

FINESS



Project funded under the Socio-economic Sciences and Humanities



European Commission

e-Newsletter No 3

July 2009

Welcome to the third issue of the FINESS electronic newsletter!

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FINANCIAL SYSTEMS, EFFICIENCY AND STIMULATION OF SUSTAINABLE GROWTH

Purpose of the project

The main purpose of FINESS is to get a clear understanding of the implications of on-going financial market integration in Europe on economic growth, employment and competitiveness, to identify likely future paths of the development and to draw policy relevant conclusions. On the macroeconomic level, the role of financial systems and their transmission channels on growth is being explored by innovative and tailor made

econometric techniques, taken dynamic interactions between financial, product and labour markets into account. A broad range of indicators to measure the degree of financial integration will be constructed, and their development in time will be addressed. Insights into the working of financial institutions will be provided for the microeconomic level from the perspective of heterogeneous agents. The comparative approach is especially useful to uncover catalysts and bottlenecks in the architecture of financial systems. Empirical analysis will be done using elaborated econometric methods. In addition, likely future paths of the development are identified and policy relevant conclusions are drawn.

By exploring the impacts of financial systems from the perspective of heterogeneous agents, new insights into the working of financial systems and for the optimal policy design in integrated financial markets are provided. In particular, the project investigates the role of the financial structure, for example, the banking sector, markets for private equity and venture capital, for improving efficiency and sustainable growth of start ups and established firms. Specific issues regarding the transition period of the new member states and the gender dimension are also addressed.

Project developments

The FINESS project successfully started in February 2008 with a Kick-off meeting in Berlin. At this meeting the consortium established the project management structure, including the Steering Group and the Advisory Committee, and approved the detailed plan of activities. At the end of February the project partners announced in several languages the official project launch at their websites. Since March 2008, the project has developed an increasing dynamism in the implementation of its work programme. In April 2008 the project website was launched at <http://www.finess-web.eu>. Up to the end of July 2009 **18 FINESS working papers** were published there. The FINESS Policy Briefs contain non-technical summaries of policy-relevant conclusions and are provided to the European Commission. Electronic newsletters are published at the seminannual frequency and are distributed to more than 2000 addresses covering different target groups. This is the third newsletter of the project. All FINESS working papers, policy briefs and newsletters are also available to the broad scientific community for download from the website.

On February 2, 2009 an **Advisory Committee Meeting** was organised in Berlin, where the project participants presented their research output. Active discussion led to a huge number of useful comments and constructive proposals from inside the team. The papers were presented at the **International Scientific Conference** of the FINESS network in Berlin in March, 5-6. More than 50 researchers attended the conference. In addition to the comments obtained from the advisory committee members, the papers were discussed by external experts well-known by the international scientific community. Moreover, researchers from cooperating networks like **FINNOV** and **POLHIA** participated in the event and improved the discussion of the papers. Immediately after the conference, the 2nd **Steering Group Meeting** took place. Further steps in the project and organisational issues were discussed.

The team attached great importance regarding the dissemination of results. After the publication on the Internet the authors started presenting their working papers at relevant workshops and conferences and publishing them as discussion papers. In general, the team advanced successfully towards the implementation of the research plan. All major objectives for the subperiod were achieved.

Furthermore, we invite all relevant ongoing research projects to exchange ideas with FINESS. For any cooperation proposals, please do not hesitate to contact the scientific coordinator, Christian Dreger, email: cdreger@diw.de.

Research News

A number of new papers was produced over the recent months. For example, we have worked on the development of the process of financial integration process in Europe, and looked at the implications of the design of mortgage markets on the transmission of monetary policy. We have explored the relationships between bank ownership and the capital structure of firms, and investigated the relevance of bank competition for the growth of private enterprises. We have discussed the effects of financial and product market frictions for the allocation of consumption risk in an international framework and studied gender differences in investment decisions.

Sean Holly, Ivan Petrella: The financial integration of the European Union: Common and idiosyncratic drivers

The purpose of this paper is to establish how far the process of financial integration has gone in the European Union. There is growing evidence that the appearance of the Euro has accelerated the integration of a number of financial markets among those countries who have adopted the Euro. We identify the growth in financial integration as the process by which idiosyncratic factors at the national level become less and less important for the behaviour of particular markets. While the Euro plays an important part because it eliminates currency risk, financial integration will still emerge between other European countries as long as the institutional and legal barriers are removed.

Sean Holly, Mehdi Raissi: The macroeconomic effects of European financial development: A heterogeneous panel analysis

This paper investigates the macroeconomic benefits of international financial integration and domestic financial sector development for the European Union. The sample consists of 26 European countries with annual data during the period 1970-2004. We attempt to exploit more fully the temporal dimension in the data by making use of the common correlated effects (CCE) estimator. We also account for the nonstationarity of time series by employing the cross-section augmented panel unit root test of Pesaran (2007) and recently developed panel cointegration techniques. We check the robustness of these results by using the fully modified OLS method of Pedroni (2000). Our empirical results suggest a relationship between domestic financial sector development and labour productivity. We report evidence that real GDP per worker is positively linked to a measure of international financial integration (stock of international financial assets and liabilities expressed as a ratio to GDP). We also try to disentangle the effects on real GDP per worker of different types of capital flows (FDI, Portfolio equity, Debt) and are able to identify a significant positive effect on GDP per worker of debt inflows which we could attribute to the institutional environment that has been fostered by the European Union.

Kalin Hristov, Rossen Rozenov: Financial convergence in the new EU member states

In this paper we explore the issue of financial convergence in the new EU member states (NMS). The transition path to a market economy for some countries was very uneven due to delayed structural reforms and bad macroeconomic policies. As a result some countries achieved markedly better outcomes in terms of increase of per capita income and price stability than others, despite the similarity in initial conditions. The capital flows to the financial sectors increased substantially. This massive inflow exerted a downward pressure on interest rates and bond yields

Financial convergence is investigated using two concepts – cross-sectional measures and time-series measures. We point to some weaknesses in the conditions for convergence and definitions of the speed of convergence and propose new ones. Using data on interest rates and bond yield spreads we estimate their equilibrium levels and calculate the speed of convergence implied by the model. In addition, we adopt a time-series approach for testing for convergence which does not require that the economy is in equilibrium and allows for structural changes in the process of transition to equilibrium.

Lieven Baert, Rudi Vander Vennet: Bank ownership, firm value and firm capital structure in Europe

We investigate whether or not banks play a positive role in the ownership structure of European listed firms. We distinguish between banks and other institutional investors as shareholders and examine empirically the relationship between financial institution ownership and the performance of the firms in which they hold equity. Our main finding is that after controlling for the capital structure decision of the firms and the ownership decision of financial institutions in a simultaneous equations model, we find that there is a negative relationship between financial institution ownership and the market value of firms, measured as the Tobin's Q. This is in contradiction with the monitoring hypothesis.

Gábor Pellényi, Tamás Borkó: Bank competition and firm growth in the enlarged European Union

We examine the impact of bank competition and institutional factors on net firm entry in a sample of European manufacturing industries over the 1995-2006 period. Taking

into account industry differences in the need for external finance, we find that bank competition helps firm entry. In addition, better institutions – especially legal structure and property rights – also have a positive impact, particularly through a better functioning financial system.

Sven Blank: International consumption risk sharing with incomplete goods and asset markets

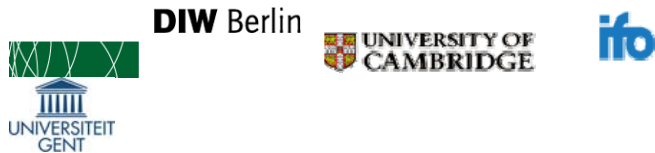
Perfect consumption risk sharing requires both, frictionless goods as well as frictionless financial market integration. This project aims at analyzing the consequences of both type of frictions for the allocation of risk across countries in a unified framework. To this end, the theoretical model by Ghironi and Melitz (2005) is extended to allow for trade in international equities. This setup incorporates impediments to international trade in goods and assets. Preliminary results indicate that both type of frictions matter for international consumption risk sharing.

Oleg Badunenko, Nataliya Barasinska, Dorothea Schäfer: Risk attitudes and investment decisions across European countries – Are women more conservative investors than men?

This study questions the popular stereotype that women are more risk averse than men in their investment decisions. The analysis is based on micro-level data from large-scale surveys of private households in five European countries. We enrich the conventional approach to examination of gender differences by explicitly controlling for investors' self-perceived willingness to take financial risk. Our results confirm the gender stereotype only partially. We find that women are less likely to hold risky financial assets. However, conditional on ownership females allocate an equal or even a higher share of their wealth to these assets than men. Our findings suggest that especially in case of women, the declared attitude toward financial risks may be misleading as it does not necessarily reflect the actual willingness to bear risks.

Kai Carstensen, Oliver Hülsewig, Timo Wollmershäuser: Monetary policy transmission and house prices. European cross country evidence

This paper explores the importance of housing and mortgage market heterogeneity in 13 European countries for the transmission of monetary policy. We use a pooled VAR model which is estimated over the period 1995–2006 to generate impulse responses of key macroeconomic variables to a monetary policy shock. We split our sample of countries into two disjoint groups according to the impact of the monetary policy shock on real house prices. Our results suggest that in countries with a more pronounced reaction of real house prices the propagation of monetary policy shocks to macroeconomic variables is amplified.



SEVENTH FRAMEWORK PROGRAMME



FINESS

International Project Conference

Financial Systems, Efficiency and Stimulation of Sustainable Growth

March 5-6, 2009
Berlin

Conference Venue

Berlin-Brandenburg Academy of Sciences
(Berlin-Brandenburgische Akademie der Wissenschaften)

- Einstein Hall -
Jägerstrasse 22-23
10117 Berlin

<http://www.finess-web.eu>

Programme

March 5, 2009

- 10.30-11.00 Welcome Address**
FP7 Funded Research in Response to the Financial and Economic Crisis
 Dominik Sobczak, *European Commission, DG RTD*
- 11.00-13.00 Session 1. Recent Trends in the European Financial Market Integration**
- Chairman:** Giovanni Urga
- 11.00 -11.40 *The Financial Integration in the European Union: Common and Idiosyncratic Drivers***
 Presentation by Sean Holly, and Ivan Petrella (UCAM)
 External discussant: Ray Barrell, NIESR
 Comments by Advisory Committee (AC): Giovanni Urga
- 11.40-12.20 *Financial Integration in the European Stock Markets***
 Presentation by Burcu Erdogan (DIW)
 External discussant: Timo Teräsvirta, University of Aarhus
 Comments by AC: Eric Girardin
- 12.20 -13.00 *European Financial Market Integration: A Closer Look at Government Bonds***
 Presentation by Sebastian Weber (DIW)
 External discussant: Markus Baltzer, Bundesbank
 Comments by AC: Wendy Carlin
- 13.00-14.00 Lunch (buffet)**
- 14.00-15.20 Session 2. Structural Change in Financial Market Integration: The Macroeconomic View**
- Chairman:** Anindya Banerjee
- 14.00 -14.40 *The Macroeconomic Effects of European Financial Development: a Heterogenous Panel Analysis***
 Presentation by Sean Holly (UCAM)
 External discussant: Boris Hofmann, European Central Bank
 Comments by AC: Anindya Banerjee
- 14.40 -15.20 *Money Demand in Integrated Financial Markets***
 Presentation by Christian Dreger (DIW)
 External Discussant: Oliver Holtermöller, RWTH Aachen
 Comments by AC: Anindya Banerjee
- 15.20-16.00 *International Risk Sharing with Incomplete Goods and Asset Markets***
 Presentation by Sven Blank (UoT)
 External discussant: Domenico Delli Gatti, Università Cattolica del Sacro Cuore (FP7-POLHIA)
 Comments by AC: Giovanni Urga

- 16.00-16.20 Coffee break**
- 16.20-18.20 Session 3. Economic Policy Design in Integrated Financial Markets**
- Chairman:** Alfred Steinherr
- 16.20 -17.00 *Credit Frictions and Labour Market Dynamics***
 Presentation by Atanas Hristov (DIW)
 External discussant: Jan in't Veld, European Commission, DG ECFIN
 Comments by AC: Giovanni Urga
- 17.00 -17.40 *Monetary Policy Transmission and House Prices: European Cross Country Evidence***
 Presentation by Timo Wollmershäuser (ifo)
 External discussant: Jiri Slacalek, European Central Bank
 Comments by AC: Anindya Banerjee
- 17.40-18.20 *Does the Nominal Exchange Rate Regime Affect the Real Interest Rate Parity Condition?***
 Presentation by Christian Dreger (DIW)
 External discussant: Boriss Siliverstovs, ETH Zurich
 Comments by AC: Alfred Steinherr
- 19.30- 21.30 Continuation of discussion (dinner)**

March 6, 2009

- 09.00-11.00 Session 4. Banking Systems and Economic Performance**
- Chairwoman:** Doris Neuberger
- 09.00 -9.40 *Bank Ownership, Firm Value and Firm Capital Structure in Europe***
 Presentation by Lieven Baert and Rudi Vander Vennet (UGhent)
 Discussants: Neeltje van Horen, De Nederlandsche Bank
 Comments by AC: Doris Neuberger
- 09.40-10.20 *Bank Competition and Firm Growth in the Enlarged European Union***
 Presentation by Gábor Pellényi (ICEG)
 External discussant: Balázs Égert, OECD
 Comments: Olena Havrylchyk, CEPII
- 10.20-11.00 *Financial Convergence in the New EU Member States***
 Presentation by: Rossen Rozenov (IME)
 External discussant: Cezary Wójcik, National Bank of Poland/Warsaw School of Economics
 Comments by AC: Eric Girardin
- 11.00-11.20 Coffee break**
- 11.20-12.40 Session 5. Financial Institutions and Market Participants**
Chairman: Eric Girardin

- 11.20-12.00** ***Determinants of Private Equity Investment in European Companies***
Presentation by Oleg Badunenko and Dorothea Schaefer (DIW)
External discussant: Christopher F. Baum, Boston College
Comments by AC: Doris Neuberger
- 12.00-12.40** ***Risk Attitude and Investment Decisions across European Countries – Are Women More Risk Averse Investors Than Men?***
(DIW) Presentation by Nataliya Barasinska and Dorothea Schaefer
External discussant: Alexander Muravyev, IZA Bonn
Comments by AC: Alfred Steinherr
- 12.40-12.50** **Closure of the Conference**
- 13.00-15.00** **Business Lunch of the Steering Group with the Advisory Committee**
- 15.00-16.00** **Organisational Meeting of the Steering Group**

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