The Case Against Helicopter Money

By Michael Heise   *Thu, Apr 21, 2016*

'Distributing largesse financed by the central bank would have dangerous systemic consequences in the long run,' writes the chief economist of Allianz SE.

Despite years of expansionary monetary policy, the European Central Bank has failed to push inflation back up to its target of “below but close to 2%.” The latest measures—a zero interest rate on the ECB’s main refinancing operations, an increase in monthly asset purchases from €60 billion ($67 billion) to €80 billion, and an even lower deposit rate of -0.40%–are unlikely to change this. That is why some economists are urging the ECB to go even further, with so-called “helicopter drops” – that is, financing private consumption by printing money.

The idea of helicopter money dates back to the monetarism debates of the 1960s. A central bank, it was argued, never runs out of options for stimulating aggregate demand and stoking inflation, provided it is willing to resort to radical measures. But what was once a theoretical notion now seems to be a concrete possibility.

In practice, helicopter drops would arrive in the form of lump-sum payments to households or consumption vouchers for everybody, funded exclusively by central banks. Governments or commercial banks distributing the money would be credited with a deposit or be given cash, but no claim would be created on the left-hand side of the central bank’s balance sheet.

This type of single accounting would reduce the central bank’s equity capital, unless it realized (sold) valuation reserves on its balance sheet. Proponents defend this approach by claiming that central banks are subject to special accounting rules that could be adjusted as needed.

The proponents of helicopter drops today include some eminent figures, including former US Federal Reserve Chair Ben Bernanke and Adair Turner, former head of the United Kingdom’s Financial Services Authority. And while ECB President Mario Draghi has highlighted the technical, legal, and accounting obstacles that stand in the way of helicopter drops by his institution, he has not ruled them out.

The question now is: Is such an extreme step really justified?

The answer is no. While helicopter drops are a viable policy option if deflation is spiraling downward, as it was in the late 1920s and early 1930s, that is not the case today—neither in the eurozone nor in the global economy.

True, demand growth is subdued, reflecting the lingering fallout from the global financial crisis that erupted in 2008. Banks, firms, and households are still cleaning up their balance sheets and working off the heaps of debt they amassed during the credit boom that preceded the bust. But they have already made significant progress, meaning that the drag on growth is set to diminish.

Consumers today are not holding back on spending because they expect goods and services to become cheaper, as one would expect during a period of deflation. Instead, they are gradually increasing their spending, taking advantage of restored income growth and large gains in purchasing power caused by collapsing oil and commodity prices. As a result, most advanced economies are once again producing at close to capacity.

Data on corporate profits also contradict the view that we are mired in deflation. Price stability has not put profit margins under pressure. On the contrary, in many advanced economies, profits are high—even reaching record levels—owing partly to lower input costs.

In this environment, distributing largesse financed by the central bank would have dangerous systemic consequences in the long run, because it would create perverse incentives for everyone involved. Policymakers would be tempted to resort to helicopter money whenever growth was not as strong as they would like, instead of implementing difficult structural reforms that address the underlying causes of weak economic performance.

All of this would raise expectations among financial-market actors that central banks and governments would always step in to smooth out credit bubbles and mitigate their consequences, even if that meant accumulating more debt. These actors' risk perception would thus be distorted, and the role of risk premiums would be diminished.

Add to that the impact of the depletion of valuation reserves and the risk of negative equity—developments that could undermine the credibility of central banks and thus of currencies—and it seems clear that helicopter drops should, at least for now, remain firmly in the realm of academic debate.

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