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ЄВРОПЕЙСЬКИЙ ЦЕНТРАЛЬНИЙ БАНК ЯК КРЕДИТОР ОСТАННЬОЇ ІНСТАНЦІЇ

Статтю присвячено дослідженню категорії "кредитор останньої інстанції". Проаналізовано класичні інтерпретації "кредитора останньої інстанції" та теорії, на яких це поняття базується. Досліджено еволюцію теоретичних знань, а також проаналізовано практичний досвід. Спираючись на роботи провідних сучасних вчених, стаття має на меті обґрунтувати необхідність подальшого розвитку теорії проблеми "кредитора останньої інстанції", та висвітлити питання дискусії стосовно того, чи має стати Європейський Центральний Банк кредитором останньої інстанції. Аналіз точок зору вчених був необхідним для того, щоб зрозуміти різницю між "кредитором останньої інстанції" для банків та для урядів, а також для того, щоб позначити переваги та недоліки для економічної стабільності у ЄС. Підкреслено головні аргументи вчених-дослідників, які підтримують або не підтримують роль Європейського Центрального Банку як кредитора останньої інстанції як для банків, так і для урядів. Зроблено висновок щодо перспектив Центрального Банку як кредитора останньої інстанції.

Ключові слова: кредитор останньої інстанції; Європейський Центральний Банк; фінансова криза; криза суверенного боргу; моральна загроза; ліквідність; ризик зараження; бонди; Європейський механізм фінансової стабілізації; Європейський стабілізаційний механізм.

During recent financial crisis, which was followed by sovereign debt crisis, the EU and national governments faced a question of whether it was necessary that the ECB would become a lender of last resort. The debates appeared as well over the extent of the ECB responsibilities. Some of the specialists claim that the amount of obstacles is very big and ECB should limit itself to the function of LLR for the banks, but not for the governments.

In order to find a solution for the problem, it is important to understand the concept itself, its origin and the results previously achieved with establishment of the central bank as LLR. Besides, it should be described how the functions of the ECB are different or similar to those of the national central bank as a LLR. It is essential to answer the question of what advantages and disadvantages the EU faces when the ECB fulfills the requirements of the LLR as well as to examine the policy the ECB followed during the recent crisis. The answer to the question of the necessity of the ECB to become the LLR lies in the frame of historical experience and current economic conditions.

Another problem to be tackled upon is the question of whether the EU institutional and legal basis is prepared for the ECB to become the LLR. The possibility of following the experience of the other countries, such as USA must be explored and the differences between their economic conditions and current conditions in the EU have to be explored. It is also necessary to understand if it is appropriate to implement directly the experience of the other countries or are there differences in the EU that make the implementation of those models impossible.

In addition it is important to explore the difference between the functions of the ECB, when it lends to the banks and to the governments. The question that needs to be highlighted is whether the risks and the benefits are the same or do they differ significantly and in what way.

Another dilemma to be solved is the possibility for the ECB to stay LLR for the banks, but not for the governments and whether this policy would be efficient.

This paper aims to combine existing information on the problem of the LLR in order to explore whether modern problems can be solved with the help of classic theories and if the application should be modified, to clarify the methods.

First of all it refers to the theoretical works of the scientist and scholars, who explored the question and elaborated basic methodology. The second part deals with the problems establishment of the LLR leads to. And finally, the third one touches upon the contemporary problems the EU banking and monetary system faced during the recent crises.

The idea of central bank as a lender of last resort first appeared in works of Thornton and Bagehot. Some scientists admit that the function of ECB as a lender of last resort has been one of the main questions for central bank since they first emerged [1, p. 2]. Because on the one hand it is essential that such function exists in order to maintain financial system stable, as in some cases interbank market is not able to function properly. On the other hand a support from the central bank can result in loosening of the discipline [1, p. 2].

When the concept of a central bank as a lender of last resort was introduced, it was considered as lending money to all financial system, not each insolvent bank in particular, as the investors, who were not able to borrow money from banks, would have been obliged to shut down their business, which would be harmful to all economy [2, p. 3].

It was Henry Thornton, who first introduced the idea of lender of last resort in his work "An inquiry into the nature and effect of paper credit in Great Britain". He named three main features of LLR:

- "ultimate source of liquidity for the financial system" [3, p. 8];

- must have sufficient liquid assets in a depository available in case of disturbance;

- special responsibilities of the bank for the economic stability (especially in the time of crisis) [3, p. 8];

Walter Bagehot contributed to Henry Thornton's theory, adding that:

- depositors and banks should be let know about the support in case of crisis beforehand;

- banks must be aware of penalty rate as well;

- there are certain criteria, according to which a bank may count on help;

- a target of a lender of last resort is to help the system, not individual insolvent banks;

- LOLR is not a remedy against insolvency for banks, which fail to meet financial discipline rules [3, p. 12-15].

The rules stated by Thornton and Bagehot were largely implemented from the end of XIX century onwards. They include:

- no protection for individual banks, but for the financial system as a whole;

- maintaining stability of well disciplined, reliable institutions only and letting weak and insolvent banks disappear;

- maintain only solvent institutions;

- in case of granting a support to an institution, to reassure that its guarantees are secure;

- give full information about prospective measures in advance [3, p. 8].

Facts give evidence in favor of establishing the LLR as Great Britain, where it was possible to escape crisis situations turning into recession several times between 1878 and 1914 [4, p. 26]. On the other hand, LLR in USA was established much later and that was one of the reasons for the crisis to be so severe after 1929 due to the lack of support to banks from Federal Reserve [4, p. 26].

Among reasons behind establishing central bank as a LLR the following can be mentioned. One of the aims of the bank is to maintain liquidity, keeping the balance between long term investments and deposits available [1, p. 2]. But, in terms of interbank relationship, if one bank fails to comply with its obligations, it can result in partner banks insolvency, which leads to the payment impasse which increases systematic risks [2, p. 3]. In addition a run on one bank can provoke runs on other banks as well, in case the depositors believe banks' equities are similar. This kind of panics are more likely to happen than those involving withdrawing money in banks with completely different assets [2, p. 3]. "Contagious risks provide a strong and compelling call for CB to play the role of LOLR" [5, p. 1061], as they "can cause banking panics, with depositors seeking to switch out of the deposits of banks perceived as riskier into currency, foreign exchange, or into those banks perceived as safer" [5, p. 1061]. Another factor is that, the cost of bank liquidation might be more than bail out [2, p. 3].

On the other hand existence of LLR creates a number of problems. As, for example, in banking, it makes the depositors less prudent and makes them pay less attention to monitoring bank's activity [2, p. 4]. In addition, commercial banks become less accurate as well, because they are sure, that they are protected by LLR from risk of failure [2, p. 4]. Managers in this situation may be inclined to perform more risky operations [2, p. 4]. This means, that the problem of moral hazard arises [2, p. 4]. As a solution, Bagehot suggested providing penalty rate to escape the

issue, but the problem of bank solvency becomes more complicated this way and additionally to serve as an indicator to other players that the bank has problems [2, p. 4]. In this situation the Central Bank can restrain of giving the information about bailout plans and thus avoiding moral hazard [2, p. 4]. Plus, when the Central Bank keeps its policy in secret, the stakeholders are made to stay prudent as they are not aware not only of possibility of rescue, but also about the penalty and keeps investors alert to monitor bank's activity [2, p. 4]. Thus, when talking about adverse macroeconomic shocks, the Central Bank should be precise about performing a function of LLR ex ante, as it increases bank survival possibility [2, p. 5].

As for the European Union, the LLR for banks might be needed because of the following problematic. Through the past year some bank groups have gained a status of European, meaning providing services more than in one European country [2, p. 6]. They establish branches and subsidiaries [2, p. 6]. The subsidiaries are more independent than branches, so in the case of bankruptcy they are individually responsible and are registered, licensed and insured individually in each country as well [2, p. 6]. Unlike subsidiaries, branches are much more connected to parent bank and are regulated by it, branches are insured by home country [2, p. 6].

The danger of such banks emerges in the case of liquidity shock in one country, which can be transmitted from country to country. In this situation, especially when dealing with subsidiaries, the National bank might have to act as a LLR. The situation is aggravated as multinational banks can chose from which country they prefer to withdraw funds, picking the country, where the aid of Central Bank is more probable [2, p. 6-7].

In the situation when European LLR does not exist there are two options:

1) Only bank of the parent country provides the aid.

2) The responsibility is shared between National banks [2, p. 7].

The disadvantage of the first scenario is that only one country and one National Bank takes the responsibility and bears costs. In the second case, however, conflict of interests is possible and coordination is needed. But in times of crisis the reaction must be quick, in order to prevent aggravation. Therefore the process of coordination, which is time-consuming, is counterproductive in certain sense [2, p. 7].

In case of ECB officially becoming a LLR it can reserve a right to intervene only if it concedes it necessary and leave the regulation of ordinary cases to National Central bank. It can lead to prolonging the decision, making process, though [2, p. 7].

The role of the LLR for the banking system seems to be less controversial than that for the governments. According to some scholars the EU hesitated less about granting the support to the banks during the crisis in 2008, but it had more doubts about providing liquidity to national governments. Finally the ECB intervened by buying the government bonds [6, p. 2].

There might be two main reasons, which the researches name, when referring to the cause for borrowing from LLR:

- illiquidity theory

- risk taking theory [7, p. 4].

Illiquidity theory says that the illiquidity of the banking system is a consequence of market failure. The LLR can be useful to prevent bank failure in this case. The risk-taking theory on the other hand states that there might

be an increase in risk-taking with the help of the LLR [7, p. 4]. Moreover, the governments can encourage the banks to take additional risks in case of distortions in the country [7, p. 8].

Among the main problems of the LLR for the governments the following can be distinguished:

- inflation, which is thought to occur because buying the government bonds provokes the increase of money stock. The opponents of this opinion, on the other hand say that the LLR does not increase the money stock, but the money base, which does not provoke the inflation. On the contrary it stops the financial crisis from becoming a recession;

- the taxpayers have to bear the costs. But the intervention of the central bank into the open market is always connected to additional expenses of the taxpayers;

- moral hazard. The problem of moral hazard for the governments is similar with that in banking system. There is a risk that the governments will issue too many bonds. The opponents of this idea, however, admit that moral hazard will exist always and that solving the problem of moral hazard should not be the problem of the ECB. Instead it has to concentrate on the issue of fulfilling the functions of LLR;

- legal issue, which according to the scholars has to be explored in details. There is an opinion that the ECB has limited authorization for these operations under the EU law. However, the ECB is allowed to conduct the operations on the open market under the Article 18 of the "Protocol on the Statute of the European System of Central Banks and the European Central Bank". The operations on the open market give additional liquidity to the bondholders, which means financing budget deficit, but not giving credits to the government [6, p. 11-12].

Nowadays, the role and the notion of LLR changed due to significant changes in world financial system. That is why countries need to adapt new regulating mechanisms on the basis of classical Thornton-Bagehot model, which was the case for Federal Reserve, BOE and ECB as well [8]. Due to globalization, increasing importance of investment banks, aggressive profit oriented investment behavior and EU's active participation in global investment process (including investments in toxic papers in USA), European banking system faced the same issues as that in other countries. ECB's methods of problem resolution had several peculiarities, though [8, p. 4-5].

The first reason for deviation from Federal Reserve as well as from classical model is the fact that ECB has only limited set of tools for apply LLR policy [8, p. 31]. Art. 123 and Art. 125 TEFU do not allow neither bail-outs no governmental deficit subsidizing [9]. Under these conditions, in order to "prevent the intensification of the crisis into a solvency crisis for households, government, firms and financial institutions with high debt burdens" [8, p. 23]. ECB reduced refinancing rate, which is controversial to what was stated in Thornton-Bagehot model [8, p. 23]. In addition, collateral demands were made more flexible as well [8, p. 23].

ECB took several non-standard measures in order to stabilize EU financial system as well during recent financial crisis, which should be taken into consideration when discussing its possible official role as LLR.

First of all, it should be stressed, that the ECB can theoretically be a LLR for the government and for the banking system [10, p. 1]. And the problem of moral hazard is relevant for both cases [10, p. 1]. That is why the scientists point out that the coordination of fiscal and monetary policy

is essential [10, p. 9]. It should be admitted, though that practice showed that compliance of the governments with fiscal and monetary policy is much higher than the discipline of bank managers and their compliance with financial regulations and general prudence and accuracy [10, p. 1].

Because of the restrictions of the Treaty, by May 2010, when Securities Market Program was announced, the European authorities took a decision to provide help to the governments via purchasing securities in the secondary market. This measure was stated as non-controversial to the Treaty of functioning of European Union. It was criticized, though, because the European authorities waited until the end of the elections in Germany [10, p. 2]. It should be admitted that the decision about the SMP met some critique inside Governing Council of ECB that means that there are certain discrepancies in views [10, p. 2].

Further aggravation of crisis made ECB to take new measures, which consisted in long-term refinancing operations as a help to banking sector. The amount of the first package of aid was 489 billion and the second one - 530 billion. This solution was criticized under the reason that such a system would put taxpayers under additional risk as helped undisciplined countries to escape their responsibilities and the keep letting the citizens too live beyond means [10, p. 5]. Some scientists, on the other hand, opposed this opinion and stated that simple intervention for speculation prevention was not enough to tame the crisis.

Finally, in 2012, the ECB launches a new program for SMP, which was called Outright Monetary Transactions [10, p. 7]. It is an updated document in which takes into consideration different position in the Governing council and sets a number of conditions, which are necessary for the governments of MS to comply with in order to have a right to issue the securities [10, p. 7]. This program was not welcomed warmly as well [10, p. 7]. The reason for it was that the document this time was a compromise between two main points of view, the core of which lied in the question of origin of crisis [10, p. 7]. Mainly of those, who thought that the reason was in speculations and those, who considered that it was in structural issues and irresponsible behavior [10, p. 7].

Thus, considering all the aforementioned points, it can be stated that due to the modern economic conditions and relevance of the moral hazard, the combination of fiscal and monetary policy is important [10, p. 9-10]. Plus, scientists come to consensus on the following points which the states and the EU must comply with:

- a co-operation mechanism settled;
- flexibility improvement, mainly the ability of regulatory mechanism to comply with economic cycles and economic peculiarities of a particular country;
- financial stability advance;
- co-operation model improvement in order to coordinate common actions between actors for achieving the most relevant goals in short time frame [10, p. 9-10].

As the debates around the ECB as an LLR for the governments continue, there is a need to take a closer look at the nature of monetary union as there are some peculiarities on the government bond market inside the monetary union. Among them, the following are distinguished:

- the countries in the monetary union can not possibly provide such an extent of control over their bond market as the national government as they do not issue bonds in their currency;

- national banks usually have a function of LLR for banks in critical situations;
- absence of LLR makes the banking system more vulnerable as it increases;
- risks for liquidity;
- the risk of a bank run;
- the risk even spreads on the solvent banks as the panic might make the deposit holders to withdraw the money because of the panic;
- on the other hand the mechanism of the national bond market is similar to that in the banking system. It means that in case of risk, the bondholders want to get rid of their bonds and sell them, which increases the risk of lack of liquidity;
- the bond rates grow and liquidity crisis becomes solvency crisis;
- that is why the fear of illiquidity itself aggravates the situation [6, p. 2-3].

The LLR can solve this problem, by assuring the liquidity [6, p. 2-3].

If the central bank of the monetary union does not provide additional liquidity, that may be done by the national central banks, which involves more expenses [6, p. 2-3].

The main arguments against the Central Bank as an LLR in monetary union are as follows:

1. The ECB as LLR for the governments will not be successful, because of the absence of the banking union.
2. LLR is only suitable for short - term crises.
3. The USA is a monetary union, but there is no LLR for the states.
4. Previous experience demonstrates that if the Central Bank buys sovereign bonds and thus has a function of LLR for the country, it leads to inflation [11, p. 4].

But if each of the questions explored carefully, they can be opposed:

1. The EU does not have single government like national states do. That means also that there is no fiscal unity in Member States. The ECB, thus, can not be a LLR for the governments, but for the banks. But since the crises, the ESM and the OMT can be regarded as the first steps towards unified policy, especially, with the regard to the fact that ESM was deliberately created for maintaining fiscal stability, which clearly goes beyond the function of inflation control [11, p. 3-7].

However, the supranational governance that goes further than it was aimed to be in Maastricht Treaty causes a lot of disputes inside the EU as the national governments do not want to limit their sovereignty with the supranational government for different reasons [11, p. 3-6]. In addition, The EFSF and ESM as well are not reliable enough as the liquidity is not guaranteed, when it might be needed, because EFSF or ESM do not create an unlimited amount of cash. In addition, all 28 Member States have a veto power, which jeopardizes efficient governance of the instrument [6, p. 11-12].

2. The LLR is seen as a rapid reaction anticrisis instrument, but the crisis in the EU lasts for several years, that is why, the researches claim, the LLR aid for the government can not be justified by the classic LLR theories. On the other hand, the scientists give evidences, that there the essence of the financial crisis of 2008/2009 is not much different from the crisis in EU, which started in 2010 and also that there should not be different approaches from the economic point of view [11, p. 7-9].

3. The US system implies indeed that the LLR aid is only allowed for the banks and the financial system, but not for the states. But there is a difference between the US

and the EU. Mainly, there is no fiscal union in the EU, unlike the US. The US budget is 36% of GDP of the country, and the EU - 1% of GDP of the EU. It makes the US system less prone to vulnerabilities [11, p. 11].

The US is also a banking union, which means that major banking crises are solved on the federal level [11, p. 11].

The US also reacted with major interventions in the economy in order not to allow the crisis become as severe as Great Depression [11, p. 11-12].

4. In order not to allow the inflation to spread, the solvency of the banks and the countries members of monetary union has to be ensured. If this is dubious, the question existence of monetary union should be revised [11, p. 23-24].

Conclusion

Hence, it should be admitted that current notion of LLR is not the same as it was originally, some deviation from the original model are found, due to changed world economic conditions, it keeps, though the core elements of the first theoretical model. It is now obvious, that one model of action can not be applied to every case as the country's issues, as the core of the problem can be structural. That is why broad co-ordination of policies is needed. In addition, it is difficult to make ECB be a LLR because of non-homogeneity of the EU itself, as due to the restrictions of the Treaty, which is difficult to change.

On the one hand, taking the role of LLR for ECB is advisable, as there are multinational banks emerging, which are hard to control by one state. So European LLR seems to make the system more secure. Additionally, a fast reaction is needed in the times of crisis, which is easier to achieve in one institution. There are still different national interests seen inside the ECB itself, though.

In addition, there is a number of problems emerging with the establishment of LLR, which remain vital as in case of saving individual banks, as well as in case of providing aid to governments. The most urgent of those is moral hazard, which basically means loosening of the discipline, which is counterproductive, because leads to the risk of new crises.

The ECB as an LLR to the governments is a controversial question and a matter of debates nowadays. However it should be admitted that not only economical, but also political constraints can be involved in the discussion on the issue.

It might be admitted, that during the recent crisis, the ECB led certain policy, that are very much alike to that of LLR, remaining in the frame of the Treaty at the same time. This may be considered as time of broadening the functions of ECB. But even in such case, certain criteria must be complied with to strengthen European financial system and to avoid the emergence of new threats.

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ЕВРОПЕЙСКИЙ ЦЕНТРАЛЬНЫЙ БАНК КАК КРЕДИТОР ПОСЛЕДНЕЙ ИНСТАНЦИИ

В статье исследована категория "кредитор последней инстанции". Проанализированы классические интерпретации "кредитора последней инстанции" и теории, на которых это понятие базируется. Изучена эволюция теоретических знаний, а также проанализирован практический опыт. Опираясь на работы ведущих современных ученых, в статье обоснована необходимость дальнейшего развития теории проблемы "кредитора последней инстанции", а также рассмотрен вопрос дискуссии относительно того, должен ли стать Европейский Центральный Банк кредитором последней инстанции. Анализ точек зрения ученых был необходим для того, чтобы понять разницу между "кредитором последней инстанции" для банков и для правительств, а также для того, чтобы обозначить преимущества и недостатки для экономической стабильности в ЕС. Подчеркнуты главные аргументы ученых-исследователей, которые поддерживают или не поддерживают роль Европейского Центрального Банка как кредитора последней инстанции как для банков, так и для правительств. Сделан вывод о перспективах Центрального Банка как кредитора последней инстанции.

Ключевые слова: кредитор последней инстанции; Европейский Центральный Банк; финансовый кризис; кризис суверенного долга; моральная угроза; ликвидность; риск заражения; бонды; Европейский механизм финансовой стабилизации; Европейский стабилизационный механизм.

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EUROPEAN CENTRAL BANK AS A LENDER OF LAST RESORT

The article deals with the notion "the lender of last resort". First of all, it tackles upon classic interpretations of the LLR and the theories in the basis of the notion. It explores the evolution of the theoretical framework and touches upon practical experience. Basing on the works of the prominent contemporary scientists the article tends to answer the question of the kind of changes that caused the revision of the LLR theory and reasons why the question of the ECB as LLR is important nowadays. The article discusses the problems the EU and the ECB are currently facing, when the question of ECB as a LLR arises. The opinions of the prominent scientist on this topic are analyzed in order to understand the difference between the LLR for banks and for the governments, and the advantages and disadvantages for the EU economic stability. The text highlights main arguments of the scholars, who are in favor and those, who are against the ECB as an LLR both for the banks and for the governments and makes a conclusion on the perspectives of the ECB as an LLR.

Key word: lender of last resort; European Central Bank; financial crisis; sovereign debt crisis; moral hazard; inflation; solvency; liquidity; contagious risks; bonds; OMT; EFSF; ESM.

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