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PRESS RELEASE

Helicopter money and debt-financed fiscal stimulus: one and the same thing?
(Article for the December 2016 Economic Review)

The idea of helicopter money, first floated almost 50 years ago, has recently been subject to renewed interest. This concept is broadly defined as a policy whereby a permanent increase in base money issued by the central bank serves as a means of financing measures to stimulate aggregate demand

While not seeking to either examine in detail the possible arrangements for implementing such a policy or to broach the related legal aspects, this article instead proposes a purely conceptual economic analysis on the effectiveness of helicopter money in stimulating economic recovery in a context of low interest rates and sluggish growth. In particular, the likely effects of such a policy are compared with those of a conventional debt-financed fiscal stimulus. This analysis also clearly reveals the possible risks and limitations associated with using helicopter money. The main findings of this article are the following:

Helicopter money is not a free lunch for the public sector: it is like financing expenditure by issuing short-term government debt.

Although helicopter money does not increase the gross government debt, the reduction of central bank equity lowers the government's net worth position or, equivalently, increases its net liability position because the central bank issues a debt instrument, namely base money. Moreover, in modern monetary systems, this base money pays an interest rate, so that after implementation, the dynamics of consolidated public sector finances look remarkably similar in the helicopter money and debt-financed fiscal stimulus scenarios. Both policies will lead to higher interest rate charges for the public sector, via the payment of interests, either by the central bank on its reserves or by the State on its outstanding debt.

Helicopter money is likely to be more effective than the debt-financed fiscal stimulus when the central bank accepts a temporary acceleration in inflation and private agents understand that, in doing so, the central bank is using its capacity to control the financial burden of helicopter money.

Not raising interest rates when helicopter money stimulates the economy is always an option for the central bank in order to limit the costs – for the public sector as a whole – of this economic recovery, but the price to pay under this strategy is a temporarily higher inflation rate. Even though higher inflation could also be allowed under the scenario of a conventional debt-financed fiscal stimulus, its implementation and its communication towards the general public could be a lot easier in the helicopter money scenario, where the central bank is genuinely involved in the fiscal stimulus and where helicopter money serves as a kind of commitment device.

In practice, using the helicopter money option appropriately would involve several challenges, not least to protect the economy from the potential risk of slipping into an explosive inflationary spiral.

In order to be fully effective and avoid a situation where the central bank has no choice but to abandon its price stability mandate, helicopter money would no doubt require a substantial initial level of central bank equity, solid coordination between the central bank and the State, as well as appropriate communication. Such close cooperation is by no means a simple option as it would absolutely have to avoid damaging the independence of the central bank. Besides, were a helicopter money exercise to take place, in the euro area for instance, it could raise serious questions about its compatibility with the monetary financing prohibition laid down in the Treaty on the Functioning of the European Union.

Communication
National Bank of Belgium Ltd.

boulevard de Berlaimont 14
1000 Brussels

phone + 32 2 221 46 28
www.nbb.be

Company's number:
0203.201.340 – RLP Brussels