**COVID-19 emergency package – helicopters to the rescue**

Geoff Bertram

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## Time to power up the helicopters

The New Zealand Government has embarked on a major programme of fiscal spending to support family incomes and purchasing power, while simultaneously keeping businesses afloat and workers connected to their jobs.

The cost of this programme of additional fiscal outlays was initially put at $12.1 billion on March 17, raised to a projection of $20 billion on 27 March, and is constrained only by a fiscal limit of $52 billion passed by Parliament on 25 March.

The policy is a combination of massive government spending programmes (e.g. benefit income, wage subsidies or business loans) targeted to households and firms. Its effect is to increase the disposable income of households and to sustain the revenue stream of businesses. The first of these prevents (or at least limits) the collapse of consumption spending and hence of aggregate demand. The second forestalls, to some extent at least, the threatened shrinkage of aggregate supply, insofar as that flows from potential failure of firms themselves as distinct from disruption of their supply chains.

Many lay people immediately ask "where is the money coming from?". Not surprisingly the Government, after two and a half years of being paralysed (or hypnotised) by its self-imposed Budget Responsibility Rules, has opted for an answer that is politically saleable, but not obviously economically sensible.

In a statement of 31 March entitled "Strong Govt books support 'go hard, go early' response" the Minister of Finance, Grant Robertson, indicated that he expected the expansionary fiscal programme to be financed by an increase in government debt. Financial commentators and bank economists almost uniformly echoed this line. This, one should recall, fits neatly with the desire of financial investors and the banks to add a larger stock of safe government bonds to their wealth portfolios. This process would give them, as bondholders, a secure future claim on this country's taxpayers.

Minister Robertson contrasted New Zealand with other countries whose debt levels are higher, suggesting that low government debt was crucial to providing him with fiscal space to act. But, actually, it's the economic impact of Covid-19, not the Government's nominal debt position, that is creating fiscal space. For confirmation, simply look at the size of the fiscal stimulus packages being adopted across virtually all the OECD countries regardless of their debt levels.

The immediate question is whether there really needs to be a burden imposed on future generations to service large debts allegedly incurred to "pay for" COVID-19 related fiscal packages. Statements to that effect by media commentators reflect memories of the outcome of the 2007-2010 Global Financial Crisis. But they are a product of thinking that treats government as analogous to a private-sector business or household that is forced to secure finance for its spending from an outside source.

That analogy is a false one. It involves a fundamental analytical error. Government does not face a budget constraint of the sort that faces a firm or household. When government spends, it creates money in the process, with no need to "raise" that money in advance.

In a situation where real resources are underutilised (e.g unemployed labour or machinery), newly created purchasing power injected by government can bring those resources into use. This need not have inflationary consequences in the short run (I discuss the longer run in the second of these three articles).. But issuing government debt on the open market now under the pretence that this is necessary to "finance" the fiscal programme would have the effects of:

(i) neutralising much of the boost to overall demand by sucking money back out of the economy just when it is most needed; and
(ii) imposing a large, unnecessary and unfair wealth transfer from future taxpayers to today's older, wealthier buyers of the bonds (including overseas investors). Note further that the future taxpayers are mostly the young people who will find their employment most adversely impacted on by this crisis.

The limits to non-inflationary money creation are set not in the financial marketplace or in the government accounts, but in the real economy (i.e. the economic activities devoted to producing goods and services). A money-financed spending programme in a non-inflationary setting leaves no necessary burden on future generations – just the massive benefits of an avoided recession and consequently a stronger economy.

This is not wild radicalism. It is mainstream, even conservative, economics. Milton Friedman was an early advocate of what came to be called "helicopter money"[1]. Right now around the world, this central proposition of Modern Monetary Theory is being applied: "the helicopters are coming"[2].

The political taboo on money creation is just that – a political construct, not an economic one. In 2003, the then governor of the US Federal Reserve, the Republican appointee Ben

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1 Friedman, Milton (1948). A Monetary and Fiscal Framework for Economic Stability. *The American Economic Review* 38 (3): 245–264.

2 Willem Buiter "The helicopters are coming", Project Syndicate 26 March 2020, https://www.project-syndicate.org/commentary/helicopter-money-coronavirus-response-by-willem-h-buiter-1-2020-03 .

Bernanke, wrote the following in support of monetisation of government spending in Japan[3]:

> "To strengthen the effects of fiscal policy, it would be helpful to break the link between expansionary fiscal actions today and increases in the taxes that people expect to pay tomorrow. Cooperation between the monetary and fiscal authorities could help solve the problems that each policymaker faces on its own. Consider for example a tax cut for households and businesses that is explicitly coupled with incremental central bank purchases of government debt, so that the tax cut is in effect financed by money creation… Under this plan consumers and businesses have extra cash on hand, but no current or future debt service burden has been created to imply increased future taxes."

In 2014 the Bank of England published a pair of papers[4] that overturned the old theory of money contained in most standard macroeconomic textbooks[5] (though the key points were already long established in the journal literature and in central bank practice). Their central theme was that in the modern economy, money is created primarily by private-sector banks supplying loans to their customers. These loans subsequently become demand or term deposits held by those customers, who can then use their deposits to undertake spending on goods and services. The amount of outstanding bank credit, and hence the amount of "broad money" available to finance private spending in the economy, varies endogenously with the demand for credit by firms and households, which in turn varies inversely with the prevailing interest rate. The role commonly assigned to the central bank is to set (or at least influence) that economy-wide interest rate by varying the interest rate it pays on banks' reserve deposits (in New Zealand this boils down to the overnight cash rate, OCR). However since the GFC, central banks have increasingly taken on the task of -prudential regulation of the financial sector. In particular this has involved them in imposing various reserve asset requirements imposed on banks, effectively opening the way for various credit rat5ioning arrangements to curb excessive credit creation.

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3 Ben S. Bernanke *Some Thoughts on Monetary Policy in Japan*, addresss to Japan Society of Monetary Economics, Tokyo, May 31, 2003, *https://www.federalreserve.gov/boarddocs/speeches/2003/20030531/* .

4 Michael McLeay, Amar Radia and Ryland Thomas. "Money in the modern economy: an introduction", *Bank of England Quarterly Bulletin* 2014 Q1: 4-13, https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2014/money-in-the-modern-economy-an-introduction.pdf?la=en&hash=E43CDFDBB5A23D672F4D09B13DF135E6715EEDAC , and "Money creation in the modern economy" *Bank of England Quarterly Bulletin* 2014 Q1: 14-27, *https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2014/money-creation-in-the-modern-economy.pdf?la=en&hash=9A8788FD44A62D8BB927123544205CE476E01654* and https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2014/money-creation-in-the-modern-economy-long-run-data-annex.xls?la=en&hash=CAAE034551619AA756595E669F2C194FB2E67081 .

5 In that old story the government, through the central bank, supplies a certain quantity of base money in the form of currency and bank reserves, and this is multiplied up as fractional-reserve banks make loans as a fixed multiple of those reserves, so that the quantity of money is set on the supply side. Experience showed that central banks had no such control over the quantity of money, and that it was in fact determined endogenously by the demand for bank loans.

Just as expansion of bank lending increases the broad money supply, so a reduction means monetary contraction. This will happen if the demand for credit by the non-bank private sector falls – for example, if firms and households concentrate on paying-down debt rather than expanding it. In the context of the current crisis, credit expansion is not an immediate concern, but a shrinkage of bank loans and bank balance sheets is highly likely. That creates the space into which money created by a fiscal deficit can perform a stabilising function. "Helicopter money" is therefore a valid and viable policy option. It has solid credentials in the economic literature[6], and the time to implement it is now[7].

## Will it be inflationary?

The New Zealand Government has embarked on a major programme of fiscal spending to support family incomes and purchasing power, while simultaneously keeping businesses afloat and workers connected to their jobs.Many lay people immediately ask "where is the money coming from?".While the banks are the primary creators and destroyers of money, they are not the only source. Government spending creates money, while taxes and bond sales (government borrowing) extinguish it. A balanced budget in which spent money is exactly clawed back by tax revenues leaves the total amount of currency (including deposits at private sector banks) unchanged.

What happens to the total money supply when government runs a money-financed deficit? As the newly created money flows into private sector holdings of currency and bank deposits (that is, into "broad money") the immediate question to ask is what is happening at the same time to outstanding loans of the banking sector, which are the basis for the bulk of the broad money supply. If the quantity of money created by the banks is falling, the additional broad money injected by the deficit provides a substitute. That is, the additional private sector bank deposits resulting from the deficit offsets the fall in those deposits due to a reduction in bank credit. If, on the other hand, the fiscal deficit is accompanied by an increase in lending by banks, then the total broad money supply would expand..

Would this be inflationary? Not necessarily. It all depends on two things. First, what is happening to the supply of goods and service available for purchase? Second, what is the propensity of private firms and households to spend, rather than simply hold (or save), any increase in their money balances? If the propensity to spend falls, an increased money supply may not translate to increased demand pressure on prices.

There are two well-worn arguments that are routinely used by arch-conservative opponents of monetisation (i.e. a money-financed deficit). One is that coordinating monetary and fiscal

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[6] For a detailed, rigorous technical exposition see Willem Buiter "The simple analytics of helicopter money: why it works – always" in *Economics: the Open-access Open-assessment E-journal* 8: 1-51, October 2014, Version 3 revised 2016, http://www.economics-ejournal.org/economics/journalarticles/2014-28/version-3/count .

[7] Jordi Gali, "Helicopter money: the time is now", Chapter 6 in Richard Baldwin and Beatrice Weder di Mauro (eds) *Mitigating the COVID Economic Crisis: Act Fast and Do Whatever It Takes*, London: CEPR Press, March 2020, https://voxeu.org/content/mitigating-covid-economic-crisis-act-fast-and-do-whatever-it-takes , pp.57-61.

policy is a violation of central bank independence. The case for insisting that any deficit must be "fully funded" by sales of government bonds is because such bond sales ensure the deficit can occur with no monetary effects. That is, the bond sales withdraw money from the hands of the private sector equivalent to the money injected by the deficit itself. . That, in turn, is argued to be necessary to preserve the much-touted independence of the central bank to manage monetary conditions.

In this context, US Federal Reserve 2003 Governor Bernanke's riposte bears repeating: "greater cooperation for a time between the central bank and the fiscal authorities is in no way inconsistent with the independence of the central bank, any more than cooperation between two independent nations in pursuit of a common objective is inconsistent with the principle of national sovereignty".

The second, more substantial, objection to a money-financed deficit is that once the economic crisis period has passed, an increased money supply resulting from the expenditure package may, under certain circumstances, lead to inflation. Whether or not this happens depends entirely on how the balance of supply and demand in the real economy (i.e. the supply of and demand for goods and services) plays out.

In the longer run, money-financed fiscal spending may – but will not necessarily – lead to the old "too much money chasing too few goods" problem. If and when any such excess-aggregate-demand problem emerges, selling government bonds is certainly one possible response, but not the only one.

One clear alternative would be a restriction on the ability of the banking sector to increase its lending. This could be by credit rationing or reserve asset requirements - what Adair Turner calls "a tax on future credit creation"[8]. Another is some form of explicit tax, possibly on wealth or carbon emissions, given that collection of tax revenue takes money out of circulation.

Another alternative is to let the inflation process itself bring down the real value of money balances, allowing inflation to operate as a sort of tax – especially if inflation has been below target previously, and if the chances of a wage-price spiral are low, as they clearly are at present.

The key point here is that if any of these, or other, measures are deployed to curb inflation in future, the size of the required monetary changeswill bear no direct relation to the size of the initial fiscal deficit. None of the inflation-curbing instruments are required to "finance" the initial deficit. It finances itself.

[8] Adair Turner *Between Debt and the Devil: Money, credit and fixing global finance,* Princeton University Press 2016, pp.221-222.

## Distributional impacts of financing the COVID-19 emergency package

The New Zealand Government has embarked on a major programme of fiscal spending to support family incomes and purchasing power, while simultaneously keeping businesses afloat and workers connected to their jobs.

It is important to understand the difference between Quantitative Easing (QE) and the helicopter option and the significant distributional effects of these alternatives.

QE is shorthand for the process adopted by several central banks after the Global Financial Crisis (GFC) of buying-in government bonds and other securities from the open market, thereby boosting the supply of money while loading up central bank balance sheets with these financial assets. Notoriously, the sellers of those bonds were primarily financial institutions and wealthy investors, who had very low propensity to raise their spending on goods and services. Instead they used the money to bid up the price of other assets such as shares and housing. This produced unsustainable "bubbles" while failing to produce any trickle-down of benefits to the mass of the population.

The message is clear: the bond market and the banks are the wrong channel through which to inject new money into the economy, if the aim is to avoid recession and alleviate hardship.

The right channel for the injection is direct from Government to households and firms.

Neither taxes nor borrowing are required in advance to undertake the additional spending. On the contrary, in order to be effective in boosting private sector purchasing power during the period of the crisis, the new fiscal spending needs to be monetised – that is, it needs to increase the amount of money in the economy. More precisely, it needs to increase the amount of purchasing power in the hands of the households and firms whose spending on consumption, material inputs, machinery and the like are the key to holding up aggregate demand.

Exactly how the transaction is recorded in the accounts of the Treasury and RBNZ is irrelevant: what is important is that the monetary injection goes first to the target group – ordinary New Zealanders, not banks and financiers. Then the first-round effects of money creation are on consumption and production, and the well-being of ordinary people. The banks and the bondholders are further back in the queue, where they belong.

Since at least 1755[9] economists have recognised that new money increases the purchasing power, and hence the wealth, of those who receive the new money first. This enables them to bid resources away from those who receive that money at a later time. As the first receivers spend their windfall, relative prices will change, resources will be reallocated and income will be redistributed. These changes are referred to as the "Cantillon effect": those who benefit most from a helicopter-money drop are the people underneath the helicopter.

[9] Richard Cantillon, *Essai sur la Nature du Commerce en Général*, 1755.

Is direct money creation the same as QE? My answer is no. The term QE is certainly being used increasingly by commentators to include money-financed fiscal deficits. But there is an important distinction to be drawn. Helicopter money means that the central bank directly assumes the liability of additional money created by a fiscal deficit. The central bank then absorbs the transaction into its balance sheet by recording in its books an equal notional asset that may be characterised as some sort of government bond.

This procedure is quite different from the standard QE (a la the GFC) in which the central bank enters into bond transactions with the private sector (not the government). Monetised deficits are fiscal policy; standard QE is monetary policy. With the former, the relevant liability and asset entries are confined entirely within the consolidated Crown balance sheet. This can be structured to insulate future taxpayers from any necessary burden. For example, the notional "bonds" could be zero-interest perpetuities; or the central bank could simply write them off at some later stage.

So even if the term QE is used to cover helicopter money, it is a very different sort of QE than was used in response to the GFC.

If this government is serious – and it should be - about supporting economic activity and avoiding deflation by a massive fiscal spending package, financing its package by issuing money in the current circumstances has impeccable support from mainstream economic thinking. More importantly, in the current context it is the correct, most efficacious way to proceed. The current government should not continue to be prisoners of outmoded, arch-conservative political doctrines.