# ***Tax-Backed Parallel Currencies to Reform the Eurosystem***

The Political Debate in Italy
A Comparison between the Italian and the Greek Economic Scenario

Wien, May 17, 2017

## Tax Rebate Certificates: almost a currency, but not quite

TRCs: a security incorporating the right to reduce future tax payments & financial obligations due to the government issuing them.

After two years from their issuance, TRCs would be used to exercise the right to a reduction in whatever financial obligation toward public administrations (taxes, social contributions, fines etc.).

TRCs would be exchanged for euros in the financial market similarly to any zero-coupon government bond.

They would presumably trade at a small discount vis-à-vis par value, as their acceptance to settle taxes implies that they do not carry any default risk.

TRCs would also be accepted as a means of payment, to be used eg in combination with credit or debit cards.

## <u>TRCs advantages</u>

TRCs would be allocated ***at no charge*** to several recipients:

To workers, including self-employed, increasing their purchasing power.

To enterprises, as a function of gross labor costs, to reduce them and immediately improve competitiveness.

To partially fund government expenditures such as higher pensions, unemployment subsidies, public investments etc.

*<u>Two key benefits:</u>*
Higher internal demand.
Improved enterprises competitiveness.

===> GDP and employment expansion, no external trade unbalances.

## TRCs are neither debt nor "legal tender" money

TRCs are not debt, as the issuing government has no obligation, under whatever circumstance, to reimburse them.

TRCs are not legal tender money either: nobody, other than the issuing government, is forced to accept them to settle a euro-denominated financial obligation. As such, they do not conflict with the ECB monopoly to issue legal tender money in the Eurozone.

Only the issuing government commits itself (by law) to accept TRCs to honor the right to tax reduction attached to them. This is ***the*** source of TRCs value.

## Issuing and allocating TRCs: basic principles

Issuances size and allocation must be such to:
Close the current output gap.
Reduce unemployment to pre-2008 financial crisis levels.
Raise inflation close to ECB 2% target.
Prevent external trade unbalances.

In addition, the TRC program can be structured to achieve:
Zero balance between euro outflows and euro inflows for the issuing government (in each year).
Public debt / GDP % steadily falling to attain in due course the Fiscal Compact 60% target.

Remember: **TRCs are not debt**. The issuing government can ***never*** be forced to default on TRCs, since they imply a commitment **to accept** them, **not to reimburse** them.

## TRCs program: the case of Italy

| | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|
| TRCs issuances – bln | 30 | 60 | 90 | 120 | 120 | 120 |
| TRCs uses | | | 30 | 60 | 90 | 120 |

TRCs annual issuances would gradually increase up to a maximum of € 120 bln.

It is worth remembering that the Italian 2016 GDP is 7% lower than 2007's. This approximately corresponds to € 130 bln.

The two-year delay between issuances and uses allows the economy to grow, to generate higher gross tax revenues and to offset TRCs uses.

## Italy’s underexploited economic potential

Italy’s GDP contraction is ***entirely*** due to lower internal demand. Exports are higher, which clearly suggests that Italy has the potential to quickly recover ***AT LEAST*** 2007 GDP levels.

| | 2007 | 2016 | | |
|---|---|---|---|---|
| GDP | 1.801 | 1.672 | -129 | -7,2% |
| | | | | |
| Consumptions | 1.408 | 1.330 | -78 | -5,5% |
| Investments | 389 | 284 | -105 | -26,8% |
| | | | | |
| Internal Demand | 1.797 | 1.614 | -183 | -10,2% |
| | | | | |
| Exports | 494 | 502 | +8 | +1,5% |
| Imports | 500 | 444 | -56 | -11,4% |
| Trade Surplus | -6 | +58 | | |

(Sources: ISTAT / MEF - constant 2016 euros)

## Safeguards

The EU requires Eurozone members to offset, by raising taxes and/or cutting public expenditures, any shortfall vis-a-vis public deficit targets.

In a demand-depressed environment, such actions are procyclical, deteriorate the economy and fail to improve public finances.

A TRC program could contemplate a set of ***non-procyclical safeguards***:

Instead of cutting expenditures, replace certain euro expenses with TRCs-funded expenses.
Instead of only increasing taxes, compensate higher levies by granting TRCs to taxpayers (ie compulsory euro-for-TRCs swaps).
Issuing longer term TRCs (tax-backed bonds) to reduce euro debt.
Offer, on a voluntary basis, to TRCs holders (upon expiration) to postpone using them, in exchange for a face value increase (ie an interest "paid" in "tax money").

## Ironclad commitment not to increase public debt

The joint effect of TRCs + non-procyclical safeguards allows to constantly achieve:

===> A zero balance between euro outflows and euro inflows, in each year.

===> No increase in public debt outstanding.

===> A steady fall in the public debt / GDP ratio, to attain the Fiscal Compact 60% target.

## Italian political parties – current position on tax-backed currencies proposals

M5S - 29% in recent polls
Discussing the "Moneta Fiscale" proposal for inclusion in its economic program.

Right-wing parties (Lega Nord / Fratelli d'Italia) - 17% in recent polls
Proposes issuing small-denomination tax-backed government bonds ("Minibot fiscali"), albeit as an intermediate step to Euroexit.

Forza Italia - 13% in recent polls
Proposes introducing a national parallel currency; unclear whether tax-based.
We discussed with them the "Moneta Fiscale" framework.

Partito Democratico - 27% in recent polls
Only major party not officially considering a "Moneta Fiscale" framework.

Can a tax-backed currency program be successful in Greece ?

YES.

Smaller country, lower industrial potential than Italy.

But output gap even larger.

Currently not running a significant trade deficit.

Large room for internal demand expansion.

Joined with allocating a portion of TRCs to enterprises, would allow demand & GDP strong recovery without generating external unbalances.

What about the commitment to generate a 3.5% primary surplus ?

3.5% surplus (ie excess of public sector euro inflows on euro outflows) is achievable on a permanent basis.

TRCs to generate demand expansion and trigger a strong recovery.

Euro surpluses to reduce debt, TRCs-fueled expansion closes the output gap.

## What about the Greek tax evasion problem ?

It does not make TRCs less valuable, so long as TRCs expiring each year are only a minority of gross government receipts.

Room to issue TRCs to cause a large enough demand recovery definitely exists.

## What about the debt relief ?

Actually would not in itself solve Greece's economic problems.

Greece requires demand expansion: if debt relief is granted but primary surpluses still must be generated, no meaningful recovery takes place.

Much more important to introduce TRCs and allow internal demand to expand.

Meanwhile long-term TRCs could be sold to reduce the debt burden (this btw is as well the case for Italy and other countries introducing TRCs).

Debt relief may or may not be required a few years down the road, but as strange as it may sound, it is not the most urgent issue.