Social Europe

Helicopter Money: An Old Novelty

by Marcello Minenna on 17 May 2016 @MarcelloMinenna

Times have surely changed: as little as three years ago, Quantitative Easing was considered a remote hypothesis, EU inflation was well over 2% and only a small fraction of "heretics" (including myself) dared to discuss "helicopter money" as a measure to revive the economy.

The "money from helicopters", dubbed complete madness by Milton Friedman from 1948, has been a taboo for a long time in European economic thought – especially in German circles. Today, after Mario Draghi called the idea "very interesting" during the ECB meeting of the 10th of March, the issue has become a hot potato and the German finance minister Wolfgang Schäuble has entered into conflict with the ECB.

All that clamor seems unjustified if, from a historical perspective, one thinks that printing money has been the main activity of every central bank since the 18th century. Until the counter-revolution of monetarist theory in the 1970s, a strict relationship tied together governments and their central banks; helicopter money was mainly known under the more prosaic name of "monetary financing". Here in plain words is how it worked: a government would borrow funds from the markets by issuing bonds; the central bank would intervene to purchase the unsold issues by releasing freshly printed money.

This new money would enter into circulation via public wages, salaries and pensions as well as through public investment in infrastructure: highways, hospitals and social housing, etc. Among developed countries, the phenomenon has been significant in the US and also in Italy. In the 1970s the Bank of Italy held over 35% of national public debt on its balance sheet. Just to put the sheer scale of that debt holding in perspective: the Bank of Italy now holds less than 8%, even accounting for its QE purchases (€130bn as at 30 April 2016).

At the end of the 1970s the Italian government was merrily running up deficits of the order of 8% of GDP each year; in 1976 the Bank of Italy bought over two-thirds of the bonds issued by the government. This corresponded to a huge increase in the monetary mass that contributed, together with the oil shocks of 1973-1979 and the wages indexation to prices, to a sky-rocketing rate of inflation (over 20% in 1979). High inflation, a weaker currency and higher interest rates characterized the Italian economy in the late 1970s.

The turning point came in 1979 when the disputed entry of Italy into the European Monetary System (EMS) forced the authorities to impose harsh controls on the exchange rate via an accelerated cut in inflation. Significant pressures from the EU were behind the famous "divorce" between the Bank of Italy and the Italian government that halted the central bank's purchases of government bonds on the primary market. After 1981 the public debt held by the Bank dropped rapidly to "European" levels (under 10%).

The deficit run by the Italian government, however, did not decrease during the 1980s. The debt that was not monetized anymore by the Bank of Italy piled up very fast from the relatively reasonable value of 60% of GDP in 1980 to a shocking 120% of GDP in 1990: it doubled in a decade.

Hence, it can be inferred that the taboo on helicopter money is rooted in the establishment of the EMS. Monetary financing, by affecting the inflation rate, has an inherent devaluing effect on a country's currency. This would have harmed the stability of European exchange rates and this should be avoided at all costs.

The strict prohibition on monetary financing etched into article no. 123 on the Treaty on the Functioning of the European Union and in article no. 21 of ECB statute has to be read in this perspective. Now that deflation is a force that shapes the global economy, the anachronistic nature of this architecture is self-evident. In the USA the ban on monetary financing is, pragmatically, not written in the FED statute and in Japan it is less stringent, since it is written at the level of primary law. With a clear political consensus in these countries both laws and praxis can be changed very quickly.

In my previous research I've proposed to transfer up to 40% of Eurozone debt to the ECB. The debt would then be cancelled in proportion to the GDP of the member countries, in such a way that the biggest countries (such Germany) would benefit more from the monetization. The debt forgiveness would be the last logical step of the economic policy, never realized, of risk-sharing within the monetary union. A full risk-sharing approach should prompt a revision of ECB objectives: the ECB should target not only the inflation rate, but also unemployment and the spread between government bond rates. Obviously, I'm perfectly aware that heavy amendments to European Treaties would be required – and that has little chance in the current EU political environment.

Paradoxically, EU Treaties do not prohibit unusual forms of helicopter money, such as a direct money transfer from the ECB to enterprises and households. I'm in no doubt that an *una tantum* (one-off) intervention of this kind could be arranged and could give a boost to private consumption. It has been done before: in 2008 the US government transferred a check of around $1000 to households in the form of *tax rebates*, financed with the issue of debt that was purchased afterwards by the FED.

However, the right path towards a growth revival should envisage a policy of massive investment in infrastructure and in companies' capital. In other words, it would be desirable for a monetary transfer to the EIB (European Investment Bank) to be engineered through the issue of perpetual bonds at zero interest rate. Although these bonds would have effectively a net value of zero (being unredeemable and paying no interest) and the entire operation would be comparable to monetary financing, this idea could have a reasonable room for maneuver in terms of legal feasibility. In this way the original Juncker plan could be rebooted up to €1 trillion, to be invested mainly in the countries that need it most.

Anyway, it has to be acknowledged that the rigid position recently taken by Schäuble does not bode well for an early lift-off of the ECB/EIB helicopters to rescue the Eurozone economy.