Helicopter money and quantitative easing

It is thought can helicopter money could be a source of an inflation bias, leading to alterations in people's behaviour.With no quick escape in sight for Covid-ravaged economies, authorities the world over are going back to the drawing board to find strategies to deal with this nightmare. One such strategy doing the rounds is 'helicopter money'. It basically means non-repayable money transfer from the central bank to the government. It seeks to goad people into spending more and thereby boost the sagging economy. Here we attempt to answer a few relevant questions about helicopter money. What is helicopter money?This is an unconventional monetary policy tool aimed at bringing a flagging economy back on track. It involves printing large sums of money and distributing it to the public. American economist Milton Friedman coined this term. It basically denotes a helicopter dropping money from the sky. Friedman used the term to signify "unexpectedly dumping money onto a struggling economy with the intention to shock it out of a deep slump."Under such a policy, a central bank "directly increase the money supply and, via the government, distribute the new cash to the population with the aim of boosting demand and inflation." Why is helicopter money in news now?With the coronavirus-hit economy falling deeper and deeper into a chasm with each passing day, Telangana chief minister KC Rao today said helicopter money can help states comes out of this morass. He asked for the release of 5% funds from GDP by way of quantitative easing (QE).QE, a policy followed all over the world, is the only way to deal with the situation, Rao said. "To counter (economic crisis) this we need a strategic economic policy. RBI should implement quantitative easing policy. This is called Helicopter Money. This will facilitate the states and financial institutions to accrue funds. We can come out of the financial crisis. Release 5 percent of funds from the GDP through Quantitative Easing Policy," he suggested. Is helicopter money the same as quantitative easing?Quantitative easing also involves the use of printed money by central banks to buy government bonds. But not everyone views the money used in QE as helicopter money. It sure means printing money to monetise government deficits, but the govt has to pay back for the assets that the central bank buys.It's not the same as bond-buying by central banks "in which bank-owned assets are swapped for new central bank reserves."Helicopter money is also different from a central bank directly financing the debt of a government. Is Japan deploying helicopter money?According to some analysts, the yield curve control that Japan is resorting to is basically a type of helicopter money only. That is because this strategy lets the government spend more without having to worry about bond yields jumping.BoJ, however, rejects the allegation on the basis that the "BoJ still buys bonds from the market and does not directly underwrite debt from the government, something that could undermine confidence among investors."The line, however, is blurred as BoJ buys roughly the same or bigger amount of bonds issued by the government. (Catch all the Business News, Breaking News Events and Latest News Updates on The Economic Times.)Download The Economic Times News App to get Daily Market Updates & Live Business News. Willem Buiter () Economics - The Open-Access, Open-Assessment E-Journal, 2014, vol. 8, No 2014-28, 51 pages Abstract: The author provides a rigorous analysis of Milton Friedman's parable of the "helicopter" drop of money a permanent/irreversible increase in the nominal stock of fiat base money rate which respects the intertemporal budget constraint of the consolidated Central Bank and Treasury - the State. Examples are a temporary fiscal stimulus funded permanently through an increase in the stock of base money and permanent QE - an irreversible, monetized open market purchase by the Central Bank of non-monetary sovereign - debt. Three conditions must be satisfied for helicopter money always to boost aggregate demand. First, there must be benefits from holding fiat base money other than its pecuniary rate of return. Second, fiat base money is irredeemable - viewed as an asset by the holder but not as a liability by the issuer. Third, the price of money is positive. Given these three conditions, there always exists - even in a permanent liquidity trap - a combined monetary and fiscal policy action that boosts private demand - in principle without limit. Deflation, "lowflation" and secular stagnation are therefore unnecessary. They are policy choices. Keywords: Helicopter money; liquidity trap; seigniorage; secular stagnation; central bank; quantitative easing (search for similar items in EconPapers) JEL-codes: E2 E4 E5 E6 H6 (search for similar items in EconPapers) Date: 2014 References: View references in EconPapers View complete reference list from CitEc Citations: View citations in EconPapers (44) Track citations by RSS feed Downloads: (external link) //www.econstor.eu/bitstream/10419/100652/1/794107036.pdf (application/pdf) Related works:Working Paper: The Simple Analytics of Helicopter Money:Why It Works – Always (2014) Working Paper: The simple analytics of Helicopter money: Why it works - always (2014) This item may be available elsewhere in EconPapers: Search for items with the same title. Export reference: BibTeX RIS (EndNote, ProCite, RefMan) HTML/Text Persistent link: zbw:ifweej:201428 Access Statistics for this articleEconomics - The Open-Access, Open-Assessment E-Journal is currently edited by Dennis J. Snower More articles in Economics - The Open-Access, Open-Assessment E-Journal from Kiel Institute for the World Economy (IfW) Contact information at EDIRC.Bibliographic data for series maintained by ZBW - Leibniz Information Centre for Economics (). In times of hardship, it can seem like economies need a care package consisting of much-needed funding. That’s precisely what helicopter money aims to do.Helicopter money definitionHelicopter money, also known as a helicopter drop, was developed by economist Milton Friedman. It refers to a strategy for financial stimulus used in times of recession. The helicopter money theory is based on the idea that this form of stimulation impacts the economy as if an extra injection of cash had been dropped from a supply helicopter.When is helicopter money used?A helicopter drop is used during times of economic hardship, such as when interest rates hit zero or a recession strikes. Helicopter money aims to stimulate the economy, encouraging spending to help support businesses and bring some stability to the market.How does helicopter money work?There are several ways the helicopter money strategy can be used, including:Printing new money and distributing it to the publicIntroducing tax cutsHelicopter money is a concept, but the actual initiatives derived from the concept can take different forms. When it comes to recent uses of helicopter money, 2020 was a remarkable year. COVID-19 was a huge blow to the global economy and the much buzzed-about “stimulus checks” could be considered a variant on helicopter money, due to the fact that they’re distributed by the state (as opposed to the bank). Helicopter money in 2020 has also been a consideration in Europe, with Switzerland launching a referendum on an initiative to pay out 7,500 francs to every Swiss citizen.Is helicopter money bad?The helicopter money theory is not inherently bad, but some economists argue against its efficacy because once these extra funds are distributed, it’s hard to drain them again. That means that even if helicopter money works as intended, over the long-term it may still trigger inflation. There are lots of pros and cons of helicopter money to consider.Pros of helicopter money:There is no borrowing needed, so no extra debtDoes not impact interest rates through borrowingBoosts spending by increasing aggregate demandCons of helicopter money:Can lead to over inflationCan cause local currency to lose value, causing a knock-on effect on imports and productionIrreversibleQuantitative easing is a similar, more commonly used strategy for helping to stimulate economies.What is the difference between helicopter money and quantitative easing?A similar theory to helicopter money is quantitative easing, also known as QE. This is when the central bank of a country commits to buying financial assets like bonds from the government or banks. QE requires the central bank to create more money, either in physical or digital form, and therefore increase the balance sheet.By buying these assets, the supply of money increases and the cost of money is reduced. This leads to lower interest rates, helping banks offer better terms so people are encouraged to borrow and spend. However, QE does not always guarantee this outcome and in the worst-case scenario, economies suffer from stagflation – that is, a situation wherein inflation has occurred but not the hoped-for economic growth.QE is a method the U.S Federal Reserve has turned to in the wake of COVID-19, announcing a QE plan of more than $700 billion.We can helpGoCardless helps you automate payment collection, cutting down on the amount of admin your team needs to deal with when chasing invoices. Find out how GoCardless can help you with ad hoc payments or recurring payments. GoCardless is used by over 55,000 businesses around the world. Learn more about how you can improve payment processing at your business today.Learn moreSign UpRelated topicsFinance Stanislav Jourdan, head of Positive Money Europe, Brussels, fears a return of self-defeating austerity policies after Covid. Nevertheless, he does not consider a debt cut of European government bonds held by the ECB to be urgent. Nor does he contemplate a deep-freeze of these sovereign bonds by converting them into zero-coupon perpetual consols. Instead, he wants to lift the ban on the ECB contributing directly to financing government expenditure (as stipulated in Art. 123(1) TFEU). Of course, one can and should do both: deep-freeze government debt and rewrite Art 123 TFEU - while cancelling debt on a central-bank balance sheet in times of zero and negative interest isn’t urgent indeed and, besides, cannot neatly be done without extinguishing related central-bank liabilities too, that is, central-bank money on bank and treasury accounts). Who would want to be that silly? >> ECB debt cancellation: A last resort, not a first-best strategy. • The NGO Positive Money developed the approach of monetary financing as a debt-freeze substitute for conventional debt-funded Keynesian deficit spending. The proposal, prepared by Andrew Jackson, can be found in the brochure titled> Sovereign Money from page 16 onwards. In the meantime, Positive Money carried out a campaign > QE for People in the eurozone, more generally also referred to as > Public Money for the Public.E. Lonergan and St. Jourdan of Positive Money Europe have written a Policy Brief > Citizens' Monetary Dividend. Upgrading the ECB's Toolkit, Sep 2016. Deputy Governor of the Swedish Riksbank, Cecilia Skingsley, says > Helicopter money should be consideredRomain Baeriswyl of the Swiss National Bank makes > The Case for the Separation of Money and Credit by monetary lump-sum transfers from the central bank directly to citizens (in fact a citizens dividend). This is thought to be an effective instrument of CPI targeting. Adair Turner, last chairman of the UK Financial Services Authority, adopted the idea as overt money finance. In his opinion, helicopter money is no more risky than present QE > Printing money to fund deficit is the fastest way to raise rates, Financial Times, 10 Nov 2014.Frank van Lerven has gathered a number of impressive case studies when government-issued money decisively contributed to overcoming deep-seated recessions and depressions. He has also written > A Guide to Public Money Creation: Outlining the Alternatives to Quantitative Easing, Positive Money, 28 April 2016. An argument often made for helicopter money is that increasing the stock of money in circulation counters slow economic growth by stimulating economic activity. The theory goes that if there is more money circulating in the economy, people will have more to spend; this increased spending will encourage businesses to produce more, thus generating jobs. Increased spending may also raise inflation, which could result in a lower exchange rate, thus helping exporters. In a growing economy, money is created when banks lend, and destroyed when loans are repaid or cancelled: money creation typically slightly exceeds money destruction, so the total amount of money in circulation gradually increases in line with economic growth. If central banks add money directly to a growing economy, rather than relying on commercial banks to create money in response to demand for loans, they can trigger high inflation like that in the 1970s. But after a financial crisis—when economic growth slows or falls—the stock of money in the economy can fall rapidly as people pay off or default on loans and don’t replace that borrowing, just as banks hurt in the crisis tend to do less lending. The economists Milton Friedman and Anna Schwartz argued that it was this “debt deflationary” fall in the stock of money that caused the Great Depression.1 In the Great Recession of 2008-9 and thereafter, central banks heeded Friedman’s advice and used quantitative easing (QE) to add money to the economy, thus preventing a catastrophic fall in the quantity of money in circulation. However, some argue that the money created by QE does not go to people who will spend it productively. It goes to those who own financial assets, who are typically rich. Because rich people already have enough money to meet all their daily needs, their propensity to spend any additional money they are given on goods and services produced by businesses is very low. They are more likely to invest it in other financial assets, which may or may not result in increased business investment. Thus, increasing the money supply with QE may not have much effect on either inflation or exchange rates.2 Economists who advocate helicopter money in times of slow economic growth say that instead of relying on QE, central banks should give money directly to ordinary, middle-income citizens, because they are more likely to spend it on goods and services. This would encourage businesses to produce more, thus generating jobs and increasing both the incomes of workers and the returns to shareholders. It would also typically raise inflation and lower the currency exchange rate.3 In most countries, the central bank is an arm of government. Some economists observe, therefore, that helicopter money simply amounts to higher government spending. So, they argue, instead of distributing money to ordinary citizens, governments should increase their deficits in times of slow economic growth. If distribution of money in the economy needs to be skewed more toward those with a higher propensity to spend, the government can simply increase transfers to lower-income people and/or cut taxes for low- to middle-income people. The central bank could finance the ensuing increase in the government deficit by creating new money.4 However, central bank financing of government deficit spending has long been associated with extremely high inflation and currency exchange rate collapse. For example, in Venezuela, the central bank has been financing a rising government deficit. Venezuela’s currency exchange rate has collapsed, the country is experiencing hyperinflation and the government has defaulted on its external debt. As a result, Venezuela is in deep recession, and production has all but ceased.5 The experience of Venezuela, and previous hyperinflationary episodes in (among others) Germany, Hungary and Zimbabwe, is the reason why many fear central bank financing of government deficits. In many countries, including the United States, it is illegal.6 One-off drops of helicopter money to ordinary people by the central bank could be a way of increasing economic activity in the economy without risking the high inflation and currency exchange rate collapse associated with explicit monetization of a government deficit.7 It could also help ensure that monetary stimulus aimed at ordinary people is seen as temporary: tax cuts and transfer increases can be politically difficult to reverse.8 Helicopter money could also be a way of increasing purchasing power in the economy when the government lacks the fiscal space or the political will to increase spending. For example, in the Eurozone some countries are too highly indebted to increase spending, while others are unwilling to do so for political reasons. The economist Eric Lonergan argues that the European Central Bank (ECB) should stimulate the Eurozone economy by giving money directly to every citizen.9 Some economists argue that temporary monetary stimulus in the form of helicopter money would not be necessary if governments invested sufficiently, for example in public works, social housing and small businesses. They argue for large increases in government spending via state investment banks. In times of slow economic growth, central banks could buy the bonds issued by those banks as part of their QE programs.10 However, others say that as public investment is a long-term initiative, helicopter money would still be needed to address short-term variations in purchasing power due to economic shocks.11