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Mini-Bot: Ingenuity or Ignorance

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Policy Brief

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With the infringement procedure launched by the European Union against Italy in December 2017 (not to be confused with the potential infringement procedure for excessive debt, avoided for the moment) because of the structural problem involving the long deadlines that Italian public administration (PA) employs for paying their supplier companies, many have expressed the will to address the problem “... **even through instruments such as small-denomination government bonds**...”. The pressure from the League and the 5 Star Movement parties was decisive. By including just few words in the motion, they rekindled the dangerous public debate on mini-BOTs. The subject must now be clarified, since nowadays well-constructed lies seem to be as relevant as the reality of the facts.

On May 28, 2019 the Chamber of Deputies voted unanimously (subsequently, the PD party admitted that it had made a mistake by voting because of the last-minute amendments made to the text) on a parliamentary motion (which was therefore not binding for the government) concerning the measures to be taken in the matter of the PA’s payment of supplier debts, that is, the so-called trade payables. Such a motion would be a very ambiguous sign from the EU’s third largest economy directed towards the creation of a ‘parallel currency’ to the euro and in the worst-case scenario, Italy’s possible exit from the EU. In fact, with the approval of the motion, the spread actually rose from 266 to almost 290 points, forcing the Ministry of Economy and Finance to officially deny that it is considering measures for the introduction of such mini-BOTs.¹

Before going further into the subject, it is necessary to take stock of the motivation behind the controversial parliamentary motion adopted on May 28.

The PA buys goods and services from thousands of Italian companies and the payment by the state is issued with extreme delay. Normally, an occasional delay is due to the fact that the state, in the face of the PA’s trade payables, finds credits, that is, the taxes due by the taxpayers. Let us assume that, from the amount of credits that the state expects to receive, a part is irrecoverable due to matters of competence. Therefore, the lower revenues obtained will lead to several eventualities: an increase in taxes, a reduction in public expenditure or an increase in debt. Usually, the state issues new debt securities in the form of ordinary Treasury Bills (bots), precisely because of the physiological temporal asymmetry between expenditure (including trade payables) and revenues (taxes), without renewing them at maturity but repaying them with fiscal revenue (revenue from taxes). However, if a part or all of the state's claims do not materialize in the ongoing

¹“No measures are under consideration for their issuance as there are no grounds for settling the PA's debts by means other than legal tender money.” - Minister of Economy Giovanni Tria to the Chamber.

financial year, the state will have to raise taxes or refinance expenditure by issuing new debt. This new debt will necessarily have to be renewed at maturity in order to have the necessary hedges for the following years as well.

Moreover, the Italian structural delay is strongly encouraged by the presence of non-strict (European and national) rules on the accounting of trade payables in the debt of the PA. Therefore, without explaining the nature of the mini-BOTs, any measure aimed at solving the problem without acting on the regulation in question would be totally, or in part, neutralized by the existing incentives. Therefore, it would be necessary to calculate the trade payables in the public debt at the time of maturity, with appropriate sanctions and also inspection instruments.

Even if today there exists no formal definition of the instrument cited in the parliamentary motion, on the basis of the declarations made by the Eurosceptic League economist, Claudio Borghi, we assume that it is a government bond that is not issued at a Treasury auction, without a maturity date and an (non-interest bearing) interest rate, and with a small or very small denomination - 10, 50 or 100 euro. In addition, while government bonds are dematerialized, according to the League, the mini-BOTs would be physically printed and made to resemble the euro banknotes, thus violating community rules (**see: *Mini-BOTs as currency***).

Let us now look at two alternatives for dealing with the lower revenues obtained. A persistent increase in the level of taxation has recessive effects on a country's growth (a temporary increase would just postpone the problem of coverage). The issuance of new debt would increase the already high debt-to-GDP ratio, which in turn could cause holders of such debt (investors) to doubt its long-term sustainability, and would thus increase the interest expenditure on public debt. One conclusion, strongly supported, is expressed on the Il Sole 24 Ore's Econopoly blog: "... the Italian public expenditure is too high or of bad quality (or both), and therefore in a short period of time a stock of outstanding debt would be formed again."

Among the many opinions expressed on the mini-BOTs, an important judgement was made by President of the European Central Bank Mario Draghi, who said that this instrument would manifest in two forms. First, it would be a parallel currency to the euro and in that case, illegal. Alternatively, it would be considered debt.

Mini-BOTs as currency

If mini-BOTs are considered a currency (besides the fact that they would be illegal), paying trade payables and, in general, the financing of public expenditure through the issuance of mini-BOTs (a bond in the form of a bill) would represent the monetization of public expenditure, and, as clearly explained by Tommaso Monacelli in his article on lavoce.info, monetizing the deficit is a dangerous illusion, in addition to being, for good economic theory reasons, prohibited by the Treaty on the Functioning of the European Union (Article 123).

Mini-BOTs as debt

Being by definition issued debt instruments of the state, it should not be surprising if the use of mini-BOTs leads to an increase in debt. In fact, if they were used to pay PA creditors, allowing for a deferred payback or one that is shorter in time, they would decrease tax revenues, just like a tax cut. This would lead to a reduction in public expenditure hedges, which the state would have to continue financing by increasing public debt or taxes. Moreover, if we consider a time constraint for the recovery of these payments by the PA's creditor companies, there would also be an implicit cost imposed on it, unless an interest rate is recognized for the postponement of the payment of these claims.

Another implicit cost for PA creditor companies is the following. Assuming that the state balances the trade payables with the mini-BOTs and since the PA's creditors would mainly use them to pay their taxes, which would often be lower than the total credits accrued toward the PA, they will be forced to sell a part of those small-denomination government bonds to buyers (who in turn will also use them to pay taxes) at a discount. Of course, the purchasing power of these mini-BOTs will not be guaranteed by any authority (the stability of the value of the legal tender coins is recognized by the law), meaning that at the time of the mini-BOT sale the companies will receive a lower value than the initial one (otherwise why buy them?).

Alternatively, mini-BOTs could be used among households and businesses for the payment of taxes. We are once again faced with a fiscal policy that is equivalent to a tax cut. In fact, the payment of taxes with debt instruments issued by the state would amount exactly to a reduction in tax revenue. Consequently, with fewer funds at its disposal, the state would find itself with a lack of coverage for public spending, which would therefore be cut proportionally, offsetting the effect with the expansionary appearance of the mini-BOTs, or, alternatively, would be supported by issuing new debt (or raising taxes, with all the negative consequences).

In short, the concept of using mini-BOTs to pay off trade payables may seem like a good idea, but if we analyze it in detail we can intuitively conclude that such a tool is futile and limited. To conclude, it is clear that the mini-BOTs are a completely sterile, if not harmful, device for public finances, as their implementation (or just the information that the government is officially studying their implementation) would put again Italy on the road to leaving the euro.