Could 'helicopter money' help Europe's economy take flight?

Weekly Market Compass: If governments aren't willing to enact fiscal stimulus, central banks may need to consider more hands-on ways to promote spending

Sep 16, 2019 | Kristina Hooper, Chief Global Market Strategist

Last week, the European Central Bank (ECB) decided to take a significant step away from normalization and toward more accommodation. It cut the deposit facility rate by 0.1% to a level of -0.5% (the first time the deposit rate has changed since 2016) and announced a re-ignition of quantitative easing (QE).[1] The ECB will begin purchasing €20 billion worth of assets each month beginning in November – less than a year after QE tapering ended in December 2018 – and running "for as long as necessary."[1] The ECB also said that the key interest rates will remain at the level they are now until inflation hits 2% – which is essentially committing incoming ECB president Christine Lagarde to negative rates (although this is not set in stone and could obviously change). It is worth noting that Draghi revealed serious disagreements among ECB Governing Council members.

This past week I spent in Europe, meeting with clients in five different cities around the continent. It was an opportune time to be there, given the ECB decision. So many clients asked about the ECB and why it was continuing to use tools that it had seemingly exhausted. They talked about all the negative implications of a negative interest rate policy and wondered how long it could go on. They asked about QE and how long it would take before the ECB might be forced to enlarge the scope of assets it purchases – such as stock exchange-traded funds (ETFs) and real estate investment trusts, which the Bank of Japan has been doing for years. We also talked about the market distortions created by current monetary policy – how it has had a bigger impact on asset prices than the economy, in my view, which in turn has exacerbated wealth inequality and helped fuel the populist movements that have been on the rise in the last several years.

ECB President Mario Draghi made it clear last week that governments need to step up fiscal stimulus because that's what is really needed right now. As he explained, "It is high time for the fiscal policy to take charge."[2] And that served as a call to action to the European Commission finance ministers, who were meeting last Friday in Helsinki. Fiscal stimulus was seriously discussed, and it seems that they are moving toward a willingness to loosen purse strings. Having said that, there are some central bankers who believe that the ECB's decision last week was unnecessary, including the head of Germany's Bundesbank, which raises the question of whether some government leaders feel the same way. So what if European governments choose not to fiscally stimulate – or at least not stimulate adequately? This is a particularly relevant question to ask given that the European Monetary Union is a monetary union but not a fiscal union.

Could 'helicopter money' benefit the economy?

This raises the question of whether very experimental monetary policy, such as helicopter money, could become a serious topic for debate among central bankers and policy experts. By way of background, helicopter money was a term coined by economist Milton Friedman in 1969 to describe the concept of central banks dropping money into an economy. Helicopter money, at its most basic, is the printing of money by central banks (without taking on any additional debt) to then be spent on government programs or given directly to individuals.

Ben Bernanke revisited the concept of helicopter money in 2002 as a way to prevent deflation. And Irish economist Eric Lonergan wrote an editorial in The Financial Times arguing that central banks consider helicopter money (specifically, cash transfers to households) as an alternative to cutting interest rates. This is why helicopter money is also referred to as "quantitative easing for the people." The concept of helicopter money was covered in a recent book by Adair Turner titled Between Debt and the Devil – Money, Credit and Fixing Global Finance.

While helicopter money started as an abstract economic theory, it moved closer to the forefront of conversation when it was mentioned during an ECB press conference in early 2016. Specifically, when Draghi was then asked about helicopter money, he did not immediately dismiss it outright. Instead he said it was "a very interesting concept," although he admitted the ECB had not "really studied yet the concept."[3] At last week's ECB meeting, Draghi was again asked about helicopter money, and he explained, "All these innovations in monetary policy need to be looked at and studied and thought over. These are big changes in the way monetary policy works, and we have not discussed this. These may be part of the future strategic review, but at this point the Governing Council never discussed" them.[4] Draghi also shared his personal view that giving money to people is a fiscal task, not a monetary policy task.

Ironically, I believe helicopter money may make more sense than other monetary policies because it simulates fiscal policy. Keep in mind that monetary policy acts more like a blunt instrument, not a surgical tool. Central banks can inject liquidity into the economy and lower interest rates, but they can't ensure that people actually spend the money, thereby enabling the economy to grow. In other words, monetary policy is like bringing the proverbial horse to water – you can't make it drink. But helicopter money is different – central banks may be able to make the horse drink by actually spending the money on projects that could boost the economy, such as infrastructure, or by depositing money in citizens' bank accounts with an expiration date, so they are forced to spend it. Helicopter money may be the most surgical tool-like portion of monetary policy.

Central banks could step in where governments fear to tread

There clearly has been a reluctance on the part of many governments to enact adequate fiscal stimulus, especially in Europe. Perhaps this will change in Europe in the near future. But if it doesn't, helicopter money may become part of the ECB's strategic review in the future.

John Maynard Keynes, the late British economist, argued that when there is a drop in spending from consumers or businesses, the government must step in and spend more in order to maintain the same level of aggregate demand — and therefore prevent unemployment. If the government will not step in, perhaps central banks should.

An excellent example of fiscal stimulus can be found in infrastructure spending, which is often considered the most effective form of fiscal policy in terms of its impact on the economy. The US Congressional Budget Office estimates that infrastructure spending has a 1.8 multiplier effect. In other words, every dollar spent on infrastructure produces $1.80 in economic benefits.[5] And infrastructure spending, as we saw in the 1930s, can result in a ripple effect. As buildings, bridges, and roadways are built or repaired, they can then enable greater commercial movement and trade. If governments are unable or unwilling to pass an infrastructure spending package, perhaps that responsibility will be shouldered by a central bank.

Spender of last resort

Helicopter money is not a magic fix, and some economists worry that it could result in higher inflation. In some countries such as the US, there is growing public disapproval of unconventional central bank actions given that central banks are not directly accountable to the people. In addition, central bank helicopter spending could violate existing laws — particularly because it would be bypassing legislative bodies in order to spend.

As central banks hopefully consider new and experimental tools to boost growth, helicopter money stands out for its potential to more directly and powerfully impact the economy. While it certainly has its drawbacks, the concept of becoming a "spender of last resort" may be worth consideration by central banks such as the ECB.

Source

[1]Source: European Central Bank (ECB), Sept. 12, 2019

[2]Source: Reuters, "Draghi ties Lagarde's hands with promise of indefinite stimulus," Sept. 11, 2019

[3]Source: CNBC, "ECB's Draghi: We haven't talked about helicopter money," April 21, 2016

[4]Source: ECB press conference, Sept. 12, 2019

[5]Source: Economic Policy Institute, "The Short- and Long-Term Impact of Infrastructure Investments on Employment and Economic Activity in the U.S. Economy," Josh Bivins, 2014

Important information

Blog header image: Adam Muise / Unsplash

Quantitative easing (QE) is a monetary policy used by central banks to stimulate the economy when standard monetary policy has become ineffective.

The deposit facility rate is set by the ECB as part of its monetary policy. It defines the interest banks receive for depositing money with the central bank overnight.

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