Helicopter money: Why some economists are talking about dropping money from the sky

By Neil Irwin
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For years, central banks have been doing everything they can think of to try to get higher inflation and stronger growth. The next step just may be a metaphorical helicopter, high above Tokyo. The Bank of Japan met Friday to decide on the next steps in its long battle against deflation, or falling prices, and analysts had thought it might pursue some coordinated effort with the Japanese government using an idea with a long historical lineage.

"Helicopter money" is the term economists and market-watchers use for an aggressive form of monetary stimulus — the government's power to print money — to try to spur growth and get inflation higher. There had been buzz that the Bank of Japan could move in that direction, but it elected to take only a smaller action. The bank did say it would do a "comprehensive review" of policy in the months to come that could presage more coordination between the bank and the Japanese government.

It is an idea based on a metaphor used by the renowned economist Milton Friedman nearly five decades ago and given new life in this century by Ben Bernanke. It is also a policy that has echoes of some of the great catastrophes of economic history. And regardless of what, if anything, the Japanese central bank does this fall, if the global economy's deflationary doldrums continue, expect the discussion around these metaphorical helicopters to get louder. They say desperate times demand desperate measures. Helicopter money is what monetary policy desperation looks like.

What is helicopter money?

Normally when we say that a central bank like the Federal Reserve or European Central Bank creates money from thin air, it does so by buying up bonds or other assets from banks using money that is just an electronic accounting entry. Banks then spread money through the economy.

But what if those mechanisms aren't effective for some reason (the banking system isn't working well, for example), and the central bank wants to get money circulating through the economy anyway?

That was the thought experiment that Mr. Friedman dealt with in a 1969 paper titled "The Optimum Quantity of Money." He offered this intentionally absurd hypothetical: "Let us suppose now that one day a helicopter flies over this community and drops an additional $1,000 in bills from the sky, which is, of course, hastily collected by members of the community."

More money floating around, used to chase the same amount of goods and services, would inevitably cause prices to rise — in other words, it would bring about higher inflation.

Wait, why would anybody want higher inflation?

Deflation, or falling prices, can be deeply damaging to an economy, and Mr. Friedman's influential analysis of how the Great Depression happened focused on it primarily as a monetary phenomenon. He argued that central banks failed to supply enough money and thus allowed devastating deflation to take hold.

When prices are falling, it makes consumers and businesses reluctant to spend because anything they want to buy is cheaper tomorrow. It makes debt more onerous because you have to pay it back with money that will

be more valuable the next day. These conditions can fuel a vicious spiral: Economic weakness creates falling prices, which create more economic weakness.

Arguably, much of the advanced world — especially Japan and the eurozone — is experiencing a mild version of this right now, and the Bank of Japan and the European Central Bank have been deploying a series of increasingly aggressive tools to try to reverse it.

The Bank of Japan, for example, has pledged to do whatever it takes to get inflation up to its 2 percent target. It has bought a trillion or so yen in assets to try to make it happen, but instead a key price measure fell 0.4 percent in the year ended in May.

The question now is whether some form of helicopter money is the next step in trying to achieve that goal.

So would a central bank really drop money out of a helicopter?

No! It's a metaphor.

As Ben Bernanke famously argued in a 2002 speech, when he was a Fed governor, if a central bank created money out of thin air and gave it to the government, and the government cut taxes or mailed a check to every citizen, it would on substantive grounds amount to the same thing as Mr. Friedman's mythical helicopter drop.

(Mr. Bernanke ignored a Fed press officer's recommendation that he not use the "helicopter" reference in the speech, according to his memoir, for fear it would seem too flippant. Sure enough, it earned him the nickname Helicopter Ben from his critics. This is a prime example of why central bankers so rarely use colorful language).

But how is that different from what the central banks have been doing for years now with their quantitative easing policies?

There's a crucial difference. The Q.E. policies have indeed consisted of central banks using money created from thin air to buy government bonds. That is, in effect, printing money to fund government deficits.

But with Q.E., the central banks buy assets that the government has to pay back. The Fed, for example, has $2.5 trillion in Treasury securities on its balance sheet, but as they mature the government has to repay the money. Of course the Fed could then plow that money back into new bonds, but that will depend on its assessment of whether or not it is time to withdraw money from the economy.

By contrast, the versions of helicopter money that analysts have discussed for Japan and other countries dealing with a deflation trap involve a different type of transaction. A key possibility: The government issues a "perpetual" bond with a 0 percent interest rate, which the central bank buys and promises to hold onto forever.

That may sound technical. Think of it this way: Quantitative easing is akin to your rich uncle making you a loan under favorable terms, but making it clear you'll have to make interest payments and then pay the money back one day. Helicopter money is what happens if your rich uncle makes you a "loan," but says that you don't have to pay any interest and never have to pay it back. For practical purposes it's more gift than loan, whatever the bookkeeping technically says.

And just as you're more likely to spend the money your uncle gives you with abandon in the second situation than in the first, so a government will be more likely to spread money around.

Indeed, if you want to be liberal with your definitions, you could argue that the United States experienced a form of helicopter money in 2009, when the Fed was doing quantitative easing and Congress enacted a fiscal stimulus package that, among other things, temporarily

reduced payroll taxes. But that doesn't fit the classic definition. That's because, while the Q.E. program probably reduced interest rates and boosted stock prices in 2009, it was still acquiring bonds that the government would need to repay in one way or another.

Why do you keep talking about what the government can do? I thought we were talking about the central bank itself.

Modern democracies have a division of power. Central banks are walled off from day-to-day political concerns and granted authority over the money supply. They can buy and sell assets to try to maintain stable inflation and growth. But only democratic institutions like Congress and parliaments have the power to spend money outright.

This was a common misunderstanding during the era of bank bailouts in 2008 and Q.E. The Fed wasn't spending money in the conventional sense, but rather buying assets that would earn some market-determined return and be sold (or allowed to mature) when the Fed judged it appropriate.

But for some form of helicopter money to work, there would need to be some form of spending — such as public works, mass distribution of funds to citizens or tax cuts — that would amount to the government continuing its normal government spending without either raising taxes to pay for it or increasing public debt.

Some have proposed that central banks be granted the authority to distribute money directly to citizens, but that is very likely illegal now in most countries, and changing laws would grant further power to unelected bodies that are already extremely powerful.

But nothing is stopping elected representatives from coordinating with their central banker in a two-step process in which the central bank creates money and the democratic institutions spend it.

So why hasn't anyone done this yet?

It's potentially risky, and there are some technical complications to carrying it out.

Printing money from thin air to fund government spending doesn't have a sterling history. It is what happened in Weimar Germany in the early 1920s, when hyperinflation ran rampant. It is what happened in Zimbabwe in the first part of this century. And it is happening in Venezuela right now.

These examples show how easily things can spiral out of control when a government finances itself using its ability to create money. After all, when money-printing boosts inflation, it tends to also increase interest rates and hence borrowing costs. Then, the government may need yet more newly printed money to fund itself the next year, and so on.

The consequences when things do spiral out of control are stark. Money loses its role as a store of value, and commerce can grind to a halt. The International Monetary Fund projects Venezuela will have inflation of 481 percent this year and 1,642 percent next year. At one point, a 100 trillion Zimbabwe dollar bill reportedly wasn't enough to buy a bus ticket in the country's capital.

The advanced economies have spent decades writing laws and building traditions to keep things like that from happening. And one of those core principles is that central banks should remain independent from politics and not fund the government with money-printing.

The discussion of helicopter money boils down to whether the deflationary cycle in advanced economies like Japan is sufficiently problematic that they should abandon some of those traditions to try to jolt economies into a higher-performing level.

And even if officials decide it's justified, there are some technical reasons that the way central banks work in 2016 — influencing the money

supply by setting a target interest rate — could reduce or eliminate the effectiveness of any Q.E. program. (Mr. Bernanke explained that concern in a recent blog post).

So is it going to happen?

Never say never. A decade ago, no one could have imagined that major central banks would deploy large-scale quantitative easing or negative interest rates, but that is the world we are living in.

In Japan, analysts think it is more likely there will be a combination of new fiscal stimulus from the government paired with yet more Q.E. from the central bank, perhaps explicitly coordinated in some way. That amounts to a soft form of the policy.

Even with that, there is an open question of how much it really differs from policies that are already in place, like open-ended bond buying by the central bank combined with fiscal stimulus combined with pledges to keep going with both until inflation rises. Some of the "helicopter money" discussion, in a modern context, is as much about communication as the underlying economics.

But whatever the Japanese central bank does, it is a safe bet that its counterparts in Europe and the United States will be watching very carefully, looking for signals of whether some form of helicopter money belongs in the arsenal for responding to the next downturn in the West.