Report on

Willem Buiter, Seigniorage, economics Discsussion Paper 2007-8

The paper discusses and analyzes four different concepts of how the fiscal authority (Treasury) can appropriate real ressources from the central bank (based on the central bank's monopoly to issue fiat money). These are 1.) seigniorage, 2.) the revenue of the central bank, 3.) the inflation tax and 4.) the operating profits of the central bank. The author first explores the relation between these concepts in a steady state environment. He establishes a ranking of these concepts in terms of the revenue maximizing inflation rate. He then generalizes the measures he considers by focusing on a real time analysis, i.e. an analysis outside the steady state.

In a next step (sections 2 and 3) he derives the intertemporal seigniorage identity and develops a framework to examine the relationship between the four different concepts from an explicitly real-time perspective. Doing this, Buiter stresses the necessity to distinguish between the budget constraint of the government/fiscal authority and that of the central bank if the latter is operationally independent. The intertemporal model that the author develops can be considered a valuable contribution to the literature because it permits to address all questions related to the transfer of ressources from the central bank to the Treasury in a stringent framework. In section 4, Buites explores how the fiscal claims on the central bank impact the conduct of monetary policy and may interfere with the central bank's inflation target. Section 5 is devoted to some special aspects related to cooperation between the central bank and the fiscal authority.

The paper suffers from some deficiencies that should be eliminated before publication. Some assumptions need to be motivated and discussed in more detail and some implications need to be better explained. In section 4, the author deviates from the usual formulation of staggered price contracts a la Calvo (1983) by assuming that no firm can adjust its price in the *current* period. Prices are thus fully rigid in the current period. Calvo contracts are usually employed to model an intermediate degree of price stickiness (prices are neither fully flexible nor fully fixed as in the older style Keynesian literature). The author does not give an explanation for

this representation of the way prices are set. In a footnote, he merely states that the price level is not fully pre-determined if his assumption would be relaxed. It would also be interesting to know how robust the results are against changes in the price setting assumption (i.e. what happens if the usual formulation of staggered price contracts is employed?).

The author stresses that the governmental budget constraint need to be decomposed into the budget constraint of the central bank and that of the fiscal authority. In a related literature it is argued that the government can follow non-Ricardian fiscal policies under which the intertemporal budget constraint is satisfied for some, but not all, price paths. On this basis Woodford (1995) among others shows how fiscal policy can affect inflation rates which is a question the current paper also poses. The current paper, however, does not pay attention to the previous literature and does not discuss its approach relative to Woodford's approach. In particular, the question arises how Buiter's results are affected if the intertemporal budget constraint of the fiscal authority in his model is not fulfilled for all price paths.

Propositions 3 – 5 in section 4 critically hinge on the assumptions that the central bank chooses the inflation rate on its own and that the fiscal authority unilaterally decides on the net tax paid by the central bank to the Treasury. These assumptions could be discussed in the light of the fiscal theory of the price level.