

**Discussion of**  
**'Can the Central Bank Alleviate Fiscal Burdens'**  
**Ricardo Reis**

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- Great paper! Important topic.
- Very pedagogical & well written.
- Summarizes key ideas from Ricardo's work on central banks (CB) during past 5 years
- Key insight: CB balance sheet structure & rule that determines the CB dividend payment to the fiscal authority can matter for inflation & interest rates

- Might expect that only the consolidated budget constraint of the CB & of fiscal authority matters (unaffected by transfers from CM to fiscal authority)
  - Why does CB budget constraint matter in its own right? Because CB dividends affect the balance sheet of the CB:
    - (i) mix between currency & interest paying reserved
    - (ii) asset holdings
- Currency issuance (seigniorage) affects interest rate & inflation

These issues have become especially important since financial crisis: many major CBs now hold risky assets and pay interest on reserves.

⇒ CBs now face major balance sheet risk that affects its dividend.

Can CBs become go bankrupt? Not in legal sense.

CB can always pay interest on reserves by issuing more currency, but this raises price level, and thus lowers real return on reserves & currency

= de facto insolvency

⇒ Refutes popular notion that a country that prints its own money can never have a sovereign debt crisis.

If investors fear sovereign default, government bond price falls ⇒ capital loss for CB ⇒ inflation ↑ ⇒ creditors require higher yields ⇒ Gov't driven into default or hyperinflation.

To maintain price stability, after negative CB balance sheet shocks, the CB may need a real transfer FROM the government (negative dividend):

Price stability requires 'Fiscal Support'  
(Del Negro & Sims, 2015)

Consolidated CB + fiscal budget constraint:

$$R_t^{CB} / P_t - A_t^{CB} / P_t + D_t^{Treasury} / P_t = \sum_{\tau=0}^{\infty} E_t \rho_{t,t+\tau} (f_{t+\tau} + d_{t+\tau})$$

$R_t^{CB}$ : Commercial bank reserves at CB

$A_t^{CB}$ : CB assets

$D_t^{Treasury}$ : Government debt

$f_{t+\tau}$ : primary fiscal surplus (real)

$d_{t+\tau}$ : CB dividend paid to Treasury (real)

Assume  $A_t^{CB} \downarrow$  (i.e. net debt  $\uparrow$ ). Triggers  $P_t \uparrow$  (FTPL),

$f_{t+\tau} + d_{t+\tau} \uparrow$ . Response will depend on response of  $d_{t+\tau}$

## Comments:

- Ricardo's paper provides a terrific overview of accounting convention and dividend rules used by leading central banks: 'risk provision', 'deferred accounts', 'general reserves'.

Key question: how is CB net income defined? based on constant real/nominal net worth?

Can CB dividend be negative and for how long?

Negative CB dividend ('fiscal support') may put CB independence into jeopardy: 'political risk'.



Added complication for ECB: once CB facing many independent fiscal authorities. ECB dividend policy offers (limited) scope for **redistribution** and **risk sharing** between member countries.

- Main contribution of paper: detailed analysis of CB budget constraint.

- **Burning question: do differences between CB dividend rules matter for macroeconomic performance?**

Analysis of budget constraints is extremely interesting and important, but incomplete.

Need to use a fully specified dynamic macro model: compare macro dynamics under alternative CB set-ups.

- Standard macro-theory has completely abstracted from the CB balance sheet. Standard DSGE theory describe CB behavior by interest rate rule, and abstract from money and the CB budget constraint
- Given the major balance sheet risks faced by CBs, applied macro models should incorporate CB budget constraint. Ricardo's paper provides valuable insights on how to achieve this!

- A POINT OF DISAGREEMENT WITH RICARDO:

Ricardo uses conventional definition of seigniorage as CB issuance of non-interest rate paying money. However, the CB may also be earning 'seigniorage' income on interest bearing reserves issued to commercial banks, as interest rates on reserves are likely lower than the rate of time preference (as reserves provide liquidity services).

Empirically, IOER (interest rates on excess reserves) have typically been LOWER than the nominal GDP growth rate.

⇒ The perpetual rolling-over of CB reserve liabilities seems be consistent with a stable reserves/GDP ratio, and it would NOT amount to a Ponzi scheme.

- What will be the future shape of central banks?
  - ▶ Will CB balance sheets shrink to pre-crisis size (relative to GDP)?
  - ▶ Will major CBs continue to hold risky assets?
  - ▶ Will interest on (excess) excess reserves be kept in CB toolkit?

CONCLUSION: OUTSTANDING PAPER &  
VERY PROMISING RESEARCH PROGRAM

I LOOK FORWARD TO READING FUTURE  
PAPERS BY RICARDO ON THESE ISSUES

**THANK YOU !!!**