

Central bankers should not fly helicopters

Helicopter money was never intended to be taken as a credible policy move. So it's worrying that the idea is gaining ground

> Helicopter money will never fly. Excuse the pun. You might have heard some commentators talking about it, but what is it? Helicopter money was first introduced as a thought experiment by monetary economist and Nobel laureate Milton Friedman in 1969 to illustrate the potential inflationary impacts of monetary policy. Though Friedman never intended the idea as a serious policy proposal, worryingly, helicopter money has become vogue in some circles as the panacea to deliver developed world economies from their growth fatigue and *lowflation*. But as Friedman pointed out, "there is no such thing as a free lunch".

The principle of helicopter money is straightforward. The central bank creates new money, and rather than buying assets in order to introduce the cash into the economy, as it normally would, the central bank transfers the money to economic agents without exchanging any assets, as if throwing the money from a helicopter.

Proponents of helicopter money say the easiest way to pull it off would be to finance a one-time tax cut or increase government spending. The government would act like a middle man, facilitating the transfer of cash from the central bank to the private sector. Unlike normal fiscal expansions, the government need not issue any bonds with a helicopter drop. Public deficits and debt would remain unchanged.

Private businesses and households would invest and spend the windfall, stimulating aggregate demand, generating growth and a rise in inflation. In essence, the 'drop' facilitates a fiscal expansion that would never have to be paid back. Sounds like a free lunch? It isn't.

> There are several important reasons why helicopter money is a very bad idea. First, it would, in effect, re-politicise central banks that had gained independence and credibility during



Helicopter money would seriously risk creating excess inflation

recent decades – the independence that helps prevent governments from tinkering with monetary policy for political purposes. Crossing the line between monetary policy and fiscal policy seriously risks undermining the hard-won credibility of central banks. Second, monetisation of fiscal spending would be hard to reverse. Government debt is the primary asset central banks buy and sell in order to conduct normal operations. Without the corresponding assets on the balance sheet, the central bank might find itself short of assets to sell to the market in order to mop up any excess money in the economy in the future.

Third, helicopter money would seriously risk creating excess inflation. Arbitrarily increasing demand without increasing supply is a recipe for higher prices. History paints a clear picture. Excessive inflation is far more likely than excessive deflation. Given a choice between either today's world of high employment, slow-ish growth and low inflation, or a 1970s world of rapid inflation and high unemployment, the former is surely better.

More importantly, extreme policies should only be considered when other policy measures are not available or possible. First and foremost, across the developed world, monetary policy is already ultra easy. Thanks to the relaxed policies of central banks in the US, the eurozone, Japan and the UK, the rule of the day in markets is 'no news is good news'. Markets are awash with central bank liquidity and could easily lend more to the real economy without much hindrance if economic participants demanded loans.

Most developed world economies are growing at trend. For non-monetary reasons, potential growth has slowed over the past decade. In the developed world, ageing populations, gross imbalances within and between economies, and a lack of serious supply-side reform are preventing a stronger expansion. Growth is less vigorous than before, and in conjunction with a weaker appetite for debt after the Lehman lesson, inflationary pressures have weakened.

Monetary policy cannot, no matter how drastic the effort, increase the size of the engine that drives an economy. Only other non-monetary policy measures can do that. Central banks have powerful tools at their disposal. Used properly, they can help economies recover smoothly. Used improperly, as history reminds us, they can devastate economies. Helicopter money would be a dangerous step towards the latter. ♥



Kallum Pickering is senior UK economist at Berenberg Bank

IKON IMAGES