FINANCIAL AND ECONOMIC STABILITY MANAGEMENT ON MICRO AND MACRO LEVELS

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The financial soundness of individual enterprises and private individuals has impact on the overall financial stability of a national and also global economy. The main channel of this impact is, of course, through financial institutions, namely banks.

The good working of the financial system is critical to the success of an economy and is a key element in economic development. The financial system is a coordinating mechanism that allocates capital to productive investment opportunities. If the capital goes to the wrong uses or stops flowing at all, economy will operate inefficiently and its growth will be low (Mishkin, 2006).

Key words: Financial and economic stability, management on micro and macro levels

Problem Description

Problems with the financial soundness of enterprises and individuals can lead to insolvency of a bank, which can through payment system and other channels spread to other banks and create so called systemic implications. Central banks and financial market supervisors are working together to evade this possibility. The activities of these institutions can be dividend into supervision and oversight. Supervision, also called microprudential supervision, deals mainly with the examination of individual institutions, and the supervisor has the right to impose financial sanctions and implement policy also with other means. In oversight or macroprudential supervision the implementation authority is much more limited, and the main means of policy implementation is persuasion.

The management of individual enterprise or personal finance soundness is in the hands of enterprise or the respective individual. The bank has only limited influence on the management of soundness of its clients, and the amount of influence differs according to the legislations of individual countries. The bank primarily can manage its own soundness or economic and financial stability through acquiring (or not acquiring) clients and choosing the exposure level to the individual client's financial and economic soundness. Rarely are banks deeply involved in the management of client's affairs, usually this happens only in complete insolvency cases.

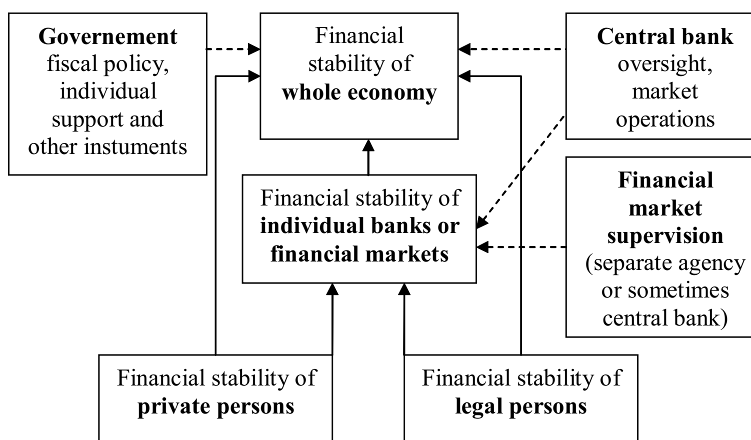

Fig. 1. Financial and economic stability of individual agents and economy

Recognition of the role of central banks in financial crises dates back to Thornton and Bagehot in the eighteenth and early nineteenth centuries, respectively (Ferguson, 2002). The historical function of central banks as potential source of emergency liquidity through open market operations or to particular institutions through discount window lending creates a need for central banks to monitor markets, the transmission of monetary policy being highly dependent on the functioning of key financial institutions and markets. Another evidence of central bank's interest in financial stability stems from their role in the operation or oversight of payment systems that act as the critical supporting activity in financial markets (Ferguson, 2002). The objective of financial stability to varying degree has been incorporated in the charters of the central banks.

In many countries supervision and oversight are

done together by central banks. The trend of the recent years is that supervision is split from the oversight function. Supervision is usually done by a specialized institution, which usually together oversees banks, capital markets and insurance companies. Of course, in the case of split supervision and oversight, the institutions are closely cooperating. Some of the factors determining such division of working tasks are:

- There are significant benefits if the supervision of financial institutions, markets and insurance companies is done in a single institution. Wile the supervision of financial institutions and markets can be done easily by central banks, the supervision of insurance companies is an unnatural function for the central banks;
- Central banks have instruments for the regulation of economy on macro level, namely:

- regulation of money supply;

- regulation of required commercial bank reserves;

- operation and policy setting of payment systems;

The central banks are usually entrusted the role of economic and financial stability in a country. Almost in all developed countries there is a special law regulating the work of the central banks. However, the financial stability objective is not specifically stated in the law, but rather implicitly. Usually there are several institutions involved in ensuring financial stability: a separate financial market supervisor, sometimes also the equivalents of finance and/or economics ministries.

In evolution of banking and payments, arrangements emerged with a single institution offering a settlement asset that all banks were willing to accept. This institution often later became the central bank, with central bank liabilities emerging as the ultimate settlement asset. While the first central bank in the world was started and first paper money in Europe issued in Sweden by a Riga born Dutch merchant, who managed to convince the king of the necessity for a central bank (Sveriges Riksbank, 2008), municipal banks already existed at the time in Amsterdam, Hamburg and Barcelona, which offered depository and also basic clearing services, however, with no money emission and fractional reserve banking features.

In practice a hierarchy then tended to develop below the central bank, with the top tier of banks settling directly across the books of the central bank and offering settlement in their own liabilities – commercial bank money – to banks in the tier below. Hence, central bank and commercial bank money settlement typically co-exist (Bank for International Settlements, 2003). The customer typically settles in commercial bank money, but relies on at par convertibility of these deposits into central bank money (cash) (Manning et al, 2007).

Conclusion

The central banks often together with specialized financial market supervisory institutions (Financial and Capital Market Commission in Latvia, Fiansinspektionen in Sweden, etc.) bear the overall responsibility for financial stability in a country. Usually the Central bank is responsible for the use of monetary, payment system and other instruments to facilitate a smooth development of the economy, but the specialized financial institution and market supervision institution is responsible for the supervision of individual market participants and markets, with much larger enforcement capabilities onto individual participants and markets. The central banks in their turn are charged with the correct use of the instruments at their disposal and oversight powers, which are based on coercion and mutual agreement with market participants. The government, from which central banks and financial market supervisors are usually largely independent (especially the central banks) is also entrusted important instruments, fiscal policy, granting support to individual institutions in trouble and other instruments, largely with the thought of ensuring overall economic stability, development and efficiency. In the case of the financial and economic problems of individual enterprises and private persons that amount to significant dangers to the development of the whole economy, all of the above mentioned state policy implementation agent's act together to solve the problems and coordinate their policies to use the most appropriate instruments in the best way.

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