Comment on
Adalbert Winkler, The ECB as Lender of Last Resort: Banks versus Governments

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In the broadest sense, *Winkler's* contribution addresses the ECB's monetary safety net for the eurozone, especially its role as a lender of last resort (LoLR) for governments and banks. The following four aspects provide a different and critical perspective on his statements.

1 Divergence between currency area and fiscal sovereignty in a non-optimal currency area

Against the background of the special *conditions* of this monetary union, *Winkler's* analysis disregards the specific mechanisms and consequences of a LoLR. The (a) divergence between national territory and currency area as well as the accompanying (b) divergence between monetary and fiscal authority and responsibility, (c) combined with a (currently still) federal structure of the eurozone pose special characteristics, which differ from the normal mechanisms of a LoLR (e.g. the FED). As a result, eurozone crisis countries face specific incentives for fiscal profligacy and for a lack of will/ability regarding structural reforms. Furthermore, there is a harmonization of interest rates despite different market risk premiums which leads to regional redistribution. These incentives and characteristics are linked with the LoLR and play an essential role. Hence, a comparison to the FED is not appropriate in this regard. The eurozone allows a permanent *cost externalization*, as opposed to the FED and the U.S. national territory.

In this context, the distinction between "*stability of the euro*" in the sense of purchasing power stability and "*stability of the eurozone*" relating to the conservation of the current euro currency area becomes more important. *Winkler* sees no contradiction here, since the LoLR measures to keep all member states would not visibly endanger price stability.[1] By not addressing these different political objectives, he ignores any relevance for the economic constitution of the eurozone. There is at least a potential conflict with Art. 119 para. 2, 3 Treaty on the Functioning of the European Union (TFEU), which primarily provides the fundamentals of price stability and sound public finances.

[1] The indicator remains worthy of discussion: Should a cost of living index or special asset price indices be used? In addition, the long-run effects of this monetary policy are unclear, especially in case of a necessary reversal.

2 LoLR as a permanent and long-run safety device

In his analysis *Winkler* refutes the notion that the LoLR function only applies to short-term crisis situations. In fact, the OMT commitment constitutes a *permanent LoLR for governments*. In addition, the ECB has created a *permanent LoLR for banks*, not least through the full allotment at an interest rate of 0.05 % while reducing the quality requirements: central bank money now has the characteristics of a *quasi-free good*. It is due to this very fact that the LoLR function of the ECB becomes questionable, since the provision of emergency liquidity assistance turns into a permanent institution, which leads to the corresponding adjustment effects.

Furthermore, the question arises whether a clear distinction between a (short-term) *liquidity crisis* and a (long-term) *debt crisis* is possible at all? What about the willingness and the ability of the crisis countries to repay (keyword: wealth tax) their debts? And to what extent will creditors, the ECB and the European Council press for such an intensified debt servicing?

Yet, this strategy is consistent with a non-optimal currency area setting, which seems to apply to the eurozone. Here the LoLR function is being used against a structural deficiency which can hardly be solved. At best, it can be offset at *high costs*. *Winkler* does not address these costs at all: counterproductive incentives regarding sound public finances, misallocation of capital towards unproductive and maybe consumptive uses, interest rate distortions, significant aspects of redistribution as well as high risks of losses for the ECB.

3 Rejection of a rule-bound (regulatory) policy

This aspect is linked to another fundamental criticism, namely the abolition of rule-bound action by the ECB, which is virtually supported by the author. If this value standard applies under an independent ECB, the society is exposed to arbitrariness and a high risk of failure even up to a chaotic breakup of the eurozone. Therefore *binding regulations* should remain attached to this *independence*. They replace a permanent democratic legitimation of every single decision by the ECB. According to the fable, even Odysseus had self-doubts and asked for "binding regulations". The problem becomes obvious when the causes for a non-optimal currency area are not eliminated due to a lacking willingness and/or ability of the nations to reform and the exception becomes the rule. Even if one would not question the success of the rescue policy: who can guarantee that it stays successful without binding regulations?

4 Result: hybrid, unstable structures in the euro area

Winkler names the conditions for the usage of the *OMT program*: here, especially an existing ESM program *and* a simultaneous capital market access are contradictory and can only be accomplished by a precautionary credit program. However, this endangers a quick response which is necessary to solve a liquidity crisis. In addition, at least countries with an existing capital market access – albeit at high interest rates – do not need a LoLR in the short run. The OMT program *lacks the precondition* to be used as an instrument by a LoLR – unless the conditions will be adjusted according to the necessities.

To a limited extent, the LoLR function is replaced by the financing of crisis countries through the purchase of government bonds, primarily by national commercial banks. In both cases, public liquidity shortages due to a lack of credit access can be solved by a simultaneous increase of the money supply. Here the commercial banks can achieve relatively high yields, due to cheap ECB money at insufficient capital adequacy. At the same time, the purchase is the *cause for a combined bank and national crisis*. That is also why, in my opinion, a distinction between a LoLR for banks and a LoLR for governments is too short-sighted.

It should be noted that the LoLR for governments and banks are part of a hybrid and in the long term unstable structure, which currently characterizes the (partly planned) *additions to and alterations of the Treaty of Lisbon*. The following elements are substitutive and complementary to the LoLR measures in the sense of a rescue of the monetary union:

- inclusion in the reconstruction into a fiscal/transfer union (Two-Pack/Six Pack)
- Target credits
- banking union
- European monetary fund / Eurobonds
- European unemployment insurance

As implied by the support for Latvia, Hungary and Romania, EU member states do have access to credit assistance (Art. 123 f. TFEU) and monetary support (Art. 143 f. TFEU) outside of the eurozone – all of this being a different expression for a LoLR *outside of* the monetary union.

5 Conclusion

The contribution represents an isolated and instrumental perspective, which is inadequate with regard to the problems that arise in the context of the structural order of the EU and the crisis of the monetary union.

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