Helicopter money as a policy option

Lucrezia Reichlin, Adair Turner, Michael Woodford, 20 May 2013

With persistently weak economic conditions becoming the norm in Europe, economists are considering increasingly unconventional policy options. One tool that has yet to be taken out of storage is “helicopter money”, i.e. the overt monetary financing of government deficits. This column recounts a policy debate on helicopter money that was held at LBS in April 2013 among three of the world’s leading monetary economists.

Introduction by Reichlin

Since the crisis central banks have implemented a variety of non-standard monetary policies aiming at stabilising nominal demand in the presence of major disruptions in financial markets. These policies had different intermediate objectives: market making, controlling long term interest rates or asset prices, support of credit via subsidies. They had a role in stabilising financial markets after the collapse of Lehman Brothers and the banking crisis which followed. Their effects on the real economy, however, are uncertain.¹

Notwithstanding this uncertainty the Bank of Japan has recently engaged in bold action, announcing that it will double the monetary base and its holding of government bonds in the next two years.

- Some think that quantitative easing will fuel the next financial bubble and that exiting will create financial instability (see Stein 2013).
- Others think that more should be done to sustain the real economy.

Adair Turner has recently put a different option on the table (Turner 2013): “helicopter money” or permanent money creation. This is an idea that was originally discussed by Milton Friedman (Friedman 1948) and more recently by Bernanke in relation to the zero lower bound problem in Japan (Bernanke 2003). As Bernanke has suggested it can be implemented via transfers to households and businesses via a tax cut coupled with incremental purchases of government debt, so that the tax cut is in effect financed by money creation.

Although the idea has been around a long time it is a taboo today. Non-standard monetary policies in response to the recent crisis have all led to an increase in the size of central banks’ balance sheets but in the recent experience no central bank, including the Bank of Japan, has purposefully increased the monetary base and committed to keep this additional money in circulation permanently. The idea, however, gets some support from academia.

In his 2012 Jackson Hole speech Michael Woodford suggested a version of flexible inflation targeting whereby the central bank commits future monetary policy to a permanently higher nominal target (such as the path of nominal GDP) and discussed various tools within that framework, including permanent increases in the monetary base via fiscal transfers (Woodford 2012).

In a situation of persistently weak economic conditions it makes sense to consider all options including tools that have stayed long in the closet.
The following is a summary of the questions posed by Reichlin and the answers by Turner and Woodford.

**Question one: Adair, can you explain why, in your view, helicopter money is an option for monetary policy that is relevant to today?**

‘Helicopter money’ – by which we mean overt money finance of increased fiscal deficits – may in some circumstances be the only certain way to stimulate nominal demand, and may carry with it less risk to future financial stability than the unconventional monetary policies currently being deployed.

The crucial first question is: do we want more nominal demand? The answer should be yes if (i) we are confident that some of the increase will take the form of increased real output or (ii) if some increase in the inflation rate is in itself desirable. These conditions seem likely to apply in some developed economies today, with nominal GDP growth rates very low, depressed by private sector deleveraging in the aftermath of the financial crisis. And if these conditions do not pertain, we should not be trying to stimulate nominal GDP by any means.

So let’s assume that increased nominal GDP growth is desirable. The problem is that other levers may be ineffective or have adverse side effects. Monetary policy, in both its conventional and unconventional forms, may be ‘pushing on a string’. Reducing policy interest rates to the zero bound fails to stimulate credit supply and demand in a ‘balance sheet recession’ in which the private sector is deleveraging. Cutting long-term interest rates by quantitative easing may be equally ineffective. And very low interest rates, sustained for many years, will encourage a search for yield, hence financial innovation and carry trades, which create risks to financial stability.

Fiscal stimulus, in its conventional funded form, financed by bond issues, may be more effective. Fiscal multipliers may be high when central banks are committed to keeping interest rates low for the foreseeable future. But with public debt levels already high and rising, concerns about future debt sustainability may create ‘Ricardian equivalence’ effects with households and companies aware that tax cuts today will have to be offset by tax rises later.

In this specific environment – ‘helicopter money’ – should be regarded as an available option. Ben Bernanke proposed this for Japan in 2003. If Japan had used it then, it would now have some mix of a higher real GDP level, a higher price level, and lower public debt to GDP.

**Question 2: Mike, what in your view are the potential effects of this policy on the economy as compared to traditional quantitative easing and how do you relate it to your framework of targeting the path of nominal GDP?**

It is possible for exactly the same equilibrium to be supported by a policy of either sort. On the one hand (traditional quantitative easing), one might increase the monetary base through a purchase of government bonds by the central bank, and commit to maintain the monetary base permanently at the higher level. On the other (‘helicopter money’), one might print new base money to finance a transfer to the public, and commit never to retire the newly issued money. Suppose that in either case, the path of government purchases is the same, and taxes are raised to the extent necessary to finance those purchases and to service the outstanding government debt, after transfers of the central bank’s seignorage income to the Treasury. Assuming the same size of permanent increase in the monetary base, the perfect foresight equilibrium is the same in both cases. Note that the fiscal consequences of the two policies are actually the same. Under the quantitative easing policy, the central bank acquires assets, but it rebates the interest paid on the government bonds back to the Treasury, so that the budgets of all parties are the same as if no government bonds were actually acquired, as is explicitly the case with helicopter money.

The effects could be different if, in practice, the consequences for future policy were not perceived the same way by the public. Under quantitative easing, people might not expect the increase in the monetary base to be permanent – after all, it was not in the case of Japan’s quantitative easing policy in the period 2001-2006, and US and UK policymakers insist that the expansions of those central banks’ balance sheets won’t be permanent, either – and in that case, there is no reason for demand to increase. Perhaps in the case of helicopter money, it would be more likely that the intention to maintain a permanently higher monetary base would be believed. Also, in this case, the
fact people get an immediate transfer should lead them to believe that they can afford to spend more, even if they don’t think about or understand the consequences of the change for future conditions, which is not true in the case of quantitative easing.

But while I grant this advantage of Adair’s proposal, I believe that one could achieve a similar effect, with equally little need to rely upon people having sophisticated expectations, through a bond-financed fiscal transfer, combined with a commitment by the central bank to a nominal GDP target path (the one that would involve the same long-run path for base money as the other two policies). The perfect foresight equilibrium would be exactly the same in this case as well; and as in the case of helicopter money, the fact that people get an immediate transfer would make the policy simulative even if many households fail to understand the consequences of the policy for future conditions, or are financially constrained. Yet this alternative would not involve the central bank in making transfers to private parties, and so would preserve the traditional separation between monetary and fiscal policy.

**Question three: Adair, do you agree with Mike that a bond financed fiscal transfer, combined with central bank action in pursuit of a nominal GDP level target would be desirable and better than pure helicopter money?**

Well as Michael quite rightly says, if there is perfect foresight, the equilibrium resulting from the two strategies is exactly the same. But perfect foresight may not naturally arise. It may need to be created by the transparency of overt money finance.

Michael’s proposal is essentially that (i) the government increases its fiscal deficit, directly putting money into people’s pockets (whether by tax cuts or public spending increases); and (ii) the central bank commits to maintaining a nominal GDP growth path, buying government bonds as necessary to achieve this even if, as is highly likely, achieving and maintaining that path of GDP level is likely to entail a permanent increase in the monetary base.

And if individuals and companies perceive that the increase in the monetary base will in fact be permanent, they will not rationally worry about any Ricardian equivalence cost of the future increase in government debt burden. They will understand that the fiscal stimulus is effectively going to be paid for with permanent central bank money.

Clearly therefore, Michael’s proposal is substantially very close to open monetary financing. But it isn’t quite overt. And that creates a danger that perfect foresight will not pertain and that individuals and companies will still worry unnecessarily about future government debt burdens. As a result, we might have to do even more quantitative easing type bond purchases to achieve Michael’s nominal GDP level target, creating the financial stability risks I referred to earlier.

The crucial question to me therefore is whether the more overt form of the strategy can be made consistent with central bank independence and with appropriate discipline against overuse of money finance. I believe it can.

**Question 4: Helicopter money is a form of fiscal policy. The question arises of whether it is the central bank, the Treasury or both in coordination that should implement it. This has the potential to threaten the principle of central bank independence or at least it may force us to reconsider the rules that govern the relation between Treasury and central banks today. Mike, what is your view on how we can deal with the problem of moral hazard possibly caused by an unclear separation between them?**

I think this would indeed be a problem with outright ‘helicopter money’, and it is why I prefer the alternative sketched above. The policy that I proposed would require coordination of monetary and fiscal policy actions, but it could be carried out while preserving a traditional separation of roles. The fiscal authority would make the transfers, issue debt to pay for them, and later tax people to service its debt; the monetary authority would conduct open-market operations in the amounts needed to keep nominal GDP on the target path (or to keep nominal interest rates at zero, if undershooting of nominal GDP is unavoidable), hold assets against the liabilities that it issues, and distribute its
earnings to the Treasury. The fact of such coordination on joint efforts to achieve a desirable equilibrium would in no way imply that the Treasury gets to dictate monetary policy, and so I don’t see it as raising moral hazard concerns. Indeed, it could be implemented by a central bank that commits itself to its policy (namely, use of monetary policy to achieve the nominal GDP target) regardless of what the fiscal authority does. I believe that the policy would be more certain of success (assuming an economy initially at the zero lower bound) if the fiscal authority were to cooperate, because success would not depend purely on the expectation channel; but it would be a sensible one for the central bank regardless.

**Question five: Adair, how do you respond to the concern that your proposal dangerously undermines central-bank independence?**

I absolutely agree that there are dangers in breaking a taboo by recognising that Outright Monetary Financing is possible: but I think there are ways to guard against that danger. And conversely, I think we should recognise that Michael’s proposal might also undermine appropriate fiscal discipline.

Michael and I both agree that optimal policy today requires closer coordination of monetary- and fiscal-policy actions. In his option the fiscal authority can increase the fiscal deficit, directly stimulating the economy, confident that there will be no crowding out offset, since it knows that the central bank, committed to a nominal-GDP target, will purchase and in all likelihood permanently keep much of that debt. But that in itself might endanger fiscal indiscipline; the fiscal authority might run increased fiscal deficits to a greater extent than reasonably justified by the nominal GDP target and by the likely permanent increase in the monetary base.

Under the Outright Monetary Financing approach that I propose, by contrast, the scale of money financed fiscal deficits would be clearly determined in advance by an independent central bank. The fiscal authority would decide how to spend the money (the balance between tax cuts and public expenditure): but the central bank would determine the amount of permanent money finance, consistent with an appropriate inflation or money GDP target. And it would do so as an independent central bank, and through the same decision making processes which govern the use of other monetary-policy tools.

*Editor’s note (as first lines of the body of the column): This column summarises a CEPR-London Business School debate between Adair Turner and Michael Woodford on this policy option chaired by Lucrezia Reichlin that was held in April 2013 at LBS.*

**References**


Woodford, M (2012), "Methods of Policy Accommodation at the Interest-Rate Lower Bound", speech at Jackson Hole Symposium, 20 August.
For quantitative evidence on the macroeconomic effects for the US see, amongst others, Khrishnamurthy and Vissing-Jorgensen, 2011. On ECB non-standard policies, see Lenza, Pill and Reichlin, 2010 and Giannone, Lenza, Pill and Reichlin, 2012.