

ALEXANDRE LAMFALUSSY
THE WISE MAN OF THE EURO



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A conversation with Christophe Lamfalussy,
Ivo Maes and Sabine Péters

THE WISE MAN OF THE EURO

Alexandre Lamfalussy

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CONTENTS

Preface by Jacques de Larosière	7
Introduction	10
Acknowledgements	13
CHAPTER 1	
A family of priests	15
CHAPTER 2	
The war years	29
CHAPTER 3	
The rise of communism and fleeing to Belgium	37
CHAPTER 4	
Political refugee and student in Louvain	49
CHAPTER 5	
Doctoral thesis in Oxford and marriage in Brussels	61
CHAPTER 6	
In the economics department at Banque de Bruxelles	71
CHAPTER 7	
A one-year sabbatical at Yale	81
CHAPTER 8	
At the helm of Banque de Bruxelles	93
CHAPTER 9	
La Relève, commitment to Europe and views on communism	105

CHAPTER 10	
Basel: the BIS and the Latin American debt crisis	113
CHAPTER 11	
Constructing the euro: the European Monetary System and the Delors Committee	131
CHAPTER 12	
Laying the foundations of the European Central Bank	141
CHAPTER 13	
European financial integration and chairmanship of the Committee of Wise Men	151
CHAPTER 14	
Financial stability: the warnings of a wise man	159
CHAPTER 15	
The financial crisis and the debt crisis in the euro area	167
CHAPTER 16	
Belgium, Corsica and Hungary	179
ANNEXES	
<i>List of abbreviations</i>	187
<i>Chronology</i>	188
<i>Major publications</i>	197
<i>Index of people</i>	202

PREFACE

Alexandre Lamfalussy is one of the most important figures in international finance today.

Indeed, as a central banker he has had a major impact on Europe's monetary history.

A committed European from the start, he employed all of his intelligence and energy to further this cause.

In parallel, Alexandre Lamfalussy pursued a career as a professional economist. Having gained a DPhil in economics from Oxford University, he went on to teach at the Catholic University of Louvain and at Yale. He has published a large number of books and articles that are regarded as authoritative in the fields of financial stability, globalisation and its impact on the weakening of the system as well as on the imperfections of the international monetary system.

Moreover – and this is also what sets him apart – Alexandre Lamfalussy was a practising banker: he spent 20 years at Banque de Bruxelles, where he became Chairman of the Executive Board in 1971. These years in banking gave him an intimate and practical knowledge of markets and risks.

It was in 1976 that he entered the world of central bankers that he would never leave. He was called on by the Bank for International Settlements to take up the key post of Economic Adviser. He was then the institution's General Manager from 1986 to 1994. During the 18 years he spent at the BIS, Alexandre Lamfalussy was at the heart of all of the major discussions in the economic and financial sphere: the deregulation of the exchange rate system, the international credit boom, the effects of financial innovation and the efforts undertaken by Europe to create a zone of monetary stability. On all of these subjects, 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.

Having taken part in the work of the Delors Committee on Monetary Union, in 1994-97 he was the first President of the European Monetary Institute. He consequently played a fundamental role in the creation of the European Central Bank (ECB). Prior to the ECB's establishment, the national central banks had to be prepared for the unification of monetary policy with all that that entailed in terms of IT systems, the harmonisation of settlement systems and human cooperation between teams of experts who did not know one another, and so on. This meticulous

preparation meant that the ECB was able to start operating without any hitches.

In 2000 the European Council called on Alexandre Lamfalussy, as the Chairman of a “Committee of Wise Men”, to make proposals to improve and better coordinate the mechanisms governing decision-making with respect to regulation in Europe. The Committee’s proposals – which set out four levels of procedure from the directive through to the technical documents – were adopted in 2003 and helped to bring some order to what had in fact been a regulatory jungle.



But what I have just referred to, while useful to recall in the preface to this volume, is inevitably a little dry and technical. “Where is Lamfalussy the man? Who is he?” people will ask me. The memories presented here in the form of dialogues answer these questions admirably.

Memoirs are a dangerous genre: more often than not they provoke antipathy rather than sympathy in the reader. And the reason for this is the pose the writer attempts to adopt.

Here there is no pose – just straightforward candour. The book covers the whole of Alexandre Lamfalussy’s life from his earliest childhood up to the present day. His answers are considered, direct and modest, just like himself. We are taken back to his past in Hungary which has never entirely left this man who had the courage to emigrate clandestinely in 1949, at the age of 19, in order to escape the Soviet hold on hearts and minds.

So it was as a free young man that he arrived in Belgium just after the war. This simple and beautiful account reads like a novel. He had no money but was talented, intelligent and hungry for work. Belgium welcomed Lamfalussy, gave him many opportunities and never regarded him as a foreigner. He was definitively assimilated into Belgian society, where he had an exceptional career and a happy family life.

The different stages of this life are recounted with great freshness and without a trace of pretension. The result is that instead of reading a technical and dull account we are plunged into the narrative of a “real” life that takes the reader on an adventure, full of twists and turns in which the characters mentioned are conjured up with a few brushstrokes and where there is often humour.

I recommend the reading of this account not only to those who are interested in international finance, but to anyone who is interested in a human story, to any-

one who reflects on what the “righteous” can do to welcome in the Other, and to anyone who sometimes gives up the hope that another life is possible even for the most disadvantaged.

Jacques de Larosière

P.S. I would like to add the following to my preface since these elements are not mentioned in the book on account of the author's modesty.

Like all of us, Alexandre Lamfalussy sometimes made mistakes. But on the absolutely crucial issues his assessments were correct and he was the first to alert the community of decision-makers. I will give three examples:

- ◆ In the 1970s he criticised the accumulation of debt, particularly in Latin America, and proposed international regulation to avoid excessive indebtedness (he was not listened to and a very serious crisis broke out in 1982).
- ◆ In the same vein, in 1979 he recommended a system of prudential supervision to prevent credit bubbles from forming, also without success. 30 years ahead of his time, Alexandre Lamfalussy invented the concept – now in vogue – of macro-prudential supervision of the financial system as a whole.
- ◆ He was one of the very first to be wary of the markets and financial innovation, whose dangers he could see. This former banker knew that the markets do not systematically regulate themselves and that financial integration is far from being a source of stability, given that it exposes cross-border institutions to increased risk.

J. de L.

FOREWORD

In 1949 a young Hungarian immigrant arrived in Belgium with a suitcase and a few dollars in his pocket. A little under 50 years later, Alexandre Lamfalussy presented the draft designs for the euro banknotes – the second global currency – to the press. This book was born out of the desire to preserve the memory and trace the life of this exceptional European.

We wanted to preserve this memory in a three-fold perspective: that of a professor of history who is passionate about Europe; that of a journalist, but above all Alexandre Lamfalussy's eldest son, who wished to record an eventful family history; and that of a central banker and professor who is a specialist in Lamfalussy's economic thought.

We opted for a book of conversations, since Alexandre Lamfalussy has never wanted to take the time to write his memoirs. Is this out of modesty or because he is always looking to the future? In any case, it took some persuasion for him to agree to take part in this exercise. There were 18 conversations each lasting about an hour and a half. They were spread out between 2010 and 2012, taking place in the morning in his house in Ohain (Walloon Brabant province) where he has lived with his wife since the 1960s. Alexandre Lamfalussy read over the manuscript during the summer of 2012 and provided a number of clarifications.

After a happy childhood in Hungary in a cultivated milieu in which education was highly valued, the Second World War began a period in which history had painful repercussions on the life of the young Alexandre. A student of economics, after the war he got a place at a university based very closely on the Soviet model which was designed to train the nation's elite classes. He quickly realised that the communist regime would not allow him to retain his freedom of thought and expression. As a political refugee and young student in Louvain, Belgium, he mixed with economists and pro-Europeans. He then won a place at Oxford, where he wrote his DPhil thesis which would be influential in the Belgian industrial world. His thesis opened the doors of academia to him at the Catholic University of Louvain, at Yale and as Chairman of the Triffin International Foundation.

Having acquired Belgian nationality, he pursued his career as a commercial banker at Banque de Bruxelles at a time when the progressive breakdown of the Bretton Woods system was opening up a period of monetary instability. At the age of 40, he became Chairman of Banque de Bruxelles. He resigned from this post following a significant foreign exchange loss. His professional career then moved towards the

central banking sector, in particular the Bank for International Settlements (BIS) in Basel, often called the “central banks’ central bank”, of which he became General Manager in 1985. Financial stability became his primary concern. He was ahead of his time in being at the centre of the BIS’s attempts to avoid the excessive indebtedness of developing countries in the 1970s. Subsequently, in the 1980s, he was involved in managing the Latin American debt crisis. He became one of the first proponents of the BIS’s “macro-prudential” approach, which advocates the stability of the financial system as a whole (and not just that of individual financial institutions). His expertise in the technical aspects of money and finance marked him out to become one of the members of the Delors Committee responsible for preparing Monetary Union and later on to become head of the European Monetary Institute charged with getting the project of a single currency under way – a task which he himself described as “navigating in uncharted waters”.

From the historian’s point of view, these conversations encapsulate the history of the twentieth century in the trajectory of one individual. Alexandre Lamfalussy’s ability to explain difficult issues in simple terms also adds to the book’s appeal. This testimony helps us to better understand his personality, his intimate convictions and all of the factors that provided the impetus and motivation leading to the achievement of a major milestone in the process of European construction: the creation of the euro. He shares with us his analysis of the crisis that the euro is currently going through.

Alexandre Lamfalussy has, since the summer of 2008, been at the centre of Ivo Maes’s research interests. This has given rise to various studies: on the “young” Lamfalussy’s economic thought,¹ Lamfalussy’s contribution to the BIS’s macro-prudential approach,² and his vision and contribution to the process of European Economic and Monetary Union³. Alexandre Lamfalussy’s account provides an unprecedented insight into the little-known role played by the BIS in Basel in safeguarding financial stability as well as into the implementation of the euro.

1 The young Lamfalussy: an empirical and policy-oriented growth theorist, NBB Working Paper No 163, *Revue bancaire et financière/Bank- en Financieuzen*, July 2009, Vol. 73, pp. 286-300.

2 On the origins of the BIS macro-prudential approach to financial stability: Alexandre Lamfalussy and financial fragility, NBB Working Paper No 176, *PSL Quarterly Review*, Vol. 63, 2010, pp. 265-292.

3 The evolution of Alexandre Lamfalussy’s thought on European monetary integration (1961-1993), NBB Working Paper No 217, *Oeconomia*, Vol. 1, December 2011, pp. 489-523.

For the journalist – who is also the son – this book has been the opportunity to record the story of a father but also of a very European family in which Belgian, Hungarian, Swiss, German, French and British forebears mingle. Much had been recounted at family gatherings but never in a structured way like in this book.

This three-fold perspective has, we hope, enriched these conversations. Although we prepared them carefully, our aim is not to offer the reader an academic work but rather to present a dialogue with a man who was one of the architects of the euro, an advocate of financial stability and a witness to Europe's momentous history in the twentieth century.

Brussels, 8 April 2013

Christophe Lamfalussy

Ivo Maes

Sabine Péters

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The authors take full responsibility for any omissions in the book.

Ch.Ly.

I.M.

S.P.



CHAPTER 1

A family of priests



I was born in Kapuvár on 26 April 1929, kind of by accident. At that time, my parents lived in Lenti in south-west Hungary, in a not very developed region. My mother preferred to give birth to me in Kapuvár, where my grandparents lived and where there was a decent hospital. Kapuvár was a village, now it's a town, 40 km from Sopron. My mother returned straight away to Lenti. One day, I went to a lecture series in Lenti. The mayor said to me, "We've been looking everywhere for your birth certificate. You're not registered!" Kapuvár would like me to become an honorary citizen as I am in Lenti. But I can't do that in two birthplaces...

What did your maternal grandparents, the Rimlers, do in Kapuvár?

My maternal grandfather was director general of forests for the Esterházy family. My father, who was a water and forestry engineer, took over from him in 1937.

Where did the Rimlers come from?

The family came originally from Nagyvarad (Oradea) in Transylvania, a town which is now in Romania, 10 km from today's border with Hungary. They were a family of Protestants and lawyers. My grandfather's brother was the last Hungarian mayor of Nagyvarad up until 1918. Before that he'd been a barrister. Nagyvarad was a very lively town. People called it the "little Paris" of the region. The Rimlers were obviously of Germanic origin but, according to the research, they had definitely settled in Hungary by the eighteenth century. They probably arrived during the period when Hungary, which had been laid waste, was being repopulated under Maria Theresa. They therefore no longer had any links with Germany and did not even speak German.

So was water and forestry engineering a family tradition?

On the Rimler side, my grandfather was the first and the tradition was passed on to one of his two sons. The fact that my father was a water and forestry engineer has nothing to do with the Rimlers. He had finished his studies before meeting my mother. This tradition of water and forestry engineering was quite strong in Hungary. Queen Maria Theresa set up two major engineering schools in what is now Slovakia: one for mining and one for water and forestry. The latter is probably the oldest of its kind in Europe. It was set up in around 1740, something like that. All of the graduates from this school had quite an exceptional *esprit de corps*. Some of them worked in the national forests and the others for the large private estates.

Were these engineers regarded as being part of the bourgeoisie?

Yes.

The bourgeoisie at the service of the aristocracy?

No, not necessarily, because at least half of them worked in the national forests. After the Treaty of Trianon, at the time when Hungary was separated from Upper Hungary, the School of Water and Forestry moved to Sopron. It is still there. Under the communist regime, the School of Mines was transferred to another university. What was remarkable was their *esprit de corps*, which survived the communist regime. When the big forest estates were nationalised in 1947, these people did not change profession. The big estates were incorporated into the national forests.

When were these big estates created?

From the Middle Ages onwards, but especially after the expulsion of the Turks. It was a period when the Hunyadis, an aristocratic family, owned up to a third of Hungary. Don't forget that Hungary remained an agricultural society for a long time. Industrialisation started in the early nineteenth century but was largely concentrated on Budapest, which became one of Europe's major industrial centres. Hungary's wealth also derived from its mines in Transylvania and Slovakia. Historically, the country's gold mines were very important. In the thirteenth century, Hungary was the largest producer of gold in Europe, which put the Harpad dynasty, the royal family, on an equal footing with all of the major countries. They were richer than the King of England and even the King of France in the thirteenth and fourteenth centuries.

And did the Esterházy's own much land at that time?

The Esterházy's owned nearly 200,000 hectares, half of which consisted of large agricultural concerns while the other half was forest. And it was in the forestry sector that my family worked. The forest estates covered a surface area of around 100,000 hectares grouped into three very compact areas: in the Sopron-Kapuvár region, the Lenti region and the region near to the Danube. The reason my father is so well known in Hungary is that when he was regional director of the Lenti forests, a tract of forest covering 30,000 hectares, he was the first to develop a wholly integrated operation. He built railways and put in a telephone line. He also set up several large sawmills. The whole forestry operation, from tree-planting through to the sawmills, was integrated.

Let's talk about the other branch of the family, the Lamfalussys. Where do they come from?

They were essentially an ecclesiastical, Hungarian, Uniate Catholic family. They said Mass in Hungarian. We still have cousins in that region who are parish priests.

What region is the Lamfalussy family from?

From the North-East, around Sub-Carpathian Ukraine and Romania.

So outside of Hungary's current borders?

Yes. But most of the family came from Buj, which is still in Hungary. They were all parish priests in Buj! One of them was even a member of Hungary's council of bishops. Buj has always been in Hungary, but the border with Sub-Carpathian Ukraine is just 20 km away. Sub-Carpathian Ukraine has always been inhabited by Ruthenes, who are mountain people, but a strip of the region is part of the great Hungarian plain and that is still inhabited by Hungarians. There are around 150,000 of them. They live in Ukraine, but Buj is in Hungary.

On your mother's side, your family was Protestant, and on your father's side Catholic. What religion were you brought up in?

Catholic. I was educated in a Catholic primary school and then at the Benedictine grammar school in Sopron. My maternal grandfather was unhappy about this. He would have preferred me to become a Protestant. An agreement had been reached between the Vatican and the Hungarian State at the end of the nineteenth century under which in mixed marriages girls followed the mother's religion and boys the father's religion. That explains why my Rimler grandmother was a Roman Catholic, like my mother, whereas my two uncles on the Rimler side were Protestant.

Was this religious dimension important in your childhood?

This is one of the few things that Hungary can be proud of: there have never been wars of religion in Hungary. The Habsburgs put in place a discriminatory system, but imposed religious tolerance in Hungary at the time of Maria Theresa. Three religions coexisted: Catholicism and Calvinist and Lutheran Protestantism.

What is the etymology of the name Lamfalussy?

Literally, it means "from the village of Lam". "Falu" means "from the village of". And the ending "ssy" denotes noble rank. It was nobility without a title that was derived from their ecclesiastical functions. The nobility formed a huge class in Hun-

gary. At the start of the nineteenth century, it constituted 5% of the population. Lamfalussy is an unusual name in Hungary. We don't know where the village of Lam was. There are other Lamfalussys in Hungary, but no link has been found with our family.

But your father, my grandfather, was born a Mihailovics?

Yes, the Mihailovics were of Slav descent. His parents died in the 1930s in Slovakia. They are buried there in a grave with inscriptions in Hungarian. Incidentally, the Slovaks always protest because they regard me as a Slovak. I've told them that they should look at my Mihailovics grandparents' grave.



As a child with his mother, in Hungary
(Lamfalussy family)

Why did your father take the name Lamfalussy?

My grandfather was born a Mihailovics, my grandmother was born a Lamfalussy and when they both died the Lamfalussy family was in the process of dying out. After the death of my grandparents, my father decided to take the name Lamfalussy. He and I were adopted by the sole surviving Lamfalussy, who was my father's aunt, my grandmother's sister. The Lamfalussys were the more historic, modestly noble, side of the family. But nobility of the Hungarian variety, since 5% of the population were noblemen, so it doesn't have the same significance. So we were attached

to the name Lamfalussy, which was about to die out because there were only girls in the family. And when my grandfather died, my grandmother said to my father, "You absolutely have to take the name Lamfalussy". And that's what happened. I was born a Mihailovics but that only lasted for two years. Through the adoption we changed our name.

Was this aunt unmarried?

Yes, she was unmarried. I have a magnificent family tree. The family really encapsulates Central Europe. I've looked at the names of my great-grandparents and there are eight names: four Hungarian, two German, one Polish and one Slovak.

Were your forebears who were priests Lamfalussys?

Yes, but the Mihailovics were too!

The middle class of the ancien régime?

Yes, it was the middle class. They were all theologians and so had been to university. On my grandmother's side, they were Protestants. Some were lawyers.

Was it a rich milieu? Did they live well?

Oh no, they lived modestly, very modestly. But they had a particular status and had studied theology at university. It was an intellectual milieu, a nascent bourgeoisie in a rural environment. My whole family is a pretty faithful reflection of the development of the bourgeoisie, with relatively large differences in terms of income. But all of these clergymen, on the Protestant side too, lived modestly. They were very well respected. My mixed ancestry is relatively typical in Hungary. There are virtually no purely Hungarian families. There was a huge amount of migration. The Turkish wars wiped out part of the population and when those territories were repopulated, it was Germans and Slovaks that settled there. The Slovaks had escaped the Ottoman invasions because they lived in their mountains: the Turks didn't like going up into the mountains. The result was an ethnic, religious and geographical mix which extended across the whole of former Greater Hungary. If we take my eight great-grandparents, only one of them was born and buried in present-day Hungary. The others are in Slovakia, Romania and Sub-Carpathian Ukraine.

When did your parents get married?

In 1927. My mother had trained to be a nurse. During the Great War she worked in hospitals, notably in Kapuvár, where there was a very big military hospital. Many of the wounded were repatriated to Hungary.