VOX CEPR's Policy Portal
Research-based policy analysis and commentary from leading economists

Create account | Login | Subscribe
Search

Columns Video Vox Vox Talks Publications People Debates Events About
By Topic By Date By Reads By Tag

A parallel currency for Greece: Part II

Biagio Bossone, Marco Cattaneo 26 May 2015

Introducing a currency in parallel to the euro could help Greece repay its external debt and resume economic activity. This second column in a two-part series evaluates the different options and their effects on aggregate demand and fiscal sustainability. The authors propose a tax credit certificates programme, which they argue could generate new spending capacity and avoid the adoption of new austerity measures.

14 A A

Introducing a parallel currency in Greece

Related

A parallel currency for Greece: Part I
Biagio Bossone, Marco Cattaneo

Fair debt relief for Greece: New calculations
Thomas Philippon

Next Greek package: Dangers for the EZ
Charles Wyplosz

The first column in this two-part series (Bossone and Cattaneo 2015) illustrated various options to design a parallel currency for Greece, which aims to avoid Grexit while helping Greece repay its external debt and resume economic recovery. This second part presents an evaluation of the different options, reports the results of our research – which simulates the application of a tax credit certificates programme to the case of Greece – and draws some conclusions.

Evaluation of the alternative parallel currency proposals

The proposals discussed in Part I can be evaluated on the basis of how each type of currency design would be expected to impact domestic aggregate demand and fiscal variables. The following observations can be made.

- Cochrane's IOUs seem to be working at best as a stopgap measure, in that they would enable to government to make payments and release euros to service the debt. Yet, the solution would likely not be sustainable over the medium term, since the IOUs would create a new class of government euro-denominated debt obligation, which nobody would know whether, when, and how the Greek government would honour. Also, issuing IOUs would only replace scarce euros but would have no stimulation effect on domestic aggregate demand, output, and employment.
- With regards to Parentau's tax anticipation notes (TANs), unlike Cochrane's IOUs, they would not represent debt obligations for the issuing government. As to the other effects, they depend on how the proposal is interpreted. If the tax notes are issued and used as a replacement for scarce euros for government payments, they would act as a stopgap measure, like Cochrane's IOUs, but would do nothing to add to domestic aggregate demand. This conclusion would change if the issuing government were to assign them to citizens as extra (additional) endowments, supplementary to their income sources. Regarding their impact on the budget, as tax notes were used to extinguish tax liabilities, they would cause shortfalls of government euro revenues and increase the deficit to be financed with new debt or taxation. Unlike tax credit certificates (TCCs), the notes would bear no deferred maturity and would not provide time for new fiscal resources to be generated as an offset. Finally, unlike the tax certificates proposal, Parentau's tax notes would not be issued to enterprises with a view to reducing their tax bill and, hence, their labour cost, thus improving their external competitiveness.
- As to Varoufakis' proposal, the FT-coins would not bring many additional resources into the economy. Individuals get FT-coins in exchange for euros they already possess. The creation of additional purchasing power for individuals and enterprises would only grow inasmuch as the FT-coins were sold at a premium vis-à-vis their face value, based on their above-par tax-…orth to the state. Giving them away free of charge – similar to helicopter money, as per the …x certificates proposal – would make their impact more effective. As in the TCC model, the …ultiplier effect set off by the additional spending would have to generate the resources to



Biagio Bossone
Chairman, Group of Lecce; Member of the Surveillance Committee, Centre d'Études pour le Financement de Développement Local



Marco Cattaneo
Chairman, CPI Private Equity

Don't Miss

Risk, return, and skill in the portfolios of the wealthy
Bach, Calvet, Sodini

Transition to clean technology
Acemoglu, Akcigit, Hanley, Kerr

Economics of the populist backlash
Rodrik

China's WTO entry benefits US consumers
Amiti, Dai, Feenstra, Romalis

Introducing VoxDev
Editors

Globalisation and executive compensation
Keller, Olney

New eBook: Economics and policy in the Age of Trump
Bown

Vox Talk: Economics and policy in the Age of Trump
Bown

Events

Shadow Banking: Financial Intermediation beyond Banks
14 - 15 September 2017 / Helsinki, Finland / SUERF - The European Money and Finance Forum and Bank of Finland

Corporate Finance Theory Symposium

cover the euro shortfalls that would affect the budget at the time of FT-coin redemption. However, all else equal, the multiplier effect triggered by the FT-coins would be weaker than under the TCC option since the spending leakages through the external trade channel would not be offset by larger exports through labour cost reductions (which TCCs make possible).
- Finally, the TCC option would not suffer from the above weaknesses. TCCs would create additional spending power, avoid negative external trade effects, and generate resources to offset euro shortfalls from tax reductions at TCC maturities. They would also have safeguards to protect the budget from the risk of fiscal under-performances (see below).

Implementing a TCC programme in Greece

Introducing TCCs in Greece could take the economy rapidly out of depression by prompting a strong recovery of output and employment. In the Annex below, a 'base case' (without TCCs) is compared with an alternative scenario (with TCCs) contemplating the issuance of €8 billion (4.5% of GDP) equivalent of TCCs in the first year of the programme, increasing to €16 billion, and €24 billion in the second and third years, respectively, and staying unchanged thereafter. The alternative scenario is run under two different hypotheses:

- A 'baseline' hypothesis, which assumes a 1.3 fiscal multiplier (that is, a 1.3 increase in GDP per every TCC issued on a yearly basis); and
- A 'conservative' hypothesis, based on a much lower fiscal multiplier of 0.8.[1]

In the base case, Greece achieves some modest real growth, with the 1.9% average primary surplus only allowing it to attain a very limited reduction in the public debt ratio, from 183% to 178% in five years. On the other hand, in the alternative scenario under the baseline hypothesis (1.3 multiplier), output strongly rebounds with real GDP growth averaging 4.3% over the five-year forecast timeframe. Meanwhile, the average primary surplus grows to 3.5% of GDP, causing the public debt ratio to fall to 131%.

Even under the conservative hypothesis (0.8 multiplier), Greece would average a more than decent 2.4% real GDP growth, while the public debt ratio would fall to less than 161% and the primary surplus would undershoot the 1.9% target, averaging 0.9% nonetheless.

What to do in case of fiscal underperformance

A number of escalating safeguard clauses would be introduced in the TCC programme to protect the budget from the event of fiscal revenues not growing in line with the primary surplus targets:

- First, the Greek government could announce a commitment to paying a fraction (presumably, a small one) of its public expenditure with TCCs.
- Second, taxpayers could be entitled to receive TCCs as compensation for additional euro tax payments. Basically, this is equivalent to replacing a tax rise with a compulsory TCCs-for-euro swap.
- Third, TCCs holders could be incentivised to postpone the use of TCCs for tax discounts by receiving an increase in their face value (equivalent to an interest being paid on TCC holdings in the form of additional TCCs).
- Fourth, the government could raise euros in the market by placing TCCs with longer maturities instead of debt bonds.

It should be noted that these safeguards are much less pro-cyclical than those that would be imposed by the EU to secure budget targets in the event of fiscal under-performance. It can be immediately seen that one or more of these safeguards, possibly used in combination, would easily accommodate even significant shortfalls in primary budget surplus targets.

As an example, under the conservative hypothesis above, the resulting 1% primary surplus shortfall (0.9% instead of 1.9%), equivalent to approximately €2 billion in the case of Greece, could be accommodated by offering some interest inducement to the bearers of TCCs maturing every year (up to €24 billion, as assumed above). Alternatively, the postponed inducement could be used to delay €1 billion equivalent of maturing TCCs, while €0.5 billion could be recovered from using TCCs to pay for some government expenses and the residual gap could be covered through a compulsory TCCs-for-euro swap with high-income earners. The impact of such safeguard measures would obviously compare much favourably with the recessionary effects of the same adjustment operated via spending cuts and/or tax hikes under the Stability and Growth Pact.

Conclusion

There are alternatives to austerity as the only adjustment rule for Greece, a rule that while
cally impoverishing the country is also proving ineffective in reviving credible growth
ts. Introducing a currency in parallel to the euro could help Greece change trajectory and

15 September - 16 January 2017 / Cambridge / Cambridge Judge Business School

IMF Eighteenth Jacques Polak Annual Research Conference: The Global Financial Cycle
2 - 3 November 2017 / Washington DC, USA / International Monetary Fund

SNB Research Conference: Monetary Policy Design, Conduct and Effects
22 - 23 September 2017 / Zurich, Switzerland / The Swiss National Bank

Call for Papers: ADBI-World Economy Workshop on Globalization and the Environment
26 - 27 September 2017 / Tokyo, Japan / Asian Development Bank Institute

CEPR Policy Research

Discussion Papers | Insights

Homeownership of immigrants in France: selection effects related to international migration flows
Gobillon, Solignac

Climate Change and Long-Run Discount Rates: Evidence from Real Estate
Giglio, Maggiori, Stroebel, Weber

The Permanent Effects of Fiscal Consolidations
Summers, Fatás

Demographics and the Secular Stagnation Hypothesis in Europe
Favero, Galasso

QE and the Bank Lending Channel in the United Kingdom
Butt, Churm, McMahon, Morotz, Schanz

Subscribe

@VoxEU

RSS Feeds

Weekly Digest

move out of depression rapidly, provided that the currency is designed in a way that carries incentives for private-sector spending.

A variety of options have been proposed. These have been illustrated and discussed in this two-part column. All options require the state to transform future tax revenues into immediate spending capacity. Each option, however, has a very different expected impact on domestic aggregate demand and fiscal sustainability. We believe that only the tax credit certificates, used as a quasi-currency, would have enough power both to create new spending capacity and to generate enough resources to pay for themselves over a recovering economic cycle. Also, sufficient safeguards can be built on these certificates, which would protect the budget against the risk of fiscal under-performance in a way that would prevent new austerity measures from becoming necessary.

References

Blanchard O and D Leigh (2013) "Growth Forecast Errors and Fiscal Multipliers", IMF Working Paper WP/13/1, January

Bossone B and M Cattaneo (2015), "A parallel currency for Greece: Part I," VoxEU.org, 25 May.

Annex

The 'base case' assumes an agreement is reached between Greece and its creditors, whereby debt is refinanced in exchange for a Greek commitment to generate an average primary budget surplus of 1.9% of GDP over a five-year time horizon. Based on recent market indications, this is broadly consistent with the most favourable attitude toward Greece, which creditors would be prepared to take in order to avoid a potentially disruptive default, with possible Grexit. The base case also assumes that Greece is able to achieve an average 1% GDP real growth under the base case, while inflation (currently strongly negative) would average 0.5% per year.

In the alternative scenario, due to TCC use for tax reduction two years after issuance, the schedule of TCC issues, uses, and amounts outstanding would be as follows:

	Year 1	Year 2	Year 3	Year 4	Year 5
TCC issues	8	16	24	24	24
TCC uses			8	16	24
TCCs outstanding	8	16	32	40	48

The total amount of TCCs outstanding would then attain €48 billion at the end of Year 5, to stay unchanged thereafter.

The simulation results are reported in the prospect below. Our simulation exercises can be made available to readers by request.

Projections for a five-years time horizon	Without TCCs	With TCCs	
		Baseline multiplier estimate	Conservative multiplier estimate
TCC annual issuances growing gradually, in three years, to		24,0	24,0
TCC use - years delay from issuance		2	2
Fiscal multiplier		1,30	0,80
Average real GDP growth	1,0%	4,3%	2,4%
Average inflation	0,5%	2,0%	1,7%
Average primary surplus	1,9%	3,5%	0,9%
Initial public debt / GDP %	183,3%	183,3%	183,3%
Final public debt / GDP %	178,3%	131,1%	160,7%

Note that TCC issuances are not included in the public budget, since TCCs do not imply any reimbursement commitment for the issuing government and (accordingly) do not constitute debt items.

Endnotes

[1] Note that a quota of the TCC issuance is allocated to enterprises as a function of their labour costs, which directly improves Greece's competitiveness and offsets through larger export the external trade imbalances that would otherwise be caused by the extra import driven by demand growth. Also note that the value of 1.3 chosen as a baseline hypothesis is the midpoint of the 0.9–1.7 range estimated by Blanchard and Leigh (2013). This value is rather prudent considering that the fiscal multiplier tends to be considerably higher in situations of economic depression.

14 A A

Topics: Europe's nations and regions Financial markets Monetary policy

Tags: Greece, greek crisis, Greek debt, parallel currency

Related

A parallel currency for Greece: Part I
Biagio Bossone, Marco Cattaneo

Fair debt relief for Greece: New calculations
Thomas Philippon

Next Greek package: Dangers for the EZ
Charles Wyplosz

11,288 reads
Printer-friendly version