

Setting up an Economic Research Centre at the Deutsche Bundesbank

The Bundesbank has been stepping up its research activities for several years. The establishment of an economic research group in the mid-nineties was followed by the publication of a series of discussion papers, the organisation of conferences and workshops on economic subjects, and invitations to external researchers to work at the Bundesbank as guests. A further step has now been taken by setting up a Research Advisory Council this month. In future, these activities are to be concentrated in a Research Centre and intensified. The present article provides an analysis of these developments.

All over the world, central banks invest substantial resources in economic research. Much the same goes for international organisations, such as the International Monetary Fund (IMF) or the Bank for International Settlements (BIS), in whose work monetary issues rate high. The US Federal Reserve System occupies a leading position in this context. Economists at the Federal Reserve Board in Washington and at the individual Federal Reserve Banks have long been addressing, with academic methods, issues of interest to US monetary policy makers. The central banks of other English-speaking countries, such as the Bank of England, the Bank of Canada or the Australian Central Bank, likewise have long traditions of economic research. At the central banks of the euro area – with certain exceptions – participation in the economic debate has only recently increased significantly. The European Central

*Economic
research at
central banks
world-wide*

Bank (ECB) engages in economic investigations in its Directorates General "Economics" and "Research", and presents them to the public at large in several series of discussion papers.

The organisation of research

Research is organised in different ways from central bank to central bank. In many central banks, no clear distinction is made between research work and "day-to-day" operations in the economics departments. In other central banks, such as the ECB or the Dutch Central Bank, research work and operations with a more direct bearing on economic practice are performed in different departments. Moreover, several central banks have set up separate institutions dedicated to the study of economic questions. For instance, an institution devoted to monetary and economic studies was established at the Japanese Central Bank in the early eighties. The Bank of Finland has, besides a research department of its own, an institution studying economies in transition, and the Bank of England has a centre for central banking studies. Fourteen years ago, the Swiss National Bank – rather like a number of other central banks – set up a study foundation dedicated to the economic research that is relevant to central banks.

The need for research

It is no accident that central banks and international institutions devote such pains to research. To be sure, it is generally agreed today what the objective of monetary policy should be, namely price stability. But even then, some questions remain unanswered, such as how to define price stability most appropriately. Above all, however, it is still a controver-

sial issue what the best policy is for attaining that goal. That applies to periods of calm, but even more so to a world in which the financial markets and financial systems are undergoing a process of increasing change. New information technologies, the globalisation of the financial markets, and new functions of those markets (e.g. in the context of the development of retirement pension systems, or as a consequence of the need to finance the enhanced structural change) are only some of the forces behind such alterations. In Europe, the launch of monetary union has been an additional circumstance that poses a challenge to central bank research.

The lack of assured knowledge has, on the other hand, been rightly accompanied by public calls for an optimum, and generally comprehensible, monetary policy. Nowadays, central banks are subject to continuous monitoring by competent critics from academic circles and from the private financial sector. Calls for a maximum of transparency are ubiquitous. In these circumstances, it is essential for central banks to seek to achieve all-round competence, and to try to make this clear to the general public. Hence research is an indispensable element in strengthening central banks' credibility vis-à-vis the public at large, and in enhancing the transparency of monetary policy.

A crucial factor in the formulation of demands and objectives within the European System of Central Banks (ESCB) is the persuasiveness of arguments, which entails a corresponding economic underpinning of the standpoints adopted. Needless to say, that

goes equally for all other national and international bodies in which the Bundesbank has to present its views. Worldwide, there is an unmistakable tendency to put policy counselling on a more scientific basis. It seems essential for the economists in the Bundesbank, which, until monetary union, was responsible for the anchor currency in Europe, to contribute their experience to the public debate under these conditions.

*Economic
research group
since the
mid-nineties*

For all of these reasons, the Bundesbank has been stepping up its research activities for several years past. The starting point was the establishment of an economic research group in 1994. The object of that group was to give staff members of the Bank an opportunity to address themselves in depth for a limited period – as a rule, six months – to a topic which is of interest to the Bundesbank, and which often emerged from their “day-to-day” operations. From the outset, the principle was to work, for research purposes, on issues emanating from operational practice, and thereafter to make the findings of such research fruitful in practical terms. As the Bundesbank sees it, this is a principle which permits a certain division of labour in all necessary contacts with universities. The principle is to remain in force in future, so that the close links between the Bundesbank’s “regular” staff and the “research workers” are likewise to be retained. On the other hand, it has turned out that the increasing specialisation of academic disciplines and the more and more sophisticated techniques that are being applied in academic research may sometimes conflict with such short-lived stays in the research group and, in specific in-

stances, may necessitate flexible solutions to the organisation of research work.

From the beginning, it was taken for granted that the findings of such studies should be presented to the public at large. Hence the Bank started publishing such findings in discussion papers in 1995. In line with general practice, such publications appear in the name and on the responsibility of their various authors. The findings do not necessarily reflect the opinion of the Bundesbank. That would result in an undue hampering of the research work. The discussion papers are also reproduced on the Bundesbank’s web site (<http://www.bundesbank.de>).

*Publication
of discussion
papers*

The discussion papers reflect the wide range of research work that goes on in the Bundesbank. As is only to be expected, however, the main focus is on monetary subjects (see the box overleaf). About two-thirds of the discussion papers published so far can be assigned to that area. Other topics relate to the sphere of external economics and public finances. Those two areas are closely associated with monetary policy. The Bundesbank has always participated in such economic policy debates. In addition, on several occasions the research group has addressed issues which are important for the Bundesbank, but do not fit precisely into this pattern. Such issues include, for instance, innovations in seasonal adjustment or the estimation of east German production potential.

Research topics

Participation in academic research and the building of bridges between theory and practice are possible only in close association with

*The organisa-
tion of scientific
conferences*

Focal points of the Bundesbank's research programme to date

In line with the Bundesbank's functions, the main emphasis of the discussion papers hitherto produced by the economic research group has been on monetary subjects. About two-thirds of the over thirty papers published so far can be classified as belonging to that category.

As a consequence of the monetary targeting strategy pursued by the Bundesbank, particular attention has been focused on the behaviour of monetary aggregates in Germany and Europe. Such papers have included several studies of the determinants and stability of German money demand, of the significance of the circulation of DM banknotes abroad, or of the relationship between the money stock and its balance-sheet counterparts in Europe. Closely associated with these papers have been studies of monetary policy instruments and indicators, and of the monetary transmission process. Examples of such investigations are discussion papers which have shed light on the mode of operation of minimum reserves, or which have described the short-term response of market interest rates to changes in central bank rates. More advanced stages of the transmission process have been addressed in studies of the term structure of interest rates, of international interest-rate linkages, or of the impact of interest-rate changes on enterprises' debt structure or on private consumption. A third group of papers may be subsumed under the heading of "inflation and inflation expectations". This group includes a study of distortions in inflation measurement – a subject that has been much discussed among the public at large and in academic circles, mainly on account of the very low rates of inflation at times.

Besides monetary subjects in the stricter sense, two other focal points are discernible in the research papers. A number of papers are concerned with external economics. For instance, studies of the determinants of exchange rates, and of their implications for the German balance of trade, may be included among them. Investigations of monetary turmoil and direct investment likewise come into this category. Finally, a number of discussion papers have addressed fiscal policy problems, such as the development and evaluation of approaches to assessing the public sector budget situation.

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economists from outside the central bank. This is why the Bundesbank has increasingly sought, and found, such contacts in recent years. One reflection of these efforts is the organisation of scientific conferences. The Bundesbank has staged spring conferences since 1999. Internationally renowned economists, and economists from central banks and other interested institutions, have been invited to such conferences in order to discuss issues of importance for monetary policy. Last year, the conference was devoted to the monetary transmission process. Given the ongoing debate of principle on the transmission mechanism, and optimum strategy, of monetary policy, and against the background of the special challenges presented following the launch of monetary union in Europe, this was an obvious subject for discussion. In the current year, the determinants of the investment process in Germany and other European countries were discussed under the heading of "Investment today for the world of tomorrow". Investment is of crucial importance for economic performance and prosperity. Central banks are anxious to know what the best monetary and fiscal conditions for the investment process are. The Bundesbank organised another conference, together with the BIS, at the end of September. It was concerned with the changes in financial systems and the concomitant challenges. During that conference, leading representatives of central banks, international organisations, the private financial sector and academe outlined their views of the implications of European monetary union for the financial environment and monetary policy. Other conferences and workshops, some of which the Bundesbank organ-

ised together with other economic institutes, were devoted to the problems posed by measuring inflation and seasonal adjustment, the estimation of equilibrium values of exchange rates, transparency in monetary policy, and auction procedures in open market policy.

Even if technical discussions are often conducted at a high level of abstraction, in the longer run they remain relevant to practical monetary policy. As a matter of fact, it is important for central bank research to take up such questions of general interest, to try to find approaches to solutions with the instruments available to it and, on the other hand, to endeavour to present its findings to the decision-makers in a readily comprehensible manner.

A further element of the strategy of communication between staff members of the Bundesbank and external economists comprises regular lectures, in which either research papers from the Bundesbank are presented to an audience of academics or, conversely, outside economists expound new findings in lectures and workshops at the Bundesbank. In such a fast-moving area as research, such exchanges and the use of state-of-the-art technical aids and methods that facilitate the exchanges are essential.

Since the beginning of this year, the Bundesbank has been offering external economists the option of paying a research visit for a limited period. By offering such a visitor programme, the Bundesbank is hoping to interest academics in problems with which it finds

itself confronted at present, or potentially, and would like to harness the knowledge and skills of outside economists for its own research. Conversely, it is offering the researchers an interesting environment, stimuli for practice-related research and, not least, the opportunity to draw on the Bundesbank's database, which cannot be made accessible to the public in its entirety on confidentiality grounds. The start of this programme has met with a good response.

The most recent step in the further development of the Bundesbank's research operations is the appointment of a Research Advisory Council. That Council convened for the first time at the beginning of October. The Council is intended to further intensify the links of economists in the Bundesbank with the academic community, to raise the scientific level of such work in the Bundesbank, and to open up new prospects for future research. The Research Advisory Council currently consists of five professors (see the box overleaf); its members have been appointed, to begin with, for three years. It is planned to enlarge this body after an initial period during which experience is to be gained. Then, more account will have to be taken of internationalisation. Here, too, the Bundesbank shows a predilection for a gradual approach.

The structures that have evolved in recent years in the areas outlined here have now reached a stage at which it makes sense to put them on a new organisational basis. This is why the Bundesbank is setting up an Economic Research Centre. The research operations of the Bundesbank will be concen-

*Research
Advisory
Council*

*Concentration
of research
activities in a
Research
Centre*

*Academic
visitor
programme*

The members of the Bundesbank's Research Advisory Council

Professor Dr Martin Hellwig, University of Mannheim

Main research interests: financial systems, fundamentals of monetary theory and macroeconomics

Professor Hellwig is chairman of the Monopoly Commission, Chairman Designate of the *Verein für Socialpolitik*, and a member of several economic associations. In the past, he has been, among other things, President of the European Economic Association and a joint editor of the periodical „Econometrica“.

Professor Dr Peter Kugler, University of Basle

Main research interests: macroeconomics, money and financial markets, applied econometrics

Professor Kugler is Head of the Monetary Macroeconomics Department of the Economics Centre of the University of Basle, and editor of the *Swiss Journal of Economics and Statistics*.

Professor Dr Manfred J.M. Neumann, University of Bonn

Main research interests: monetary theory and monetary policy

Professor Neumann is Director of the Institute for International Economic Policy of the University of Bonn. He is a member of the editorial board of a number of economic periodicals and of several economic associations. He has been Chairman of the Economic Advisory Council at the Federal Ministry of Economics.

Professor Dr Jürgen von Hagen, University of Bonn

Main research interests: internal and external monetary policy, fiscal policy

Professor von Hagen is Director of the Center for European Integration Studies, Bonn, Visiting Professor of Indiana University, USA, and Research Fellow of the Center for Economic Policy Research. He is a member of a number of economic bodies, including the French *Comité économique de la nation*, and an advisor *inter alia* of the European Commission and the World Bank.

Professor Dr Axel A. Weber, University of Frankfurt

Main research interests: monetary economics, external economics

Professor Weber is Director of the Center for Financial Studies in Frankfurt, Research Fellow of the Center for Economic Policy Research and a member of a number of other economic associations.

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trated in this centre. The economic research group will be expanded to fourteen staff members to start with, and will be integrated in the centre. Later on, the area of econometrics in the Bundesbank will likewise be incorporated in the centre. In the past, that area has, in particular, elaborated and applied the quarterly econometric model. That task will remain important in the future. Among other things, econometric models constitute the backbone of macroeconomic forecasts, whose value has, if anything, increased in the context of European monetary policy and the twin-pillar strategy pursued by the ECB. Econometric models reflecting the state of the art in this field will be indispensable to any well-informed debate on such forecasts within the decision-making bodies of the ESCB. In addition, the area of econometrics will perform a number of other research-promoting tasks.

Altogether, the Bundesbank's future Research Centre will be so well staffed that it will be able to play an effective part in the economic debate. It will be about the size of an average research department in one of the US Federal Reserve Banks. Under the US system, it has transpired that the autonomy of the research work of the individual banks has promoted the intellectual debate and competition. That will likewise be the case in the ESCB in future. Besides, the tasks in Europe are more diverse. Notwithstanding European monetary union, national peculiarities and responsibilities continue to exist in many areas with a bearing on the economy. Hence the national central banks in Europe are firmly rooted in their respective countries – more so than are the Fed-

eral Reserve Banks under the US system. They will continue to have an important intermediation and information function between the European level and the national level – namely, in both directions.

*Bundesbank
well equipped
for the future*

By this reorganisation, the Bundesbank has adjusted in the economic sphere to the new conditions and new tasks facing it as part of the ESCB. The close linkage to the “day-to-

day” operations of the Bundesbank has proved its worth, and will be retained. The rotation system whereby most staff members at the Centre will address themselves to a research project for only a limited period, and will subsequently return to their original department, will likewise be continued. That does not rule out the possibility of future adjustments, if they are deemed operationally desirable.