

Helicopter Money

BY ERIC LaROSE

Since the global financial crisis, central bankers around the world have considered and sometimes used a number of unusual policy tools, including quantitative easing (QE) and negative interest rates, in an attempt to stimulate economies and fight deflationary pressures. Now some economists and policymakers are thinking about adding another item to this toolbox: helicopter money.

No, the use of helicopter money wouldn't involve money actually falling from the sky. But it would involve a much more direct method of getting money into the hands of citizens than central banks have used before. Under traditional expansionary monetary policy, the Fed attempts to stimulate the economy indirectly by lowering the interest rates faced by banks, causing them to borrow and make more loans. In turn, the interest rates faced by businesses and consumers decrease, providing economic stimulus. In contrast, helicopter money would consist of the central bank creating money and then distributing it directly to the public through fiscal transfer payments — for instance, by financing a government spending increase or tax cut or, more drastically, by mailing a check directly to each household.

The idea of helicopter money stems from a 1969 essay by Milton Friedman, who envisioned a hypothetical scenario in which a helicopter drops \$1,000 on a community in a one-time event that doubles every individual's cash balances. In the long run, Friedman concluded, this event would do nothing more than double the nominal price level. But in the short run, Friedman believed the “helicopter drop” could increase real output, since prices would take time to adjust and firms might initially mistake inflation for real price increases.

Economic events over the past quarter-century have caused the idea to be taken more seriously as a possible tool to increase both output and inflation. In the mid-1990s, Japan began experiencing deflation, and in a famous 2002 speech, Ben Bernanke mentioned helicopter money as a possible last resort for the Fed to fight deflation should it ever reach the United States. Over the past few years, more figures have publicly discussed the idea as near-zero interest rates have weakened the ability of conventional monetary policy to further stimulate aggregate demand. Although a close aide to Japan's prime minister has opposed it, many experts speculate that the Bank of Japan may pursue this policy in the coming years.

In addition to lowered interest rates, the Great Recession saw the use of QE, in which central banks use newly created money to buy assets from financial institutions. Conceptually,

helicopter money is quite similar — some supporters call it “QE for the people.” Many believe that QE failed, however; they argue that banks did not increase lending to consumers in response to this massive liquidity increase, blunting its effects. In contrast, helicopter money could get around this problem by eliminating the middleman and putting money right in the hands of consumers, possibly providing stronger stimulus than QE. As Columbia University economist Michael Woodford put it, “the fact people get an immediate transfer should lead them to believe that they can afford to spend more.”

The primary argument against the use of helicopter money is perhaps as much about politics as economics. Helicopter

money is essentially a merging of fiscal and monetary policy, because new money is being created by central banks but distributed in the form of fiscal transfers. Central banks lack the authority to cut taxes or increase government spending. In this regard, helicopter money could threaten the independence of central banks by giving politicians some control over the money supply and the ability to finance increased government spending by printing money rather than with present or future tax hikes. Even if helicopter money were promised as a one-time occurrence,

politicians could always come back for seconds. Any short-run benefits of helicopter money could be greatly outweighed by the long-run harm of reduced monetary independence, which most economists strongly agree makes monetary policy less effective over time and creates inflationary pressures.

Additionally, helicopter money's effects may be hard to predict because its success depends largely on its ability to shape consumer behavior and inflation expectations. If consumers see such a policy as a sign of desperation, they may actually lose faith in the ability of central banks to conduct effective monetary policy, leading them to save the money instead of spending it — making helicopter money a failure. On the other hand, helicopter money, through its effects on expectations, could end up raising inflation well beyond annual 2 percent inflation targets.

Some politicians and economists in Europe and Japan are pushing to make Friedman's thought experiment a reality, and time will tell whether the European Central Bank and the Bank of Japan heed their advice. But in the United States, at least, it's doubtful that the Fed will begin coordinating policy with Congress anytime soon — in June, Fed Chair Janet Yellen said it might be considered only in a “very abnormal, extreme situation.”

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