Tilburg University

Christian Keuschnigg, Universität des Saarlandes and **Søren Bo Nielsen**, Copenhagen Business School, "Tax Policy, Venture Capital, and Entrepreneurship"
Discussants: Thomas Gehrig, Universität Freiburg and Kevin Hassett, American Enterprise Institute

Rosanne Altshuler, Rutgers University and **Harry Grubert**, U.S. Department of the Treasury, "Repatriation Taxes, Repatriation Strategies and Multinational Financial Policy"
Discussants: Mihir Desai, Harvard University and Michael Devereux, Warwick University

Rosanne Altshuler and **R. Glenn Hubbard**, Columbia University, "The Effect of the Tax Reform Act of 1986 on the Location of Assets in Financial Service Firms"
Discussants: Henry Tulkens, CORE and Bernd Huber, Universität Munchen

Eric Engen, U.S. Federal Reserve System and **William Gale**, Brookings Institution, "The Effects of 401(k) Plans on Household Wealth Accumulation"
Discussants: R. Glenn Hubbard and Andrew Samwick, Dartmouth College

Andrew Samwick and **James Poterba**, "Taxation and Household Portfolio Composition: U.S. Evidence from the 1980's and 1990's"
Discussants: William Gale and Rosanne Altshuler

Harry Huizinga, Tilburg University and **Søren Bo Nielsen**, "Withholding Taxes or Information Exchange: How to Tax International Interest Flows"
Discussants: Alan Auerbach, University of California at Berkeley and Philippe Bacchetta, Study Center Gerzensee

Alan Auerbach and **Kevin Hassett**, "On the Marginal Source of Investment Funds"
Discussants: Søren Bo Nielsen and William Gentry, Columbia University

Thomas Gehrig, "Capital Income Taxation in Fractional Asset Markets"
Discussants: Eckhard Janeba, University of Colorado and Christian Keuschnigg

Clemens Fuest and **Bernd Huber**, Universität Munchen, **Søren Bo Nielsen**, "Why Is The Corporate Tax Rate Lower than The Personal Tax Rate?"
Discussants: Roger Gordon, University of Michigan and Lars Feld

00.08

Jürg Blum:

"The Limits of Market Discipline in Reducing Banks' Risk Taking"

00.07

Philippe Aghion, Philippe Bacchetta, and Abhijit Banerjee:

"Currency Crises and Monetary Policy in an Economy with Credit Constraints"

00.06

Harris Dellas and Martin Hess:

"Financial Development and the Sensitivity of Stock Markets to External Influences"

00.05

Bertrand Rime:

"Capital Requirements and Bank Behaviour: Empirical Evidence for Switzerland"

00.04

Andreas M. Fischer:

"Do Interventions Smooth Interest Rates?"

00.03

Philippe Bacchetta:

"Monetary Policy with Foreign Currency Debt"

00.02

Dominik Egli and Bertrand Rime:

"The UBS-SBC Merger and Competition in the Swiss Retail Banking Sector"

00.01

Urs W. Birchler:

"Bankruptcy Priority for Bank Deposits: a Contract Theoretic Explanation"

Foundation Council

Dr. Hans Theiler

Dr. Hans Theiler

Dr. Hans Theiler, Director and Deputy Head of Department II of the Swiss National Bank (Berne) retired in May 2000. At this time he also transferred his seat at the Study Center Gerzensee foundation council to his successor Dr. Thomas Wiedmer. As representative of the Swiss National Bank (which founded Study Center Gerzensee), Dr. Theiler was member of the foundation council since 1986, the first active year of the Study Center. With his expert knowledge and devotion to managing, he provided

valuable assistance to the Study Center from its earliest days. He also managed very well to balance the sometimes conflicting desires of the Study Center, the Swiss National Bank and the Gerzensee community. Dr. Theiler had a sympathetic ear for the entire staff at the Study Center and was always welcomed at Gerzensee. His deep knowledge and support were especially important during the long sickness of former director Prof. Walter Wasserfallen. We thank Dr. Theiler for all his valuable help and wish him all the best for his newly gained freedom.



Prof. Bruno Gehrig, Chairman of the foundation council

External Groups

For information concerning our facilities please see our homepage, heading "External Meetings" or contact Mr. Christian Kaspar, Tel. 780 31 22



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