

Comments on *The Margins for Discretion*



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Introduction

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PRESENTATION OF THE PAPER

The Paper within the Literature

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- *Recent literature on the 19th-century Norwegian monetary experience:* Eitrheim, Klovland, and Qvigstad (2004, 2007); Klovland (1983, 2005); Knutsen (1995, 2003); Øksendal (2006, 2008, 2009).

The Paper within the Literature

- *The vast literature on the ‘rules of the game’ under the gold standard.*
- *More specifically, the literature on the ‘margins for discretion’ during crises:*
 - ✓ Dornbusch and Frenkel (1984), a pioneering model of internal and external convertibility during crises;
 - ✓ Della Paolera and Taylor (2002), on domestic financial stability as an inconsistent target with respect to external convertibility;
 - ✓ Ugolini (2010), on the role of the ‘margins for discretion’ in affecting the credibility of pegs.

A Sketch of the Argument

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- *Starting point:* In the 19th century, central banks used to have two main targets: stabilizing exchange rates and avoiding disruptions within the payments system. These were two conflicting targets, and central banks were forced to play around in order to try to keep both.

A Sketch of the Argument

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- Norges Bank's 'margins for discretion' are described.
- Norges Bank's crisis management is analyzed in the event of a number of episodes (1847, 1857, 1878, 1899).

A Sketch of the Argument

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- *Conclusion: Avoiding disruptions within the payments system was not equivalent to nowadays' financial stability target, because 19th-century central banks let many commercial banks fail; because of their fixed-exchange-rate commitments, central banks could not be lenders of last resort as much as the state could.*
- 'A central bank is only as good as the credibility commanded by the state'.

Pros

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STRENGTHS OF THE PAPER

I) A Fresh Perspective

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- As far as I know, this is the first attempt to look at Norwegian monetary history from the point of view of Norges Bank itself.

II) A Good Focus

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- I fully applaud the choice of looking at excess central bank reserves as a crucial indicator for judging central bankers' behavior under a fixed exchange rate regime.

III) Intriguing Evidence

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- The historical episodes the author presents are very interesting, as they show a lot of different strategies of crisis resolution put in place by monetary *and* fiscal authorities.

Cons

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MY CRITICISM OF THE PAPER

1) Qualification of the Argument

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- Trivially, exchange rate stability and financial stability may be two conflicting targets only if a crisis is a twin crisis. This was commonly understood even in the 19th century (Thornton 1802; Bagehot 1873).

1) Qualification of the Argument

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- But when one is to study a twin crisis, a crucial element to be looked at is the behavior of *exchange rates* during the shock.
- **Nowhere this element is brought into the picture.**
- True, the central bank's convertibility commitment formally translated into the legal coverage ratios. However, only exchange rates can reveal a number of important features (e.g. to what extent the drain was external or internal).

2) Empirical Evidence

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- Just juxtaposing excess reserves and interest rates is not enough to understand what is actually going on.
- The Bank is told to be ‘withdrawing banknotes’ from circulation. **How does the Bank manage to withdraw banknotes in practice? This remains unexplained.**

2) Empirical Evidence

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- Is there credit rationing?
- Is there discrimination against some kinds of assets?
- Are there open-market operations taking place?
- Is the Bank intervening on the bullion market?
- Are foreign exchange interventions implemented?

2) Empirical Evidence

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- The only additional piece of evidence provided is the ratio of discounts over issued banknotes. Yet this is merely an indicator of the velocity of circulation of banknotes across the central bank's discount window.

3) Definition of LLR

19

- There is confusion on the concept of lender of last resort. LLR does not mean that the central bank provides lifeboat arrangements to insolvent banks, it means that the central bank ensures that the liquidity of eligible collateral is never discontinued (Bagehot 1873).

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- There is confusion on the concept of lender of last resort. LLR does not mean that the central bank provides lifeboat arrangements to insolvent banks, it means that the central bank ensures that the liquidity of eligible collateral is never discontinued (Bagehot 1873).
- We are able to assess if the central bank is doing LLR only if we look at the price of eligible collateral during crises (market discount rates, price of national sovereign bonds, etc.: Bignon *et al.* 2009), **otherwise we cannot know.**

3) Definition of LLR

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- As a result, the fact that bank failures take place does *not* allow to conclude that the central bank is not behaving as a LLR (the 21st-century policy of systematic bailout has nothing to do with Bagehot-style LLR).

One Example

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SOME SUGGESTIONS FOR IMPROVING THE PAPER

The 1857 Crisis

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 - 3) Norges Bank 'buys up Norwegian paper abroad' (?);
 - 4) The government raises a short-term loan in London;
 - 5) The loan is 'used for domestic discounting through the government discounting commission, but would also strengthen the reserves of Norges Bank' (?).

The 1857 Crisis

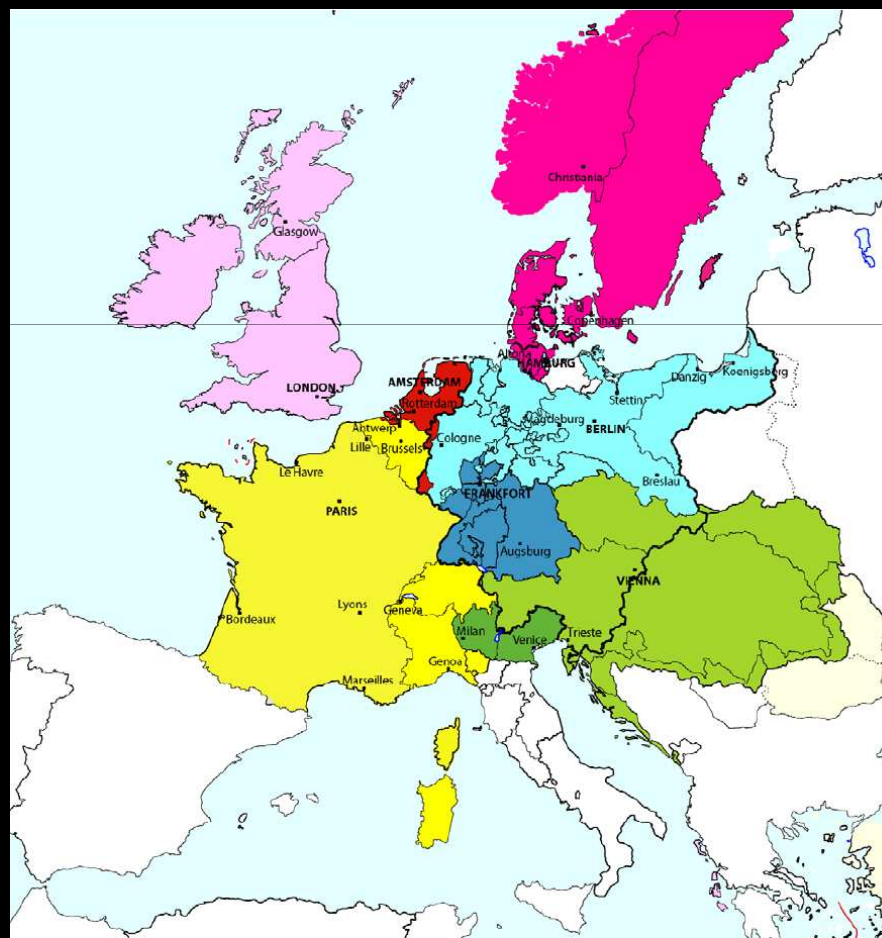
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- ‘This might be seen merely as an intervention in the foreign exchange market to support the fixed exchange rate. [...] The object was not to help bankers in distress, but to avoid a serious threat to the domestic payments system caused by the rampant illiquidity of key economic agents. Nonetheless, it is a paradox that the first major central bank rescue operation in Norway under a financial crisis was not aimed at financial intermediaries and actually took place in another country’.

Monetary Geography in the 1850s

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National Bank of Belgium, 1851-1853: Geographical origin of foreign bills discounted



Source:
Ugolini (2007)

Monetary Geography in the 1850s

Notirte Wechsel-Course: 13. October. 16. October.

		13. October.	16. October.
Paris	3 Mt.	193 ¹ / ₂	194 ¹ / ₂
"	k. S.	191	191 ¹ / ₂
Bordeaux	3 Mt.	193 ³ / ₄	194 ³ / ₄
Antwerpen	3 Mt.	192	192 ¹ / ₂
"	k. S.	190 ¹ / ₂	191
Genua	3 Mt.	196	196
Livorno	"	226 ¹ / ₂	226 ¹ / ₂
St. Petersburg, 7r R. S.	3 Mt.	31 ¹ / ₂	31 ¹ / ₂
London	"	13. —	12. 16
"	k. S.	13. 3 ¹ / ₄	13. 2 ³ / ₄
Madrid	3 Mt.	42 ³ / ₄	42 ³ / ₄
Cadix	"	43	43
Bilbao	"	43	43
Lissabon	"	45 ³ / ₄	45 ³ / ₄
Oporto	"	45 ³ / ₄	45 ³ / ₄
Amsterdam, Cour.	3 Mt.	36. 25	36. 40
"	k. S.	35. 85	35. 90
Frankfurt a. M., 24 μ -Fuss	2 Mt.	89 ⁵ / ₈	89 ⁷ / ₈
Augsburg, Cour.	"	75	75
Prag, im Conv. 20 μ -Fuss	"	80 ⁷ / ₈	81 ¹ / ₈
Wien	"	80 ³ / ₄	80 ⁷ / ₈
Triest	"	81	81 ¹ / ₄
Breslau, im 14 μ -Fuss	"	154 ³ / ₈	155 ¹ / ₈
Berlin	"	154 ¹ / ₂	155
Leipzig	"	154 ³ / ₄	155 ¹ / ₄
Kopenhagen, Thaler R.-M.	k. S.	—	—
Disconto			9 $\%$ Br.

Christiania???

Source:
Hamburgische
Börsen-Halle (1857)

A Peculiar Situation

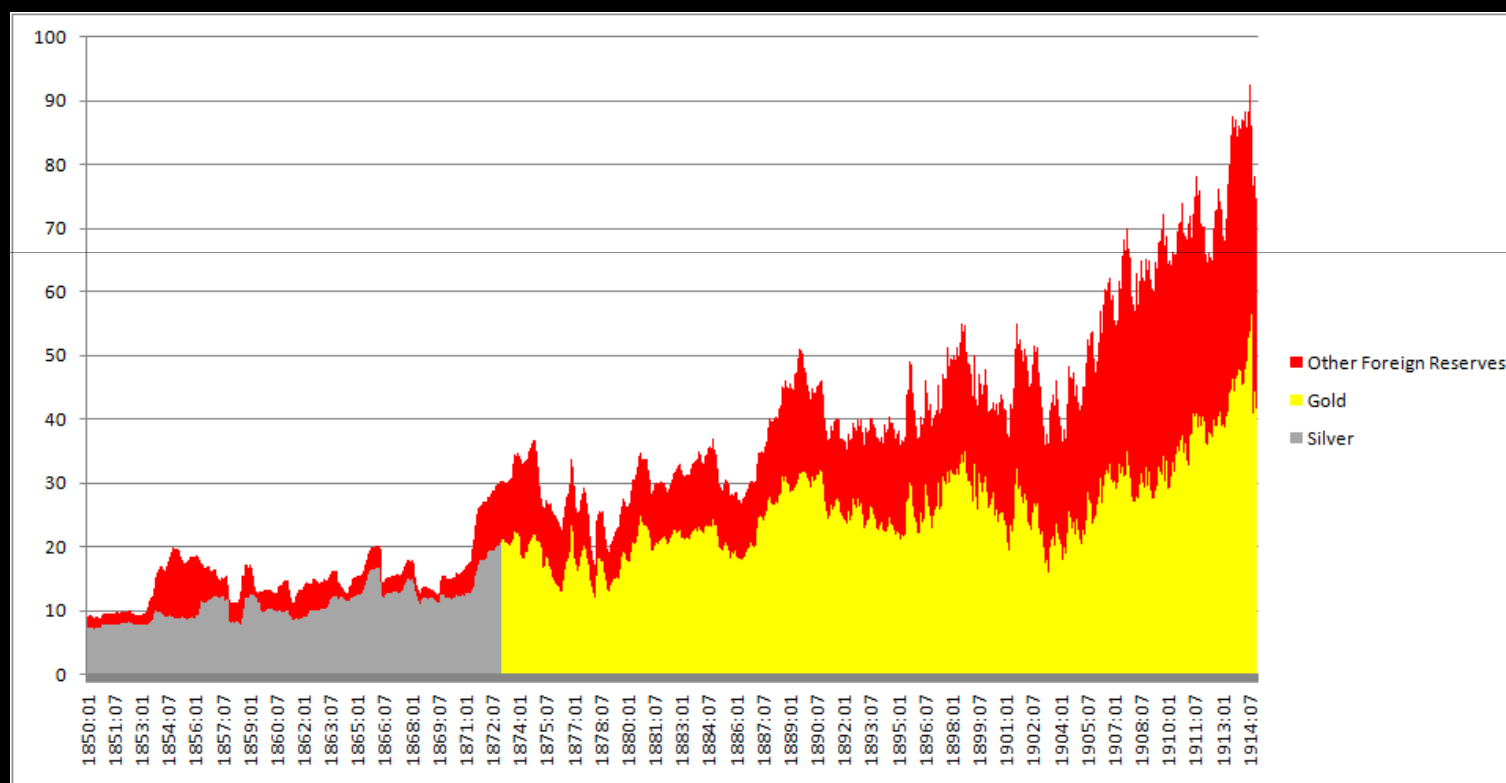
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- Available evidence suggests that Norwegian merchant banks used to keep their books in Hamburg marks, not in domestic currency (a sort of ‘dollarization’).
- This means that a liquid domestic money market *did not exist* in Norway.
- As a result, Norges Bank was obliged to be an active player on the Hamburg mark market.

An Active Player on Forex Markets

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Norges Bank, 1850-1914: Composition of foreign reserves

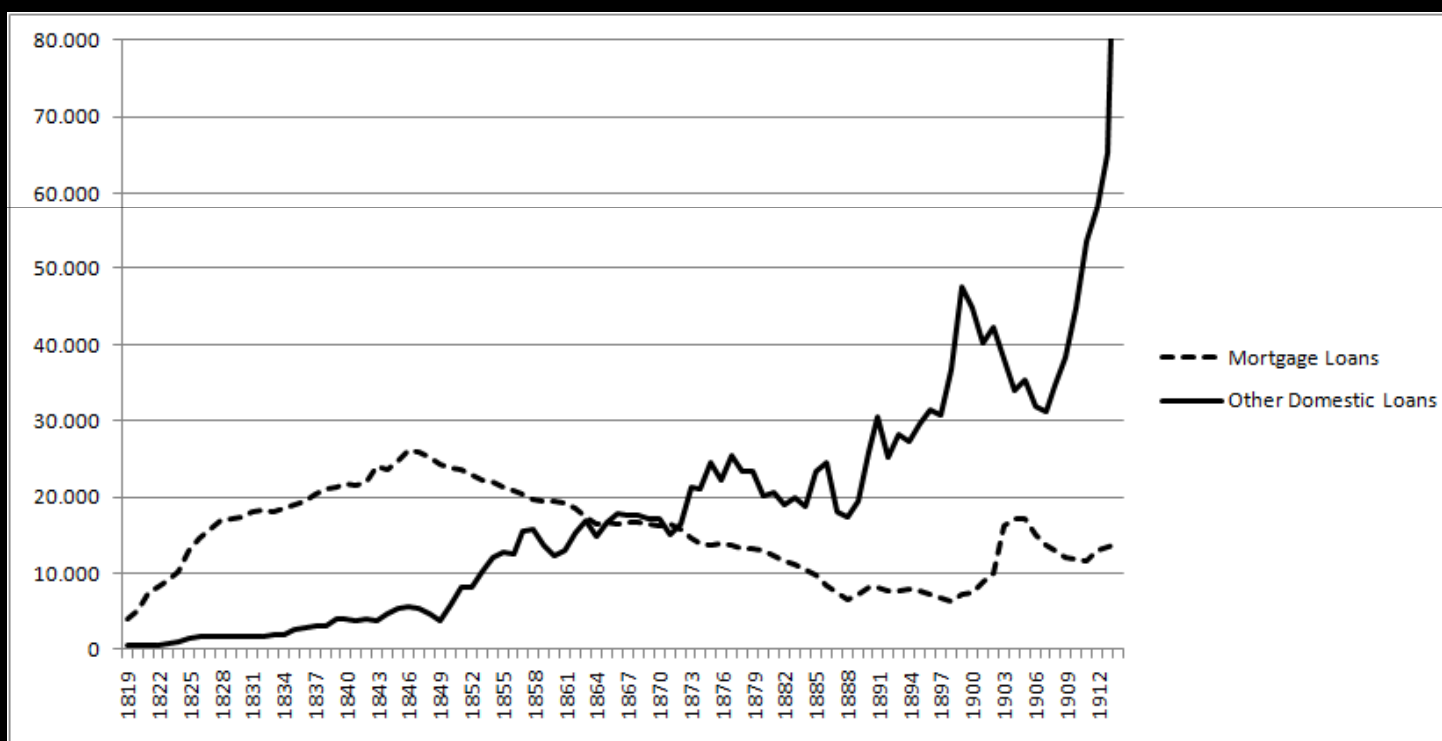


Source: Eitrheim, Klovland, & Qvigstad (2004)

A Sluggish Domestic Money Market

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Norges Bank, 1819-1914: Mortgage and other domestic loans



Source: Eitrheim, Klovland, & Qvigstad (2004)

Putting Things into Context

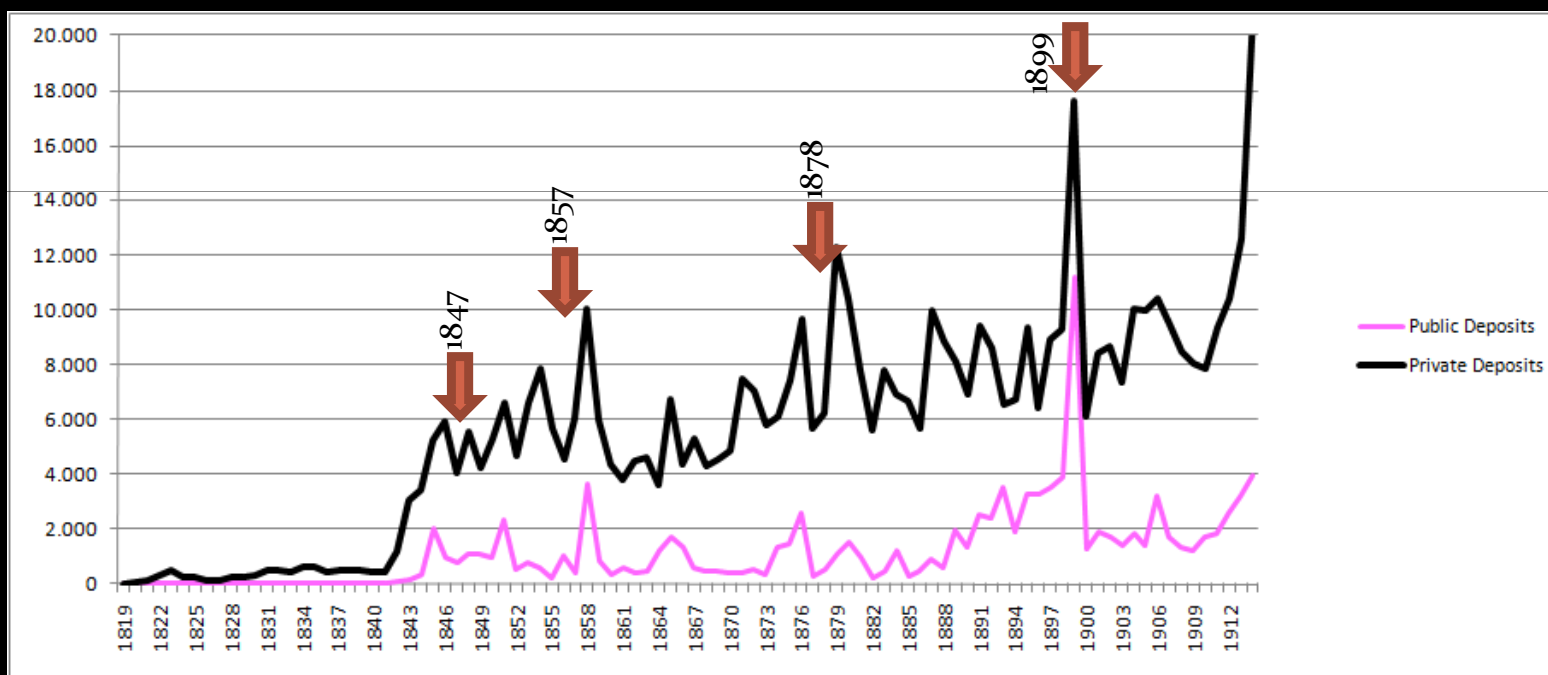
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- Norges Bank's silver shipments to Hamburg should be seen in the context of the international rescue operation led by Austria (Kindleberger 1978).
- Moreover, the government's emergency loan and its use to support Norges Bank's balance sheet should be described more accurately.

Government Deposits at Norges Bank

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Norges Bank, 1819-1914: Public and private deposits



Source: Eitheim, Klovland, & Qvigstad (2004)

Sum-Up

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- If more evidence is given and if episodes are put into their historical context more properly, the paper has the potential to provide a lot of valuable insights on crisis management in peripheral countries.

Conclusion

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A REASSESSMENT OF THE PAPER

Conclusion

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Conclusion

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- However, more evidence should be provided in order to make the argument fully convincing.
- Whence completed with the missing elements, the paper will no doubt improve our understanding of the historical relationship between monetary and fiscal authorities in crisis solving.

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