When Are Central Bank Policy Actions Fiscal?

Definitions, Examples and a Call for Transparency

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When are central bank policies fiscal?

- Alternative definitions and a preferred one
- Examples of Fed policies with and without significant fiscal elements
- The large and misleading fiscal effect of improperly budgeting for remittances
- A call for greater transparency

Alternative and preferred definitions

(1) Stock definitions of monetary and fiscal policy emphasize the actor and the type of action

- A policy is monetary if it is undertaken by a central bank
- A policy is fiscal if it arises from a government's tax and spending policies
- Not helpful for drawing an economically meaningful line

(2) A central bank policy action is fiscal if its real and distributional effects can be replicated with tax and spending policies

- This tends to make all monetary policy fiscal
- Not helpful in drawing an economically meaningful line

Alternative and preferred definitions

(3) Preferred Definition:

A central bank policy action is fiscal if it causes a direct transfer of value to or from the government

- Causes the fiscal cost of Fed actions to be quantified analogously to those of explicit tax and spending policies in the federal budget (a consolidated balance sheet perspective)
- "Direct" excludes pecuniary externalities, i.e., the effects of Fed actions on prices or rates of return
- Reasons to exclude pecuniary externalities:
  - This is the channel by which conventional monetary policy works
  - Very hard to quantify size or duration of effects
  - Budgetary accounting does not include them in other contexts

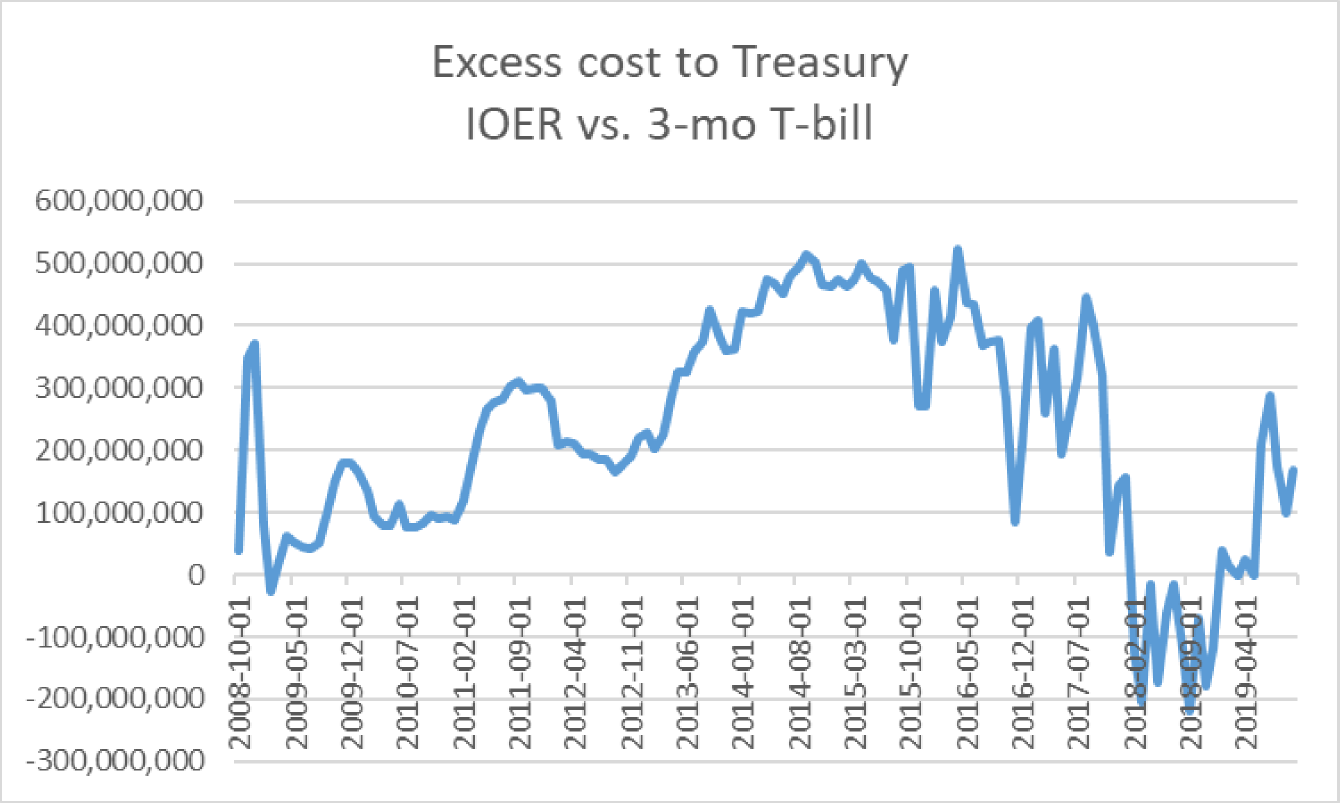
Examples: Fed policies **with** significant fiscal cost

- Paying above-market interest on excess reserves

- Subsidized credit facilities
  - e.g., during Global Financial Crisis and Covid-19 pandemic

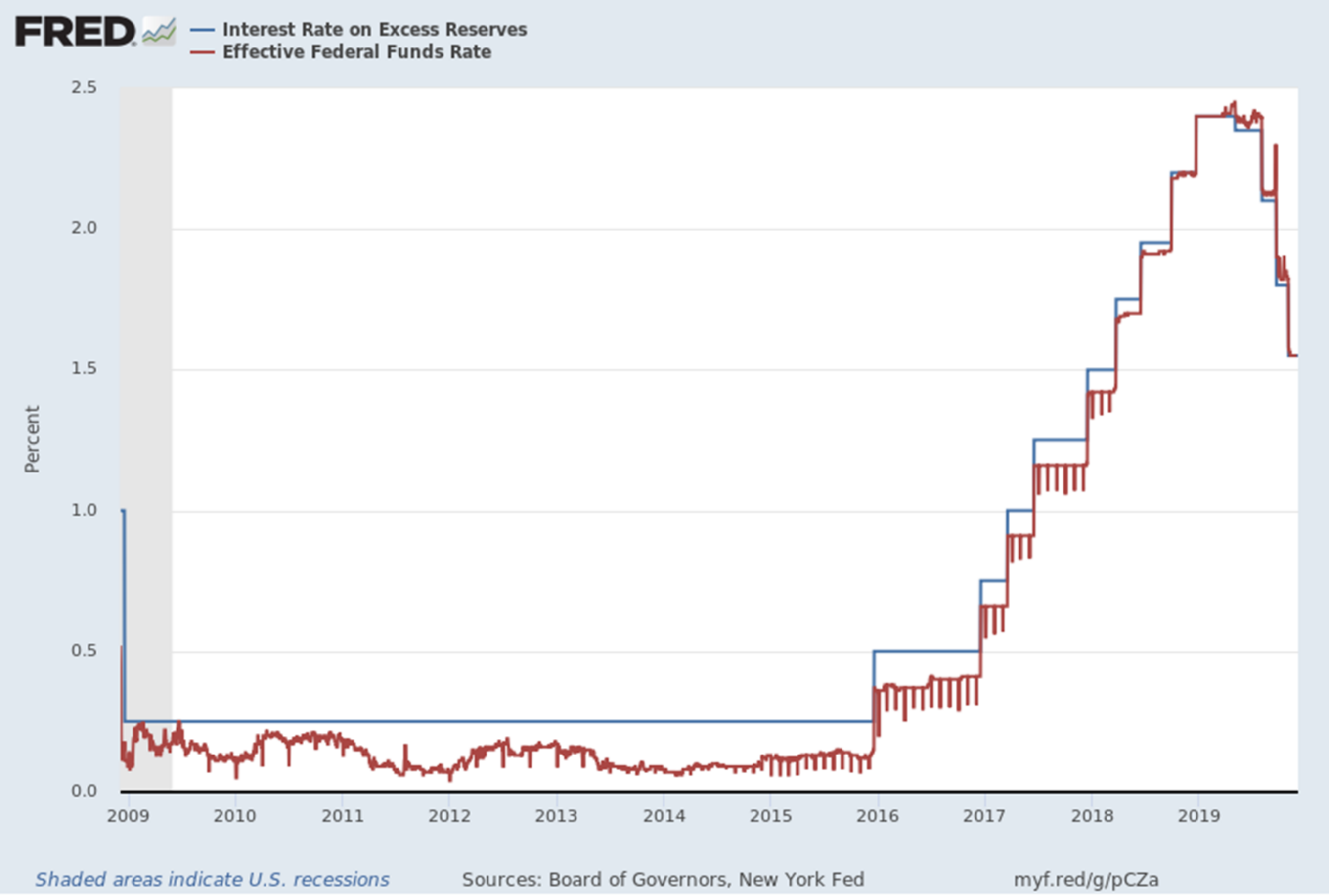
Cost to taxpayers of above-market interest on reserves

- Annual cost is (interest differential)x(excess reserves)
- Total excess interest paid is **$30.6 billion** for period 10/2008 to 10/2019
  - This is relative to 3-month t-bills
  - Relative to overnight rate cost rises to **$39.6 billion**



Above-market IOER: transfer value from taxpayers to banks

- Seeming arbitrage opportunity for banks to borrow at Fed Funds rate and invest in reserves
- Other financial institutions also benefited by depositing excess cash with banks, with the banks passing back a portion of the rate spread



An upper bound on the transfer is **$21 billion over the period,** based on the rate differential multiplied by excess reserves.

New Fed COVID-19 credit facilities with a fiscal cost

Initiative	Size limit ($ billions)
Main Street Lending facility (medium-size businesses)	600
Primary Market Corporate Credit facility (large corporations)	750
Municipal Liquidity facility	500
TOTAL	**1,850**

- Authorized under CARES Act, March 27, 2020
- Primary market security purchases at below-market prices entail subsidies
- Treasury first-loss position covered some but not all of Fed fiscal exposure

Examples: Fed policies **without** significant fiscal costs

- Buying private-sector securities (e.g., MBS or corporate bonds) at fair market prices
  - Purchases at fair market prices are zero NPV for the government
  - These purchases may be a bad idea for other reasons
  - *Note*: Changes over time in the market value of the Fed's MBS holdings change the net worth of the gov't. However, consistency with budgetary practice would not mark gains or losses to market, nor would it attribute those value changes to a particular gov't agency
- Fed COVID-19 credit facilities fully backed by Treasury and secondary market purchases

Fed COVID-19 credit facilities with minimal fiscal costs

Primary dealer credit facility (PDCF)
Commercial paper funding facility (CPFF)
Money market mutual fund liquidity facility (MMLF)
Term asset loan facility (TALF)
Central bank liquidity swaps
Secondary market corporate credit facility (SMCCF)
Paycheck Protection Program liquidity facility (PPPLF)
Temporary foreign and international monetary authorities repo facility (FIMA)

The size of many of these facilities is potentially unlimited

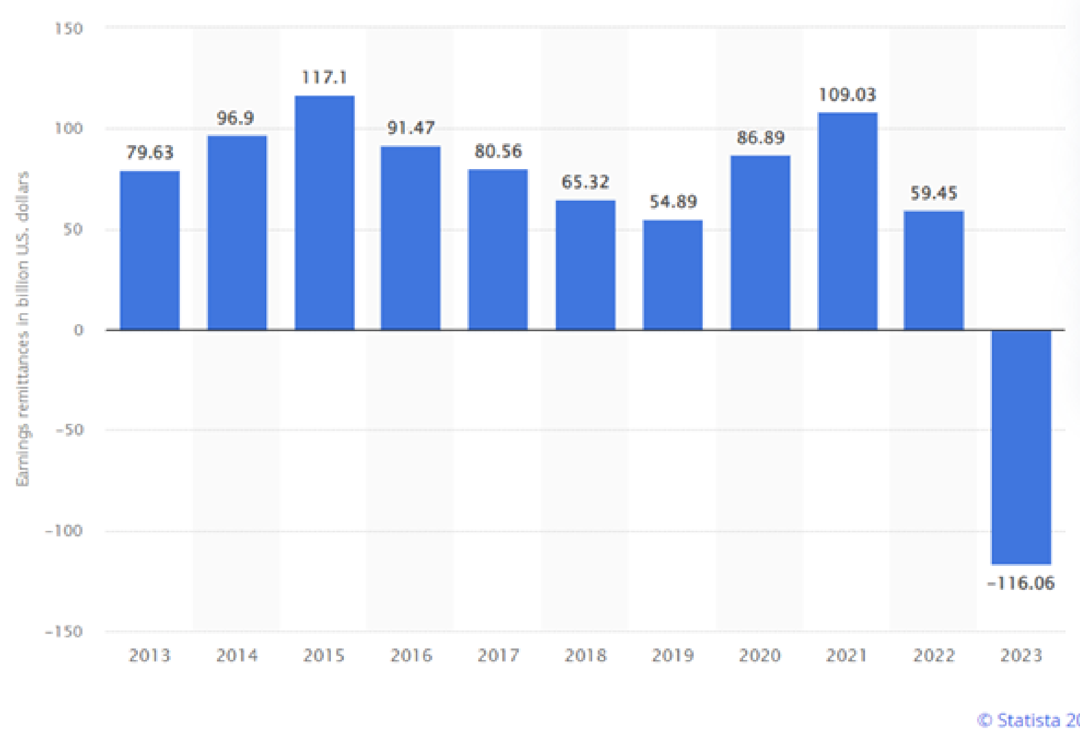
Indirect fiscal effect of flawed accounting for Fed remittances

- Open market securities purchases typically have no fiscal cost or benefit
  - $1m of Treasury's has same value as $1m of reserves used to finance investment
  - Or there is a fiscal cost if interest on reserves is above-market
  - Recall excluding pecuniary externalities
- Government budgetary accounting books remittances from the Fed on a cash basis
  - Cash in excess of expenses is remitted to Treasury annually
  - Remittances were historically large: (a) large balance sheet, (b) term & risk premium in rates
- The "profits" accommodate additional government spending
  - The reported cash inflows have significantly reduced reported budget deficits, allowing the gov't to spend more money and stay below any budget caps

Indirect fiscal effect of flawed accounting for Fed remittances

Federal Reserve's earnings remittances to the United States Department of the Treasury from 2013 to 2023

(in billion U.S. dollars)



$790 billion of illusory fiscal space created from 2013-2022

Release date
March 2024

Region
United States

Survey time period
2013 to 2023

Supplementary notes

Figures prior to 2022 were collected from previous publications. Figures are rounded.

What should be done?

- Greater transparency (and clearer thinking) about fiscal and distributional consequences of Fed policy is essential
  - To hold the Fed accountable for fiscal costs it generates
  - To encourage the Fed to adopt a cost-benefit analysis mindset when its decisions have fiscal consequences
  - To reduce pressures on the Fed to undertake fiscal actions that the rest of government wants to avoid
  - To discourage legislative curtailment of its independence
- A first step would be for the Fed to acknowledge the relevance of these issues and devote significantly more staff resources to addressing them
- Harmonizing and improving fiscal and monetary accounting practices is also important to promote transparency and more informed decision-making