

INHERENT CONTRADICTIONS OF THE GLOBAL FINANCIAL STABILITY NOTION

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Annotation. *The article discusses the fundamental issues of global finance, such as the contradictory character of the “financial stability” notion and difficulties in defining it. It offers a review of various approaches to the financial stability issue in the global financial world. It also touches the problem of ambiguity of commonly used notions as well as possible adverse effects of the financial stability.*

Keywords: *global financial stability, financial stability, stabilisation, financial crisis, instability, risks.*

Problem definition. This article is devoted to the problem of the global financial stability. This issue is a very common theme in modern economic thought. However, before we shall discuss the means to achieve and maintain global financial stability, we should clearly define what meaning we put into this notion. It turns out that it is not an easy task.

There exist plethora of various definitions of the “financial stability” notion. However, they are rather vague and oftentimes lack scientific precision. It is a fundamental problem that the widely discussed and thoroughly studied notion has no universally accepted definition. Most of the existing definitions are very situational, and while they may be useful for the purpose of the particular scientific work, they could cause confusion if we start to scrutinise them outside of the context of given scientific work. There are certain reasons for that which will be discussed later on in this article. In order to avoid confusion and contradictions in scientific debates around the “financial stability” notion we in this article make an attempt to clarify the situation and find common ground for further discussion of this fundamental issue.

Analysis of recent research and publications. Problems of global financial stability, especially in context of establishing a clear definition of the financial stability notion, have been actively discussed around the world. Various approaches and methodologies coexist. It is important to mention the works of the following researchers: E. S. Rosengren, A. Crockett [1], H. J. Allen, T. Padoa-Schioppa [2], M. Foot [4], R. Ferguson [5], G. J. Schinasi [8] and others. Some researchers agree that there is no common definition of the financial stability notion and attempt to find consensus among the existing ones, while others formulate their own proposals. It should be noted that further scientific discussion is required to establish solid and universal approach and methodology for the above mentioned issue.

Presentation of Main Material. Contemporary economic thought presents us with various ways of achieving global financial stability. However, the paradox is that there is no clear explanation of what exactly is “financial stability”, let alone the “global”

one. Thus it is of great importance to establish a clear and both economically and logically consistent basic notions of financial stability. Otherwise, it would be inadequate for the further scientific discussion.

For now, we shall scrutinise several existing definitions of the “financial stability”, provided by the world leading financial experts, to achieve better understanding of the problem.

Some sources prefer to define financial stability through the opposite notion of financial instability. If we define financial stability as an absence of instability, it is quite straightforward that we have to clearly define financial instability instead. Thus, some of the definitions deal with financial stability, while others deal with financial instability. It is of no importance in which way we define this notion. However, it is more convenient to define financial stability directly, without resorting to axillary notion of financial instability.

Andrew Crockett offers the following definition: “...define financial stability as an absence of instability...a situation in which economic performance is potentially impaired by fluctuations in the price of financial assets or by an inability of financial institutions to meet their contractual obligations...” [1]

It is a good way to explain one`s thoughts when using the financial stability term. It is, however, a much less satisfactory way of giving an exact definition. Who is to judge whether economic performance is potentially impaired or not? The first thing that crosses our mind is a panel of experts, who provide well-grounded opinion based on serious methodology and economic analysis. What we see in practice, is a vast number of separate experts who use various and oftentimes questionable methodology or even no methodology at all. This way it quickly transitions into wild speculations, instead of a solid analysis. Most of the offered definitions are incomplete without solid methodology, providing thorough and exact way to establish whether under this or that economic situation there is financial stability.

Tommaso Padoa-Schioppa provides the following: “...[financial stability is] a condition where the financial system is able to withstand shocks without giving way to cumulative processes, which impair the allocation of savings to investment opportunities and the processing of payments in the economy.” [2, p. 287]

Here we can see that financial stability is some sort of condition, under which the financial system is “stable”(able to withstand shocks). I purposefully reformulated it in such a way that we can see it as a tautology. As I see it this definition by itself gives no information at all and can be viewed as no more than a figure of speech.

Definition by Norwegian Central Bank experts: “Financial stability means that the financial system is robust to disturbances in the economy, so that it is able to mediate financing, carry out payments, and redistribute risk in a satisfactory manner.” [3]

This definition has the same problems as the ones mentioned above, however it is formulated much more clearly. It explains in a few words the idea behind this notion. Nonetheless, it does little to help us clearly identify whether any given situation is stable or not. We do not know how to perceive whether the system is robust or not and where is the borderline between these two situations.

Michael Foot describes financial stability in the following way: “...we have financial stability where there is: (a) monetary stability; (b) employment levels close to the economy’s natural rate; (c) confidence in the operation of the generality of key financial institutions and markets in the economy; and (d) where there are no relative price movements of either real or financial assets within the economy that will undermine (a) or (b).” [4]

The definition above has more sophisticated nature as it requires further elaboration of the terms such as “employment levels close to economy’s natural rate” as well as methodology for estimating “monetary stability” and “confidence in the operation of the generality of key financial institutions and markets in the economy”.

Roger Ferguson offers the following approach: “It seems useful...to define financial stability...by defining its opposite: financial instability. In my view, the most useful concept of financial instability for central banks and other authorities involves some notion of market failure or externalities that can potentially impinge on real economic activity. Thus, for the purposes of this paper, I’ll define financial instability as a situation characterized by these three basic criteria: (i) some important set of financial asset prices seem to have diverged sharply from fundamentals; and/or (ii) market functioning and credit availability, domestically and perhaps internationally, have been significantly distorted; with the result that (iii) aggregate spending deviates (or is likely to deviate) significantly, either above or below, from the economy’s ability to produce.” [5]

Wim Duisenberg provides the following: “...monetary stability is defined as stability in the general level of prices, or as an absence of inflation or deflation. Financial stability does not have as easy or universally accepted a definition. Nevertheless, there seems to be a broad consensus that financial stability refers to the smooth functioning of the key elements that make up the financial system.” [6]

Here the author himself specifies that this definition is by no means the ultimate, and he offers it for the purpose of this particular work, as a form of expressing his ideas. It may well be that some other authors consider such warning already implied in their work or it being such by a default.

Definition by Deutsche Bundesbank experts: “The term financial stability broadly describes a steady state in which the financial system efficiently performs its key economic functions, such as allocating resources and spreading risk as well as settling payments, and is able to do so even in the event of shocks, stress situations, and periods of profound structural change.” [7, p. 8]

Finally, the last definition offered by Garry J. Schinasi in his work “Defining Financial Stability”. In his work he summarises various definitions and offers his own: “A definition consistent with this broad view is as follows: A financial system is in a range of stability whenever it is capable of facilitating (rather than impeding) the performance of an economy, and of dissipating financial imbalances that arise endogenously or as a result of significant adverse and unanticipated events”. As well as: “A more general definition that does not require the specification of what constitutes a “financial system” is: Financial stability is a condition in which an economy’s mechanisms for pricing, allocating, and managing financial risks (credit, liquidity, counter-

party, market, etc.) are functioning well enough to contribute to the performance of the economy (as defined above)".[8, p. 8]

As can be seen from the above mentioned definitions, it is rather difficult to formulate the idea behind financial stability notion with precision. If we accepted such vague definition, we would not be able to draw a line between stability and instability. The question "Where the *stability* ends and the *instability* starts?" has no universal answer in such case. Therefore, it would mean that "financial stability" could no longer be used as a defined scientific notion, and could be viewed as no more than a figure of speech, a metaphor used in journalism. Of course, it is too early to lay such bold claims without further research. Thus, we shall look deeper into the roots of the financial stability notion.

Everything starts with the idea of "economic stability". On first glance, it would seem rather obvious what this notion implies. That there exist such state of economy in which no drastic changes occur, and all acting parties may be sure that in the nearest future economic situation will not change significantly. So, to put it straight, economic stability requires no changes transpiring. And here lies the biggest problem of all notions revolving around the term "stability". The problem that is inherent in this very notion and cannot be ignored. The contradiction between development and stability. For any situation to evolve into a better one, a change is required. For any situation to be stable, an absence of change is required. Thus, the idea of "stable growth" is self-contradictory. The problem is closely related with the preconceived idea of the stability of prices, which implies that the price of money or any other commodity should be more or less unchanging. The shortcomings of such way of thinking were masterfully exposed by Ludwig von Mises in his work "Human Action: A Treatise on Economics": "An outgrowth of all these errors is the idea of stabilization. Shortcomings in the governments' handling of monetary matters and the disastrous consequences of policies aimed at lowering the rate of interest and at encouraging business activities through credit expansion gave birth to the ideas which finally generated the slogan "stabilization." One can explain its emergence and its popular appeal, one can understand it as the fruit of the last hundred and fifty years' history of currency and banking, one can, as it were, plead extenuating circumstances for the error involved. But no such sympathetic appreciation can render its fallacies any more tenable.

Stability, the establishment of which the program of stabilization aims at, is an empty and contradictory notion. The urge toward action, i.e., improvement of the conditions of life, is inborn in man. Man himself changes from moment to moment and his valuations, volitions, and acts change with him. In the realm of action there is nothing perpetual but change. There is no fixed point in this ceaseless fluctuation other than the eternal aprioristic categories of action. It is vain to sever valuation and action from man's unsteadiness and the changeability of his conduct and to argue as if there were in the universe eternal values independent of human value judgments and suitable to serve as a yardstick for the appraisal of real action." [9, p. 192]

One more step towards proof that the stability notion is devoid of any scientific meaning can be made by comparing the words "stable" and "stagnant", or "rigid". The word "stable" usually has a positive connotation, while the word "stagnant" or "rigid"

id” — negative. However, if we try to imagine the economic situation, which can be described by either of these two words, it is easy to see that it is the same situation for both these words. It is the situation in which little to no change occur. From the point of view of economics, rigidity and stability have the same meaning. Thus, it is a good reason to be very careful with them in scientific works. These are the words for press and public discussions, unless they are thoroughly explained and contextualised for each particular case. Ludwig von Mises had held these two notions even in lesser regard: “In the field of praxeology and economics no sense can be given to the notion of measurement. In the hypothetical state of rigid conditions there are no changes to be measured. In the actual world of change there are no fixed points, dimensions, or relations which could serve as a standard. The monetary unit’s purchasing power never changes evenly with regard to all things vendible and purchasable. The notions of stability and stabilization are empty if they do not refer to a state of rigidity and its preservation. However, this state of rigidity cannot even be thought out consistently to its ultimate logical consequences; still less can it be realized. Where there is action, there is change. Action is a lever of change.”[9, p. 193]

It is also necessary to see the connection between the above discussed notions and the financial crisis notion. The main threat to the financial stability is financial crisis. We can say that financial stability is the economic situation under which financial crisis cannot transpire. The purpose of all efforts to establish financial stability — is to avoid financial crises. One of the easiest ways to define financial crises is to say that it is a sharp change in price for a certain type of financial assets (including money). Consequently, the financial stability is the situation under which no sharp changes in prices of financial assets are possible. That is why this problem is closely related to the one formulated by Ludwig von Mises. As can be seen in the previous paragraph, he criticised the idea of anything “unchanging” in the economy. Thus, our case is just a special case of the general economic problem in the field of finance.

For example, there no universally accepted definition of what is “good” or “bad”. If we say, “USA have a “good economy”” it makes some sense, but it does not give as exact information about the economy of USA. The same applies for the phrase “USA achieved financial stability”. If there is no exact criteria for financial stability or instability, such phrases bare no scientific value. That is why, every researcher have to clearly specify what he implies by resorting to such word combinations, what is the economic meaning of them. Multiple points of view on this problem can coexist fruitfully and create no confusion if everyone adhere to these recommendations.

Another important matter is the transition between theoretical findings and their practical application. Financial crisis is a prominent issue in modern financial thought. As can be seen from the above mentioned quotes of the renowned financial experts who were in charge of the world largest financial institutions, and had to take action to ensure financial stability, there is vast discrepancy between existing theoretical findings and their practical application. Thus, it is of utmost importance that each theoretically sound approach be put into practise in managing financial system on a certain level of global financial system. Only a sound theory proven valid by practical applica-

tion can become a generally accepted approach. The task of economic thought is to provide such theory.

Conclusions. We cannot study the problems of global financial stability, if we are not able to comprehend the basic theory concerning financial stability. That is why the issue of establishing solid theoretical basis has such great importance.

It has to be said that no single basis is possible when we deal with such complicated problems. Many approaches can freely coexist. However, every single one of them should be formulated in such a way as to avoid being self-contradictory and logically inconsistent.

While an extensive methodology cannot be offered in this article, it is possible to provide a key points of yet another approach to the issue of financial stability. Financial crisis is a sharp change in price of a certain financial assets. The probability of financial crisis occurring is a crisis risk. Financial stability is a situation in an economy at a certain time, under which crisis risks are minimised or non-existent. Consequently, financial stability notion implies the absence of significant changes in the price of financial assets. The profits in financial sphere are directly proportional to the risks. Thus the minimisation of crisis risks leads to the minimisation of financial profits. Absence of sharp changes in assets prices also implies lower profits on the financial market. Therefore, it is unclear whether it is beneficial or detrimental to establish global financial stability.

The following important questions are unanswered at present: “What is financial stability?”, “Is it possible to achieve global financial stability and how?”, “Is it beneficial to establish global financial stability?”. It seems paradoxical, but it is true. In this article we have only touched upon those questions. Much more in-depth research is necessary to even attempt to answer them in a satisfactory manner. The purpose of this article is to draw attention to these issues and invigorate further discussion.

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