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SAFE Finance Blog

Helicopter Money: a more equitable monetary policy

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Baptiste Massenot: Central banks decide on aid programs worth billions to mitigate the economic impact of the coronavirus pandemic. But how equitable are these measures?

To limit the economic damage associated with the current pandemic, the European Central Bank (ECB) recently decided to purchase 750 billion euros in corporate and government bonds, or around 2,200 euros per inhabitant of the euro area. Instead of buying bonds, why not transfer this money directly to the population, as proposed by Milton Friedman in 1969?

A single person would thus directly receive 2,200 euros, a family of four, 8,800 euros. A drop in the ocean for the wealthy, but a huge relief for the rest, many of whom struggle to make ends meet.

The poorest could finally make long overdue purchases, which would boost the economy. Economic

The poorest could finally make long overdue purchases, which would boost the economy. Economic studies suggest that households would spend more than half that amount in the following year (Fagereng et al., 2019 (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3235307)), representing a growth of the euro area economy of around 2%.

Furthermore, these households could finally escape from a scarcity mindset, to the benefit of their productivity and well-being (Shah et al., 2012 (https://science.sciencemag.org/content/338/6107/682)).

Similarly, the American government recently sent checks to most of its citizens. As a tool of monetary policy, however, helicopter money would not have to first go through lengthy political debates and would not increase public debt.

Finally, the higher demand would increase prices, helping central banks regain control over inflation, which remains stubbornly low in the eurozone and the United States despite massive efforts to stimulate it.

Are standard monetary policy tools unfair?

By purchasing bonds, central banks aim to stimulate the economy and inflation by preserving access to credit and by lowering interest rates.

Several groups benefit from such a policy. First, firms hire more workers, resulting in lower unemployment and higher wages. Second, some mortgage holders, those with adjustable rates or those who are able to refinance their mortgages, will benefit from lower monthly payments (Di Maggio et al., 2017 (https://pdfs.semanticscholar.org/2c1a/462e8eaa3dee14ad0414c3ca6a066a2abf00.pdf)). Finally, lower interest rates tend to increase house and stock prices, increasing the wealth of homeowners and stockholders.

Bond purchases, however, do not benefit several more disadvantaged groups. The unemployed who could not find a job are no better off. People for whom it would be unreasonable or impossible to borrow do not benefit either. By contrast, these groups would directly benefit from helicopter money.

To summarize, central banks can either favor some members of the middle and upper class by purchasing bonds or benefit everyone equally by using helicopter money.

Better access to credit relieves some households and businesses in the short term. However, this debt also jeopardizes their financial sustainability. When the monthly loan payments increase, events like losing a job or declining sales are more likely to lead to bankruptcy.

Several economic studies show that high indebtedness is one of the most reliable signs of the approach of a financial crisis and a recession (Schularick and Taylor, 2012; Jordà et al., 2013 (http://www.schmoelders-stiftung.de/wp-content/uploads/2016/04/Schularick_Taylor-2012.pdf)). With corporate debt already at historically high levels, stimulus policies based on bond purchases are all the more worrying.

These policies also seem to have reached their limits. Central banks can no longer lower short-term interest rates because they have reached their floor value.

Quantitative easing has also shown its limits over the past decade. Most of the monetary creation associated with quantitative easing has remained within the banks, in the form of excess reserves. Quantitative easing improves the financial health of banks and large companies, but the effects on employment and investment remain limited (Acharya et al., 2019 (https://academic.oup.com/rfs/article/32/9/3366/5298322)).

The inflation threat

What explains the reluctance of central banks to use helicopter money? Unlike traditional bond purchases that only temporarily increase the quantity of money in the economy, helicopter money permanently increases the quantity of money.

As a result, helicopter money frightens and remains a taboo because it reminds of the hyperinflation episodes experienced by Weimar Germany or Venezuela today.

There is indeed a danger of overusing helicopter money and making inflation explode. This measure should thus remain limited in time and in scope, to keep inflation at reasonable levels.

Furthermore, traditional monetary policy tools should be kept at hand. If inflation gets out of control, central banks could contain it by increasing the interest rate on their deposit facility or by selling some of their bonds.

In spite of these caveats, helicopter money offers a unique opportunity to make monetary policy more equitable and to regain control over inflation.

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