Comments on Avaro and Bignon: Liquidity Provision and risk management in 19th century France

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What’s in the paper? Questions

- What were the lending practices of the Bank of France?
  - How did a Bank that lent to multiple counterparties including those that were not banks, or even financial institutions, act as a liquidity provider
- Who borrowed from the Bank of France in 1898 and on what collateral?
  - Some discussion of variation across regions (in ‘crisis’ or not)
  - For one region (Moulins) time series differences (in ‘crisis’ or not)

What’s in the paper? Findings

- Bank lent on very good collateral to stable counterparties
    - Detailed analysis of ‘risk appetite’
    - I’m unclear about how the substitutability across the types of security is captured in the estimation – is there a production function of ‘backing’?
- In crisis regions lending was higher but risk takers were a smaller proportion of borrowers
    - Unclear why the ‘risk appetite*crises’ coefficient has opposite sign in cross-section vs panel

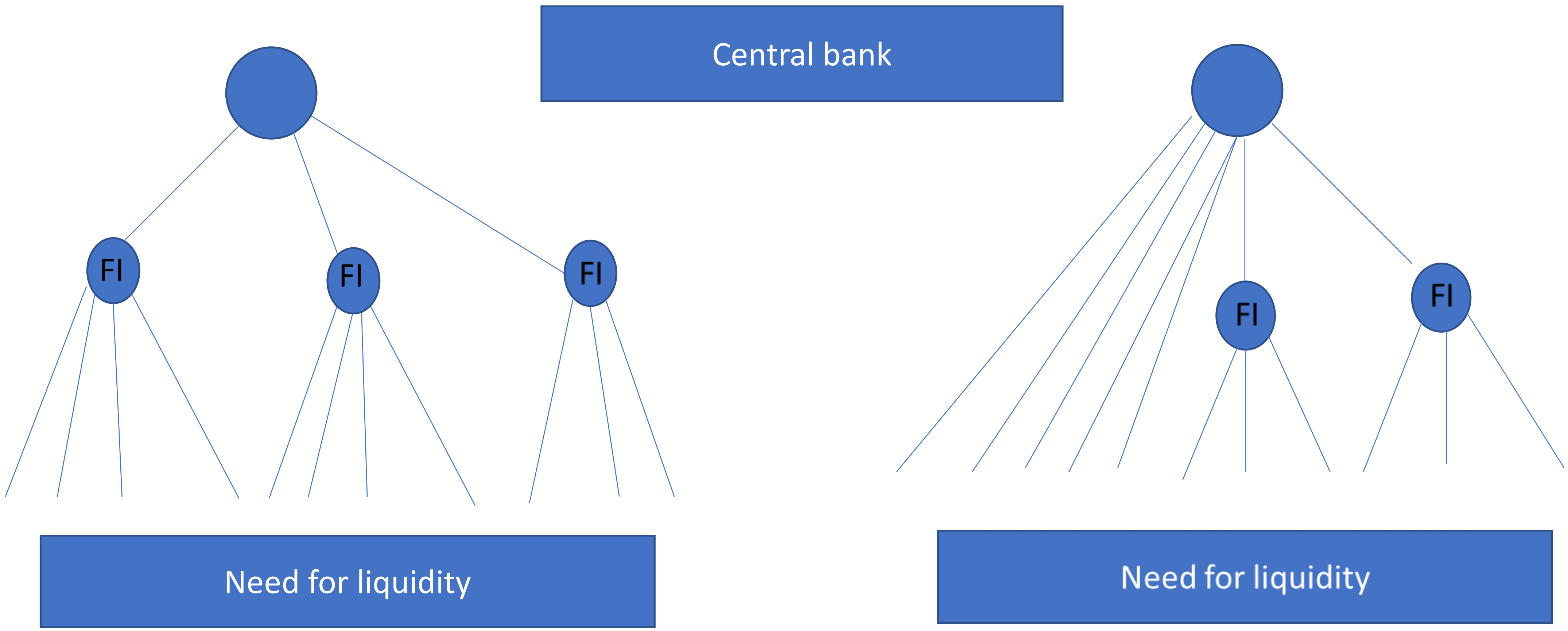
Discussion:

- The paper suggests that there are lessons for how a lender of last resort can function with a wide number of counterparties
- Relevant because
  - In the GFC central banks lent widely as well as broadening the securities that they would accept as collateral
  - In the age of CBDC central banks are talking about wider access to facilities

Lender of last resort

- Lender to an illiquid but solvent financial institution
  - Straightforward!
  - Lend on good collateral at penalty rates
- Address systemic liquidity crisis
  - Again, lend to solvent but illiquid institutions at penalty rates
- But:
  - Good collateral is likely gone
  - Penalty rates might make a solvent institution, insolvent
  - Measuring solvency in crisis is difficult
  - Potential convertibility/exchange rate concern
  - *Potential moral hazard concern*

Can we learn from the Bank of France?
Is RHS feasible? Optimal?



Can we learn from the Bank of France? - cross-section analysis

- Not clear to me
- Was the lending 'crisis lending' – ie liquidity vs a loan?
  - Very good collateral (high haircuts)
  - Very strong borrowers (mostly) – so could they not have borrowed – perhaps more expensively – in the market?
    - Need to have a single interest rate and not a rate that is risk-adjusted meant that the Bank rationed to strong borrowers
    - The Bank did make a profit, but it had a note monopoly from which it earned seignorage
    - Differential behavior in regions in 'crisis' might reflect regional effects

Can we learn from the Bank of France? – time series analysis

- At times of crisis, the amount of lending rose as did the share of lending to non FIs
- Afterwards the volume of lending returned to pre-crisis levels but the share of non FI lending stayed high
  - As though there was a set up cost to setting up a discounting facility with the Bank
  - Is this a good thing?
- In general, understanding why farmers went to Bank of France would be very helpful (eg did local banks refuse to lend on good collateral?)

Hypotheses:

- Paper: the Central Bank provided liquidity to multiple stakeholders without creating moral hazard issues or losing money
- Alternative view: the Profit maximizing Bank, with a monopoly of note issue, profited by lending to low risk borrowers with good collateral

Minor questions/notes

- Do the results suggest a very high haircut re collateral?
- Why isn’t relationship duration included in the first estimation?
- How are rolled over debts treated in the Liquidity variable? Is it lending to a counterparty summed over the year or (say) the maximum outstanding during the year?
- Re Moulin
  - was the interest rate constant across the period?
  - Is there a non-binary variable to capture ‘crisis’?