



Leibniz Institute for Financial Research SAFE  
Sustainable Architecture for Finance in Europe (<https://safe-frankfurt.de/>)

## SAFE Finance Blog

### "With Mini-BOTs, the state would make itself poorer in the longer term"

07/03/2019

Jan Krahnert: Italy's thoughts on new bonds are a cause for concern for the euro area. However, in the end, the country would do itself harm



**The Italian Parliament has approved a resolution in favor of Mini-BOTs. What is behind it and how do these securities work?**

To put it simply, Mini-BOTs are small denominations of bonds issued by a state in return for a service rendered. The state, therefore, does not pay a supplier in euros, but gives him a bond instead, which he can use to pay off his tax debt. Theoretically, a state could also issue bonds as salaries for teachers or

police officers. If the bonds are passed on, they serve as an alternative means of payment: the first recipient passes the Mini-BOT on to someone who, in turn, can settle a tax debt with it or passes it on again. In this case, the bonds begin to circulate in the economy.

### **What is the Italian government aiming for with this project?**

Italy, like many other countries, has high arrears towards suppliers. This is a problem for many companies because the state is not easily seizable and of course also a large and important customer which companies do not want to alienate. With the Mini-BOTs, Italy wants to initiate a debt relief process. This presupposes that the bonds can be passed on. If the recipient "redeems" the Mini-BOT, i.e. uses it to pay the tax debt, the state's tax revenue will fall by the corresponding amount. Now the state would actually have to reduce its expenditure - which is probably unrealistic - or get more heavily into debt if it did not want to raise taxes. If, on the other hand, the bonds are passed on between households and companies, the Mini-BOTs act as a means of payment. The state can then hope that the redemption or the associated decline in taxes will be postponed further into the future, or even not take place at all, because the bond is always passed on. For the issuer - i.e. the state that issues the Mini-BOTs - the last case will result in a seignorage income that is generated to the extent that Mini-BOTs are used for payment purposes and not for the repayment of tax debts. "Seignorage" is the term usually used to describe the return that a central bank earns through the creation of money.

### **Can this work? In your opinion, how would these bonds affect Italy?**

I do not think debt relief works as easily as described above. Namely, if the bonds are passed on, it will not happen without a discount. A buyer of the bond, for example, would only supply the equivalent of 95 euros for a tax credit of 100 euros. This is because the redemption is associated with some uncertainty because politics can in principle at any time subject the redeemability of the Mini-BOTs to changed conditions. For example, it could worsen tax liability compensation insofar that it could only be offset at an "exchange rate" of less than one.

The creditability of outstanding tax debts is ultimately a purely political-fiscal decision which is not subject to parliamentary or other control, for example by a central bank. At last, no one ensures that the value of the Mini-BOTs remains stable, as it is usually the case with the legal currency through the mandate of a central bank. The value of these bonds would, therefore, be put into question, especially in the case of states with frequent government changes, like in Italy.

On the other hand, there is an incentive for suppliers to pass on the bonds, for example, if they do not have to pay such high tax debts. That is why they would probably only be willing to accept Mini-BOTs as a means of payment at a higher value. As a result, services purchased by the state would become more expensive due to the discount for passing on. All in all, this could have negative effects on Italy's economy: a permanently stable exchange currency is hardly realistic. Government debt would then continue to increase because the government would lose net tax revenues. The cleaner and more transparent solution for Italy would be to directly increase debt without this detour – disregarding the fact that the country would come into conflict with the Maastricht rules.

### **Mario Draghi, President of the European Central Bank (ECB), has already warned that Mini-BOTs are illegal as a money substitute. Will there be a showdown with the ECB?**

Mini-BOTs as a currency that has to be accepted alongside the euro would certainly not be legal and would violate the agreements on the euro area. The ECB then would have to react, for example with sanctions. However, even below the threshold of a legal currency, Mini-BOTs could be a bone of

contention in the currency area: if the bonds were actually not used to settle tax debts but as a means of payment, that seignorage would arise for the issuing state, other countries might be tempted to issue Mini-BOTs as well. We would then have competition from national tax credits and exchange rates would arise

between the different Mini-BOT currencies. The situation would then be remotely comparable to that before the introduction of the euro.

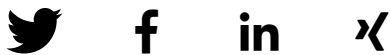
In fact, however, the danger of this kind of development and the associated suppression of the euro as a means of payment is probably rather low. In the end, the reason is the lack of trust in the stability of this parallel currency. Because of this lack, Mini-BOTs may be used to repay tax debts – but they are not suitable for a currency competing with the euro. They thus remain an instrument of public debt management without any significant monetary importance. Since they also lead to disproportionately high tax losses because of the presumed trust problem, the tax authorities are primarily damaging themselves with the introduction of Mini-BOTs. The assumption is therefore that an exchange rate to the euro would be formed for the bonds, which would demonstrate the lack of faith of the market participants in the value of such securities. With Mini-BOTs, the state would, therefore, make itself poorer in the longer term.

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