Helicopter money: The time is now

Jordi Galí 17 March 2020

The measures many countries are taking to contain the spread of coronavirus, while necessary, are bound to have a direct impact on the economy. This column argues that rather than raising taxes and/or increasing government debt to finance the necessary fiscal programmes, the time has come for 'helicopter money' – direct, unrepayable funding by the central bank of the additional fiscal transfers deemed necessary.

The rapid spread of the coronavirus in many countries constitutes a major challenge to their health systems. Under all realistic scenarios, an overwhelming number of human lives will be lost, partly as a result of the inability to provide proper intensive care to all patients that need it. This has led many governments to attempt to slow down the rate of infection through a number of measures, including home confinement, travel restrictions, closing of restaurants and theatres, suspension of sports events, and so on.

Those measures, while necessary, are bound to have a direct impact on the economy, operating through different channels.[1]

- First, they will have a direct effect on production and sales in many sectors, where activity will collapse partly or completely during the emergency, either as a result of supply disruption (due to the unavailability of inputs, labour or otherwise) or a fall in demand (due to the forced change in consumption patterns resulting from health-related measures).

A direct loss of GDP is thus unavoidable, given the path of action required to contain the spread of the virus. And if prolonged by more than one or two months, it is bound to result in a cumulative loss of output similar to or larger than that experienced during the last financial crisis.

That direct loss of GDP, which will be largely reflected in a decline in the consumption of goods and services during the health crisis, will be painful but relatively bearable. Unfortunately, that direct cost may be amplified by the presence of indirect effects if the fall in output leads to a significant reduction in employment (with the consequent loss of income and consumption). Alternatively, firms may try to keep their payroll unchanged and keep meeting other fixed expenses (e.g. rent, interest) during the inactivity period, by taking loans from banks. But banks may be reluctant to extend those loans, given the probability of default and the likely deterioration underway in their balance sheets. In the case banks went ahead and provided that additional funding, the resulting increase in firms' indebtedness would weaken their balance sheets permanently and may cause – sooner or later – a wave of bankruptcies or, in the best case, a highly deteriorated balance sheet.

A swift and well targeted policy response that is commensurate to the size of the challenge is needed to minimise the indirect (and likely more persistent) economic effects of the coronavirus crisis. One approach would be for governments to step in and provide affected firms (and self-employed workers) with the funds to keep meeting their payroll and unavoidable expenses, without raising their financial liabilities. That assistance would ideally take the form of a (non-repayable) transfer during the period of forced inactivity. A component of that net transfer should consist of

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immediate (and permanent) tax relief.

Unfortunately, such a strategy would only transfer the problem to governments, which would need to raise taxes (thus increasing the burden of households or firms, counterproductively) or to borrow in capital markets and increase their debt burdens (and be forced to raise taxes in the future).[2] Even if the EU were to relax the restrictions on that further borrowing, it would be a risky strategy given the high debt ratios (above 100% of GDP in some cases) in many of the most affected countries, with the consequent risks of a debt crisis and an immediate rise in spreads.

An eventual massive purchase of the newly issued debt by the central bank through an expanded quantitative easing programme would certainly facilitate its absorption but would not prevent the increase in governments' debt ratios, with the risks of putting some countries' public finances on an unsustainable path.

> "There is an alternative … direct, unrepayable funding by the central bank of the additional fiscal transfers deemed necessary, an intervention commonly known as 'helicopter money'"

Fortunately, there is an alternative to a strategy based on higher taxes and/or more government debt in order to finance such an emergency fiscal programme, albeit one that has remained a taboo among most economists and policymakers – namely, direct, unrepayable funding by the central bank of the additional fiscal transfers deemed necessary, an intervention commonly known as 'helicopter money'.[3]

Central banks have the ability to create money in the form of currency or, more relevantly, a credit to an account held at the central bank. In the typical arrangement, only banks and governments hold an account at the central bank. In the current context, the central bank could credit the government's account (or governments, in the case of the ECB) for the amount of the additional transfers and for the duration of the programme. That credit would not be repayable, i.e. it would amount to a transfer from the central bank to the government. From an accounting viewpoint, it would be captured by a reduction in the central bank's capital or by a permanent annotation on the asset side of its balance sheet. Thus, it should not have an impact by itself on the central bank's profits which are periodically transferred to the government, especially if the interest rate on reserves were to remain at zero. Note that such a transfer from the central bank to the government would be equivalent to a commensurate purchase of government debt by the central bank, followed by its immediate writing-off, thus no longer having an impact on the government's effective debt liabilities.[4]

> "Money-financed fiscal interventions are a powerful tool … policymakers should resort to them only in emergency situations … Unfortunately, that emergency is currently upon us … If ever, the time for helicopter money is now."

The money-financed fiscal intervention described above raises a number of issues.

- First, it is clear that there are numerous practical implementation challenges in adopting such a policy, including the need to determine (quickly) the size of transfer to which each firm would be entitled.

But those problems seem of second order relative to the macroeconomic challenge facing many countries, and they can be surmounted with sufficient political determination.

- Second, such an intervention is likely to be considered illegal in many jurisdictions.

In particular, the fact that monetary policy is (at least temporarily) driven by the requirements of the fiscal authority may be perceived as an outright violation of the principle of central bank independence. But we have seen many occasions in which rules that were considered sacred have been relaxed in the face of extraordinary circumstances (such as the ECB's decision to buy government debt during the European debt crisis). Furthermore, the central bank could agree to participate voluntarily in such a scheme, thus preserving its formal independence.

- Finally, and legal issues aside, it is clear that a recurrent use of such policies by governments

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could be a source of an inflation bias and bring about changes in individual behaviour likely to undermine their effectiveness.

But this should not be a concern in the current context, since the reliance on money financing would be strictly restricted to the duration of the emergency measures linked to the health crisis. This is a commitment for which fulfilment can always be guaranteed by the central bank, which would put its reputation at stake.

Concluding remarks

Money-financed fiscal interventions are a powerful tool. The caveats mentioned above suggest that policymakers should resort to them only in emergency situations, when other options are bound to be ineffective or trigger undesirable consequences, current or future (e.g. a debt crisis down the road). Unfortunately, that emergency is currently upon us, provoked by the coronavirus. If ever, the time for helicopter money is now.

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Endnotes

1 See Baldwin (2020), Benassy-Quere et al. (2020) and Gourinchas (2020) for a related discussion of the macroeconomic consequences of the health crisis, with somewhat different policy recommendations.

2 A massive debt-financed fiscal stimulus at the European level is the solution proposed in e.g. Benassy-Quere et al. (2020) and Gourinchas (2020).

3 See Gali (2020) for a formal analysis of money-financed fiscal stimuli.

4 An alternative approach, proposed by Paris and Wyplosz (2014) in the aftermath of the European debt crisis (and referred to as PADRE), would involve the conversion of ECB government debt holdings into zero interest perpetuities to be held permanently on the balance sheet, in exchange for a permanent reduction in the transfer of ECB profits to governments in proportion to the effective debt cancellation. Such a debt restructuring would generate sufficient fiscal space to allow governments to run large fiscal deficits if needed without the risk of triggering a debt crisis.

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