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Helicopter money: raining down or rained off?

Louis Harreau
ECB Strategist
+33 1 41 89 98 95
louis.harreau@ca-cib.com

- **"We come too late to say anything that has not been said already", so Jean de La Bruyère starts The Characters, his collection of philosophical essays. 320 years later, we face the same issue with helicopter money: everything has already been said about this potentially powerful central-bank tool. In this report, we do not claim to revolutionise the subject only to clear the air about the next potential monetary policy tool.**
- **We try to answer four basic questions: where does the 'helicopter money' idea come from? What are the different options conceivable? Is helicopter money legal for the ECB? To what extent is helicopter money effective?**
- **We end up with more questions than answers; hence, we conclude that helicopter money is a "very interesting concept" – surprise: we agree with Mario Draghi. However, as a monetary policy instrument, we have "a fair deal of scepticism and circumspection" – surprise: we agree with Benoît Coeuré too.**
- **However, the true contribution of the helicopter-money concept comes from the message it sends: there are no limits for a central bank if it focuses only on inflation. If the central bank is focused only on inflation, inflation can be a purely "monetary phenomenon" – so, we also agree with Milton Friedman.**

Where does the 'helicopter money' idea come from?

The expression 'helicopter money' owes its fame essentially to two pieces of research: **Milton Frideman**'s1969 work The Optimum Quantity of Money, and its subsequent quotation by **Ben S. Bernanke**, then member of the Board of Governors of the Federal Reserve, in a 2002 speech: *Deflation: Making Sure "it" Doesn't Happen Here*.

Milton Friedman's research formed the basis of monetarism as an economic school of thought; in this research paper, helicopter money is a parable aimed at explaining Friedman's view at that time: *inflation is always and everywhere a monetary phenomenon*.

- The parable is the following: a society lives in an equilibrium position with a nominal national income of USD10,000 a year; "Let us suppose now that one day a helicopter flies over this community and drops an additional USD1,000 in bills from the sky, which is, of course, hastily collected by members of the community. Let us suppose further that everyone is convinced that this is a unique event which will never be repeated." Milton Friedman's conclusion is that after a period of adjustment, the only variable that has changed due to this event is the general level of prices. With this parable, Milton Friedman explains that a central bank can always and under every condition manage to control price evolution.

Ben Bernanke's speech founded the guiding principles of the Bernanke doctrine – basically that the Fed has to combat not only inflation but also deflation – and earned him the nickname 'Helico Ben'.

- From Bernanke's point of view, helicopter money involves both monetary and fiscal authority: "the effectiveness of anti-deflation policy could be significantly enhanced by cooperation between the monetary and fiscal

> authorities. A broad-based tax cut, for example, accommodated by a program of open-market purchases to alleviate any tendency for interest rates to increase, would almost certainly be an effective stimulant to consumption and hence to prices. (…) A money-financed tax cut is essentially equivalent to Milton Friedman's famous 'helicopter drop' of money."

The last hype that notion received was at the last ECB press conference: a journalist asked "theoretically, does [the ECB's] toolbox also include helicopter money?" to be answered by Mario Draghi that the ECB "haven't really thought or talked about helicopter money." Interestingly, the President explained "we haven't really studied yet the concept"; and that "yet" has triggered lots of fantasies about the future of ECB monetary policy.

What are the conceivable options?

Below we try to list the different schemes contemplated, their benefits and their drawbacks. *Spoiler*: all of them lead to central-bank losses and most are forbidden by European treaties and the ECB's status.

Government debt monetisation

The central bank purchases bonds in the market and cancels them. In the case of the ECB, purchases should be in the secondary market: it does not change anything, but it makes lawyers more comfortable.

- **With cooperation from fiscal authorities**: this option is seen as the best for a helicopter-money operation in terms of fairness, effectiveness and legitimacy:
  - This is basically the option suggested by Ben Bernanke in his 2002 speech: *"a broad based tax cut accommodated by a programme of open-market purchases* … A money-financed tax cut is essentially equivalent to Milton Friedman's famous 'helicopter drop' of money."
  - Alternatively, the government can use the extra cash to engage in an investment programme. Both options should support aggregated demand, increasing the amount of liquidity in the system.
  - The fairness and the legitimacy are in the government's hands, so such a programme is no more questionable than any other investment programme or any other tax cut.
  - Problem: the potential dependency of the central bank on the fiscal authority: as the central bank needs the fiscal authorities, its independence may be questioned over the time.
  - Another problem – especially in a tax-cut scheme – is that while the helicopter-money operation is supposed to be one-off the fiscal measures may be lasting, or seen as lasting.
- **Without cooperation from fiscal authorities** (less effective than a coordinated action, but more foreseeable in a multi-fiscal-authority area): the central bank can unilaterally purchase government bonds and cancel them.
  - The less indebtedness governments have more fiscal room to lower taxes or engage in investment programmes.
  - The risk is that governments use that debt cut simply to deleverage, especially in the Eurozone's situation where budget rules are strict: fiscal room for manoeuvre is scarce on the budget side and almost non-existent on the debt side.
  - The positive side is that it does not question the central bank's independence.
- **Alternative solution** (for central banks who cannot do monetary financing): the central bank may purchase perpetual government bonds with a zero coupon in the secondary market (well, an artificial secondary market as the value of those bonds is zero). This great accounting solution resolves the issue of monetary financing and the issue of central bank capital (as long as you account for those bonds at their nominal value and not their market value).

QE for the people

Well it is not QE and it is no more 'for the people' than any other measure, but it is the name usually given to the measures by which a central bank gives cash directly to people.

- **QE for the people – plain version**: the central bank can give a cheque to each citizen of the country, or better still a gift card with a certain amount on it and an expiry date:
  - The cheque option is basically the same situation described by Friedman with the helicopter drop: it let the people manage the transition period.
  - The gift card has the advantage of encouraging people to consume: the gift card cannot be used to deleverage – there may be substitution effects whereby people use their gift card for their everyday purchases and save the equivalent amount from their regular financing source. As the gift card is expiry-dated, the central bank can manage the transition period itself and may shorten it with a quick expiry date so that the operation has a strong impact quickly.
  - Positive side: no issue in terms of monetary financing.
- **QE for the people – subtle version**: the central bank can grant any citizen a loan with an infinite maturity and no interest:
  - Theoretically, such a solution allows the central bank not to record losses if loans are accounted at nominal value. The obvious point is that accounting those loans at nominal value is a strong assumption; all the more so since, contrary to governments, people are not eternal.

Is helicopter money legal for the ECB?

First option: cancel sovereign debt so governments can engage in fiscal easing

Let's say it straight, as soon as the ECB engages in a helicopter-money operation, there will be legal issues. We trust the ECB's lawyers to find a solution – people who have managed to make the OMT programme legal should be reliable in terms of making anything legal. However, monetary financing seems to remain the latest and biggest taboo for the ECB.

The main article that forbids monetary financing is Article 123 of the Functioning of the European Union (TFEU):

1. *"Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as "national central banks") in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments."*
2. *"Paragraph 1 shall not apply to publicly owned credit institutions which, in the context of the supply of reserves by central banks, shall be given the same treatment by national central banks and the European Central Bank as private credit institutions."*

Article 21 of the Statute of the ESCB and the ECB – based on that article 123 of the TFEU – reaches the same conclusion:

> *"In accordance with Article 123 of the Treaty on the Functioning of the European Union, overdrafts or any other type of credit facility with the ECB or with the national central banks in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the ECB or national central banks of debt instruments."*

Interestingly, this article does not per se forbid monetary financing. Well, it does not forbid helicopter money more than any sovereign bond purchase operation in our view: either a sovereign bond purchase is a "credit facility in favour of central governments", in which case QE and OMT are forbidden, or it is not a credit facility and then the ECB can not only purchase them but also cancel them – which is a kind of helicopter money and is precisely monetary financing.

However, beyond the letter of the legal text, the issue of the spirit of the law is central. On that point of forbidding monetary financing, we refer to the conclusion of the European Court of Justice, which had to assess the legality of the OMT programme:

> *"It is apparent from the preparatory work relating to the Treaty of Maastricht that the aim of Article 123 TFEU is to encourage the Member States to follow a sound budgetary policy, not allowing monetary financing of public deficits or privileged access by public authorities to the financial markets to lead to excessively high levels of debt or excessive Member State deficits."*

So, no monetary financing – even if the letter of the texts does not explicitly rule it out, the spirit prohibits it. A helicopter operation cannot be based on the purchase and cancellation of sovereign bonds.

Second option: give money to people

'QE for the people' is the simple idea that the ECB gives a cheque (or banknotes, or even better a gift card) to each citizen of the Eurozone.

The purpose of helicopter money is to give away cash, somehow. The regular monetary operations are never a gift, only loans.

Back to the legal texts: the ECB's statute (Article 18) defines the open market and credit operations:

> *"18.1. In order to achieve the objectives of the ESCB and to carry out its tasks, the ECB and the national central banks may:*
>
> *– operate in the financial markets by buying and selling outright (spot and forward) or under repurchase agreement and by lending or borrowing claims and marketable instruments, whether in euro or other currencies, as well as precious metals;*
>
> *– conduct credit operations with credit institutions and other market participants, with lending being based on adequate collateral.*
>
> *18.2. The ECB shall establish general principles for open market and credit operations carried out by itself or the national central banks, including for the announcement of conditions under which they stand ready to enter into such transactions."*

So, the ECB can purchase any marketable instrument and conduct any credit operation based on adequate collateral. A priori, this rules out direct infinite credit to people – due to the collateral issue – and it rules out direct cash payments to people.

However, the ECB's statute foresees a solution in Article 20 on "other instruments of monetary control":

> *"The Governing Council may, by a majority of two thirds of the votes cast, decide upon the use of such other operational methods of monetary control as it sees fit, respecting Article 2."*

Article 2 is about the primary objective of the ECB: price stability. So Article 20 basically says 'you can do whatever it takes to have an inflation rate close to but below 2%'.

As to that two-thirds majority, however, we have bad news. It is not clear whether it is based on 'one governor one vote' or if the votes in the Governing Council are weighted according to the national central banks' shares in the subscribed capital. On the one hand, it is a monetary policy decision, so no weighting, but on the other hand – see below – it brings issues in terms of paying up capital, so weighting would be required (see Article 10.3 and Article 28.3 if you are passionate about that issue).

So, we consider that a helicopter drop for the people is legally possible but complex.

To what extent is helicopter money effective?

Actually, the true question is how does a helicopter-money operation work from a central bank's point of view. Surprisingly, the very simple idea of raining banknotes on an economic area leads to highly theoretical and unresolved issues: the ability of a central bank to operate in negative capital and the potential change in the behaviour of economic players.

A central bank's capital

We will not feed the debate about the negative capital of a central bank and the consequences for its credibility and functioning. It seems that negative capital is not an issue for a credible central bank: contrary to the time of the gold standard – when the central banks promised to convert money into a certain amount of gold – today's central banks promise only to convert money into a certain amount of goods and services. We agree with Paul De Grauwe and Yuemei Ji: negative capital is not a concern for a credible central bank in the current environment of a floating exchange rate system.

Last week, in a very timely fashion, the ECB published an 'Occasional Paper' about Profit distribution and loss coverage rules for central banks. The document by itself is a great piece of research about – well – profit distribution and loss coverage rules, but the most interesting part relative to our current subject is the seventh footnote: "Central banks are protected from insolvency due to their ability to create money and can therefore operate with negative equity." So, let us agree that negative capital is not an issue for a credible central bank.

A central bank's capital over the long term

So, if a central bank is in negative capital for a few years, there is no problem. Now the question is: can a central bank remain in negative capital forever? A priori, you may think that this is a very theoretical question, far from our everyday issues. It isn't.

If a central bank can keep negative capital forever – and if economic players are convinced of it – then the helicopter drop will be powerful: it will not trigger a change in economic players' behaviour, except that they will buy more stuff and then increase aggregated demand and prices. Some theories may argue that this will, on the contrary, generate hyperinflation as the central bank will not be able to withdraw the injected liquidity. We disagree: a central bank can still steer liquidity through reverse refinancing operations or rate increases.

In contrast, if a central bank has to go back to – at least – neutral capital, or if economic players think that a central bank cannot keep negative capital forever, then a helicopter drop will trigger adverse reactions. If the central bank has to cover the losses caused by the helicopter drop, then it will retain its dividends over the next years until the gap in its capital is filled. This is the view of Peter Praet in his interview with La Repubblica: "Helicopter money is giving to the people part of the net present value of your future seigniorage, the profit you make on the future banknotes".

In this context, the helicopter drop is a pure replication of a fiscal impulse linked to a monetary injection – so the scheme detailed by Ben Bernanke:

- Helicopter drop: the central bank expects to return to positive capital in 20 years' time and pays a dividend of EUR5bn a year.
    - At year 0 it gives EUR100bn to people.
    - Between year 1 and 20 it retains its dividend instead of paying it to the government.
- Fiscal impulse:
    - At year 0, the government issues 20 bonds with an amount of EUR5bn each and with maturity from 1Y to 20Y. The bonds are purchased by the central bank (so that we have the same liquidity injection as in the helicopter drop scheme).
    - Between year 1 and 20, the government reimburses the central bank with the dividend the central bank pays.

We have the same liquidity injection and the same fiscal impulse in both schemes. So, helicopter money – if you think that a central bank cannot operate in a negative capital situation forever – is far from revolutionary.

Conclusion

To conclude on these theoretical issues, we consider a helicopter money drop is possible in the Eurozone. It can be designed to be legally possible. The issue of the negative capital may be at the centre of the difficulties and, as it is an unresolved issue in economic theory, there will never be an objective answer until a central bank actually tries it.

Beyond the theoretical issue, we think that the legitimacy for a central bank to embark on helicopter money is very limited. Regardless of whether a central bank can act in permanent negative capital or not, a central bank's capital is still in the government's hands; frittering away that capital may be subject to great controversy. That point is particularly relevant for a central bank that faces 19 different governments. Helicopter money is too much fiscal policy to be left in a monetary authority's hands.

Nevertheless, the concept of helicopter money can be seen as the ultimate conventional unconventional tool used by the ECB: the perpetual QE of a perpetual TLTRO. Thus, in our view, the main contribution of the helicopter-money concept is that it highlights the fact that there is no limit to monetary policy – the central bank can always do more, if needed and if the central bank's principal target is inflation.

Global Markets Research contact details

Jean-François Paren Head of Global Markets Research +33 1 41 89 33 95

	Asia (Hong Kong & Tokyo)	Europe (London & Paris)	Americas (New York)
Macro Strategy	Kazuhiko Ogata Chief Economist Japan +81 3 4580 5360	Louis Harreau ECB Strategist +33 1 41 89 98 95 Xavier Chapard Global Macro Strategist +33 1 41 89 13 45	Michael P. Carey ** Chief Economist US +1 212 261 7134 Brittany Baumann ** US Associate +1 212 261 7140
Interest Rates	Yoshiro Sato Economist / Strategist - Japan +81 3 4580 5337	Mohit Kumar Global Head of Rates Strategy +44 20 7214 6651 Romain Blanchet IRD Strategist +33 1 41 89 00 64 Orlando Green CFA Senior IRD Strategist +44 20 7214 7467 Afsaneh Mastouri Interest Rates Strategist +44 20 7214 6737 Jean-François Perrin Inflation Strategist +33 1 41 89 94 22	David Keeble ** Head of US Rates Strategy +1 212 261 3274 Jonathan Rick ** IRD Strategist +1 212 261 4096
Emerging Markets	Dariusz Kowalczyk Senior Emerging Market Strategist +852 2826 1519 Gary Yau Emerging Market Strategist +852 2826 1553	Sébastien Barbé Head of Emerging Market Research & Strategy +33 1 41 89 15 97 Jakub Borowski Chief Economist - Crédit Agricole Bank Polska SA +48 22 573 18 40 Alexander Pecherytsyn Chief Economist – Crédit Agricole Bank Ukraine +38 44 493-9014 Guillaume Tresca Senior Emerging Market Strategist +33 1 41 89 18 47	
Foreign Exchange		Valentin Marinov Head of G10 FX Research & Strategy +44 20 7214 5289 Jennifer Hau FX Strategist +44 20 7214 7468 Manuel Oliveri FX Strategist +44 20 7214 7469	

** employee(s) of Crédit Agricole Securities (USA), Inc.

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Louis Harreau

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