A parallel currency for Greece: Part I

Biagio Bossone, Marco Cattaneo 25 May 2015

To prevent it from defaulting on its debt, the Greek government might need to introduce a new domestic currency, in parallel to the euro. This column, the first in a two-part series, compares the current proposals for a parallel currency and discusses how such a policy instrument could promote economic recovery.

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Absent a deal with creditors, very soon, short of cash, the Greek government might default on its debt. To prevent this from happening, and to avoid taking new extra doses of useless and painful austerity, Athens could be bound to resort to the introduction of some kind of new domestic currency – in parallel to the euro – for the government to be able to make payments to public employees and pensioners while freeing up the euros needed to pay out its creditors. The ECB has not denied this possibility. Recently, ECB sources have unofficially discussed the issue with the media in some detail (albeit anonymously), and executive board member Yves Mersch has referred to a parallel currency for Greece as one of "the exceptional tools that any government can consider if it has no other options," noting that all these tools bear high costs.[1]

Is this really so? Is it really the case that a parallel currency would be worse than the current medicine Greece is taking (and is set to be taking for an indefinite future)?

A parallel currency per se would neither prevent the risk of Greece's disorderly default nor automatically help it out of depression. But not all parallel currencies are born equal, and there are various ways to design a parallel currency, each bearing significantly different implications.

Below we compare the proposals currently on the table and discuss how a parallel (quasi) currency could be designed to promote Greece's economic recovery.[1] The issue is relevant for all countries suffering a weak economic activity, with no autonomous monetary policy, and limited fiscal space.

Parallel currency: Cochrane's IOUs

John Cochrane (2015) considers the possibility that the Greek government issues small cuts, zero-coupon bonds as promises to repay the bearer an equivalent amount of euros at some future date (IOUs). These IOUs could take the form of paper securities or electronic book entries in bank accounts, and the government could roll them over every year, just as for any type of debt obligation. The IOUs could be used to pay public salaries, pensions, and social transfers as well as to recapitalise or lend to banks. The IOUs would trade at a discount, but if the government accepted them at face value for tax payments, the discount might not be large. Mostly, the discount would reflect the risk that Greece either reneges on its commitment to accept its own debt for tax payments or suspends the roll over, thereby defaulting on the new debt. As Cochrane notices, introducing the IOUs would amount to creating a separate or dual currency that would allow Greece not to leave the Eurozone.[2]

As Cochrane points out, in modern financial markets, not only does a country in default not need to change currency, it doesn't even need the right to print money in order to actually print money, since, as he argues, bonds can be used as money these days.

> ıe does not present his IOU idea as a policy advice for Greece, but only as a theoretical ty, and supports instead the need for Greece to undertake structural reforms. However, he

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reckons that introducing the IOUs would still be a much better alternative than Greece leaving the Eurozone, with bank accounts being transformed, and people being paid in inconvertible drachmas. In the end, Cochrane concludes, promises for euros might be a superior option.

Parentau's tax anticipation notes

As a way to exit the austerity without exiting the Eurozone, Rob Parentau (2013) proposes that governments of peripheral Eurozone countries issue fiscal revenue anticipation notes to public employees, government suppliers, and beneficiaries of social transfers. These tax anticipation notes (TANs), which are well known public finance instruments to many US state governments, would have the following characteristics: Zero coupon (no interest payment), perpetual (meaning no repayment of principal, no redemption, and hence no increase in outstanding public debt), transferrable (can be sold to third parties in open markets), and denominated in euros. In addition, and most importantly, the notes would be accepted at par value by issuing governments in settlement of private sector tax liabilities. The tax anticipation notes could be distributed electronically to bank accounts of firms and households through some sort of encrypted and secure system, or they could be distributed as certificates to facilitate their possible ease of use in other transactions, subject to agents' acceptance. Essentially, governments issuing tax notes would securitise the future tax liabilities of their citizens and create a type of tax credit that would not be counted as a liability on their balance sheets nor require a stream of future interest payments in fiscal budgets. The use of tax anticipation notes would free up euros for payment of externally held public debt and for imports of essential goods.

One advantage of this alternative financing approach, according to Parentau, is that the governments issuing these tax anticipation notes (these could be called G Notes for Greece, I Notes for Italy, S Notes for Spain, etc.) can pursue the fiscal deficits that are required to return their economy to a full employment growth path – fiscal austerity can be abandoned without abandoning the euro.

Against the possible risk that tax notes issuances could accelerate inflation, Parentau recommends that the central bank of each country be held responsible not only for monitoring inflation conditions, but also for creating early warning systems for the possible acceleration of inflation under the supervision of an independent third party, like the IMF or the ECB. To prevent inflation from accelerating, hard rules could be set in place, such as automatic government spending cuts or tax hikes.[3]

Varoufakis' FT-coins

Prior to taking the position of Minister of Finance for Greece, Yanis Varoufakis (2014) also contributed to the parallel currency idea for the Eurozone peripheral countries. He proposed that governments establish their own payment system backed by future taxes and denominated in euros, and use Bitcoin-like algorithms to create a new currency called FT-coin (where FT stands for future taxes).

According to Varoufakis' proposal, individuals would pay, say, €1000 to purchase one FT-coin from a national Treasury's website under a contract that binds the national Treasury to redeem each FT-coin for €1000 at any time or accept the FT-coin two years after issuance to extinguish, say, €1500 worth of taxes. Each FT-coin would be time-stamped so that it would not be used to extinguish taxes before two years have passed. Also, every year (after the system starts operating in full steam) the Treasury would issue a new batch of FT-coins to replace those that have been used for tax payments, on the understanding that the nominal value of all FT-coins in circulation does not exceed a certain percentage of GDP, thereby avoiding that all FT-coins are redeemed simultaneously and the government ends up with lower taxes. Once in possession of FT-coins, the individual might either keep them in her FT-coin e-wallet or trade them.

Varoufakis further proposed that in order to make the system fully transparent and transactions completely free, FT-coin would be run by a Bitcoin-like algorithm designed and supervised by an independent, non-governmental national authority, and just as in the case of Bitcoin, the total amount of FT-coins would be fixed in advance, at least in relation to a variable not in the government's control (e.g., nominal GDP), while every single transaction (including tax payments using FT-coins) would be monitored by the community of FT-coin users through a Bitcoin's typical block chain process.

According to Varoufakis, one advantage of such scheme is that taxpayers would see their inter-temporal tax bill reduced. Also, to the extent that the FT-coins trade at a premium over their face value due to their above-par tax worth, they grant additional spending power to their holders, which ıpport aggregate demand. In other words, if the redemption value of one FT-coin for the €1500, above its face value of €1000, there is an incentive for the FT-coins to trade in the

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market at a premium up to their tax-worth to the state. This is the source of the additional spending power that the FT-coins grant to their holders.[4]

Our proposal: Tax credit certificates[5]

The government would issue tax credit certificates (TCCs), to be assigned to workers and enterprises free of charge. The tax certificates would entitle the bearer to a tax discount of an equivalent amount maturing in, say, two years after issuance. Such future entitlements could be liquidated in exchange for euros and be used for immediate spending purposes. Liquidation of the certificates would take place against purchases of tax certificates by those who want to acquire the right to future tax discounts. For investors, the tax credit would in fact be a safe investment instrument paying an interest comparable to a two-year zero-coupon bond. Besides, not being a debt instrument, the tax certificates would be safer than bonds.

Through liquidation, the tax credit would allow future tax discounts to be transformed into current spending. Under conservative estimates of the income multiplier (even less than 1), simulations show that the new spending taking place over the tax credit certificates deferral time would generate enough fiscal revenues to compensate for the euro shortfalls that the government would incur by receiving tax credit for tax discounts at their maturity.[6]

Tax credit certificates assignments would supplement disposable incomes and add new spending power to income earners, thus stimulating demand. The Greek government could use the tax certificates to increase net monthly salaries, reduce actual gross labour costs (by allocating a part of them to enterprises, in proportion to their labour costs), and even fund humanitarian actions, job guarantee programmes, and the like. By cutting labour costs, the tax credit would support exports, balance the effects of stronger demand on imports, and make Greece attractive for investment and production relocation from abroad.

The review above points to a number of considerations, which we will discuss in the second of this two-part series (to be posted tomorrow).

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Varoufakis Y (2014), "Bitcoin: A Flawed Currency Blueprint with a Potentially Useful Application for the Eurozone," Thoughts for the post-2008 world, 15 February.

Endnotes

1 For a review of earlier proposals for a parallel currency in the Eurozone, see Schuster (2015).

2 Cochrane's IOUs resemble those issued some years ago by the then fiscally-distressed State of California to overcome the US prohibition on states to print money, by making transferable IOUs acceptable for bill payments, see California State Controller's Office, "State Controller's Office Information on Registered Warrants (IOUs) Issued in 2009," 10 November, 2010 . Cochrane's IOUs also resemble those discussed by ECB sources for Greece, see footnote 1.

3 In addition, Parentau envisages public/private inquiries into eventual specific supply bottlenecks in the chain of production, which could trigger the redirection of infrastructure spending to help clear those bottlenecks. Inquiries into sectors with above normal profit margins or real wage growth persistently in excess of labour productivity growth could also be launched. Excess profit taxes designed to incentivise higher reinvestment rates, as well as collaborative bargaining in cases of aggressive labour demands, could be required to address any such inflationary pressures on the supply side. Also, using TANs to implement an employer of last resort approach to labour market improvement could have a stabilising effect on inflation.

4 Other advantages would be that the system would ensure: i) a source of liquidity for governments that is outside the bond markets, does not involve the banks, and lies outside the restrictions imposed by Europe; ii) a national supply of euros that is perfectly legal in the context of the European Union's Treaties; and iii) that FT-coins could be used to increase benefits to society's t members or to funding needed public works; and iv) a mechanism that allows a free and

fully transparent payment system outside the banking system, that is monitored jointly by every citizen (and non-citizen) who participates in it.

5 We have elaborated the proposal with Luciano Gallino, Enrico Grazzini e Stefano Sylos Labini, and made the subject of a public appeal posted at http://www.sylos labini.info/online/wp-content/uploads/2014/11/Appello-Inglese-rivisto_9-03-2015.pdf.

6 This is possible because the income expansion triggered by TCC injections works out its effect across the whole two-year deferral time period attached to the TCCs prior to their maturity and, therefore, expands output to a point where the related additional fiscal revenues exceed the euro shortfalls determined by the use of TCCs for tax reduction. Our simulations (see Part II of this column) show that the minimum (threshold) value of the income multiplier that makes this effect possible is less than 1.

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