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Could new tools allowing the Fed to pump money through 'the people' make U.S. monetary policy more equitable and effective?

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In recent years, worsening economic inequity and the Fed's eroding ability to nudge the economy out of recessions have reenergized discussion of finding ways for the central bank to expand the money supply directly to people. The sudden economic contraction resulting from the Covid-19 pandemic, which has hurt middle- and low-wage workers the most, may spur more such talk, along with a search for institutional changes to help the strategy work.

So far, this has mostly been a hypothetical discussion among academic economists revolving around the notion of "helicopter money." A bit derisive, the metaphor connotes a sloppy way the Fed might airlift and drop freshly printed bills to people at the bottom of the capitalist system. Such operations could function alongside the Fed's traditional indirect methods of influencing the economy through modulating liquidity by setting short-term bank interest rates and buying and selling bonds.

Manna from the Sky?

The idea of helicopter money can be traced back to a thought experiment by economist Milton Friedman in the 1960s. After being considered as a way to counter Japanese deflation in the 1990s, helicopter money reappeared a few years later when then-Fed governor Ben Bernanke suggested that injecting currency directly into the economy could combat possible deflation in the United States:

> The U.S. government has a technology, called a printing press (or, today, its electronic equivalent), that allows it to produce as many U.S. dollars as it wishes at essentially no cost. By increasing the number of U.S. dollars in circulation, or even by credibly threatening to do so, the U.S. government can also reduce the value of a dollar in terms of goods and services, which is equivalent to raising the prices in dollars of those goods and services. We conclude that, under a paper-money system, a determined government can always generate higher spending and hence positive inflation (Bernanke, 2002).

In response to the Great Recession, central banks in the United States and Europe have kept interest rates low, sometimes below zero, thereby blunting their leeway to stimulate the economy by pushing rates lower. The idea of funneling new money around the banks and bond markets directly to consumers gained new currency. Beside the argument that it might be one of the few options left in the Fed's toolbox, proponents have offered a range of reasons. Among them are that helicopter money can have a similar impact as fiscal stimulus, which Congress may not be able or willing to deliver, and that it can help moderate income inequality.

Why Now?

One condition that may thwart traditional monetary policy is what economist John Maynard Keynes called a liquidity trap. This phrase typically describes a situation when interest rates are very low and would-be investors sit on savings because they anticipate higher interest rates soon might push bond prices down and yields up. In such an environment, trying pumping new money through businesses already sitting on cash is like trying to push a wet noodle. We now may be experiencing a type of liquidity trap, not because interest rates are expected to rise soon but because high unemployment and depressed demand make it harder to justify investment. Corporate stock buy backs may be evidence of this.

A longer-term trend that may challenge conventional monetary policy is the expanded role of finance in the global economy. Some economists are reexamining the Marxian concept of "fictitious capital" – investments in stocks, securities, and sophisticated layers of financial instruments surrounding the "real capital" spent on actual means of production. In his recent book, Cedric Durand places fictitious capital at the heart of the contemporary international capitalist system and argues that growth of the financing sector, in effect, is sapping future productivity. Fees and economic rents collected by an increasing complex financial matrix are syphoning resources into the pockets of owners of wealth. One might note that traditional Fed monetary actions must pass through the financial realm to carry out its tasks of supplying money and influencing national levels of employment, economic growth, and price inflation.

Concerns and Cautions

Opponents of "helicoptering" new money directly to households cite several reasons, including:

- There's no free ride. Printing free money will eventually trigger high inflation and reduce public trust and confidence in the financial system.
- Handing money to people with nothing to exchange will make it impossible for the Fed to balance its books. Currency in circulation is a liability on the Fed's books that must be offset by real assets.
- Helicopter money would circumvent congressional authority to set fiscal policy. (Some proponents use same argument but justify helicopter money as expediency necessitated by political gridlock.) Even though distributing money through households might have merits, opponents worry that going around Congress undermines a valuable check built into the U.S. constitutional framework.
- The Fed has always worked through the financial system. Don't change that. Stick with the parts of the economy that it knows.

Steps that Could Be Taken

I claim no experience working in the banking industry – and even less refitting a central bank. Nonetheless, for the sake of inquiry and discussion, here are some options for expanding the money supply directly to consumers that may address criticisms raised. Key elements are: 1) building in congressional consent for funding and actions that the Fed may undertake, 2) using direct-to-people money in a way that supports Fed monetary policy goals, and 3) better coordinating fiscal and monetary actions.

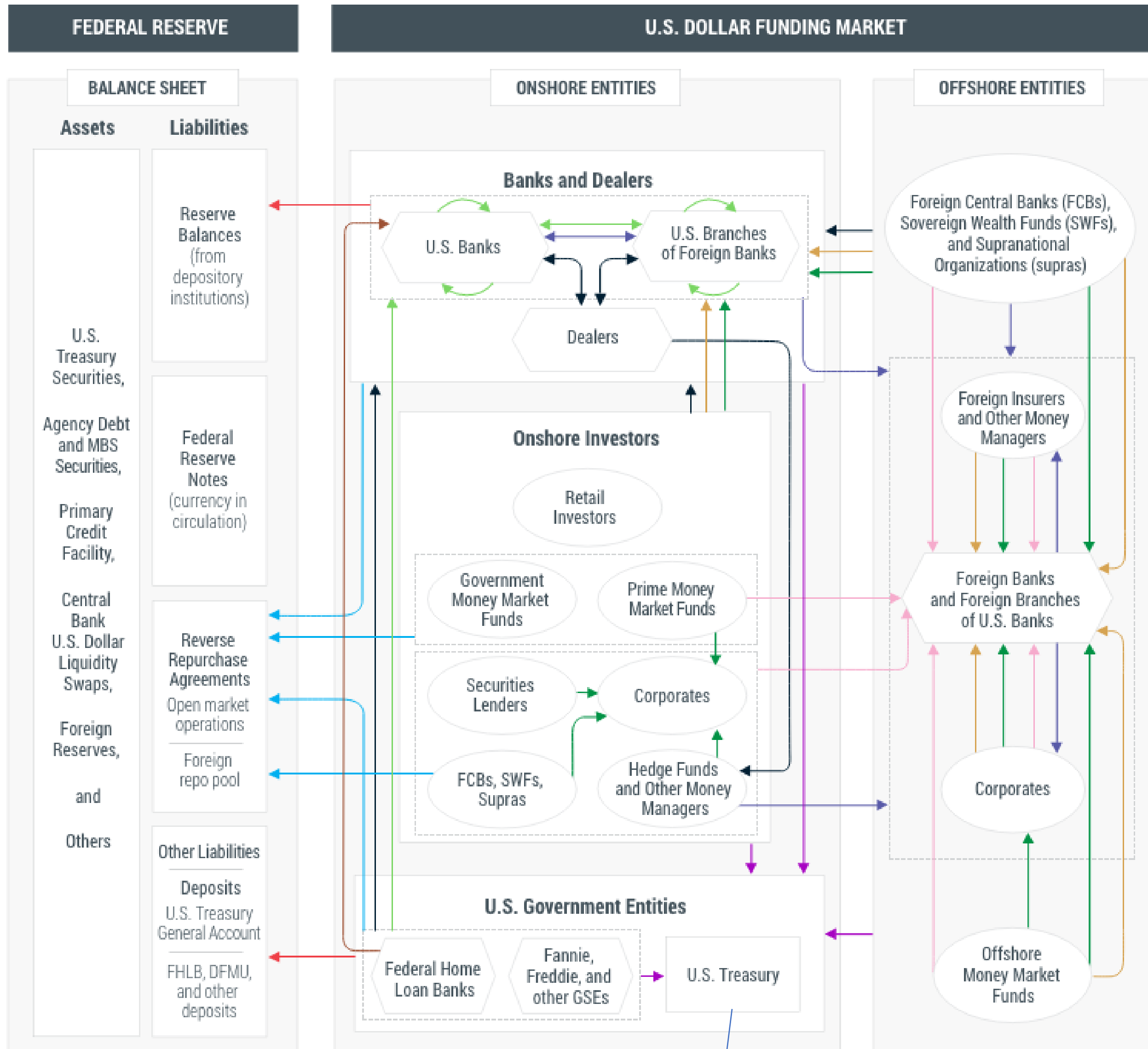
Congressional Involvement

Congress could provide the Fed with authority, either well in advance or at the last minute, to distribute money directly to households up to a pre-set limit with the requirement that the Fed provide a rationale for how such a transfer would support its monetary and broader economic goals. It could also require a degree of consultation with congressional leaders or the executive branch when distribution decisions were made. A key topic might be whether the economic environment can tolerate additional monetary expansion without triggering unacceptable rates of inflation.

Real Assets

Along with authorization, Congress could provide assets to offset the liability of putting new money into circulation. Like Ulysses planning to sail by the Homer's sirens, Congress would make an advance directive giving the Fed leeway to act in a time of crisis should gridlock or other factors bar timely legislative action.

Figure 1 – The Federal Reserve Bank & Balance Sheet with New Features



Assets:	***Liabilities:***
U.S. bonds	**Reserves**
Gold	**Currency in Circulation via Households**
Other?	

Household Stimulus Trust (or American People's Bank)

- **Receives $$ from Treasury for stimulus when fits monetary policy goals (recessions, Covid shutdown)**
- **Establishes system for distributing currency to households (possibly including backup bank accounts to make sure everyone has one).**

An Intermediating Institution Representing Consumer Interests – Trust Fund? Bank?

Resources authorized by Congress for this purpose could be placed in an intermediary institution. This could take many forms. It could function simply as governmental checking account – a pass-through between Treasury and the Fed.

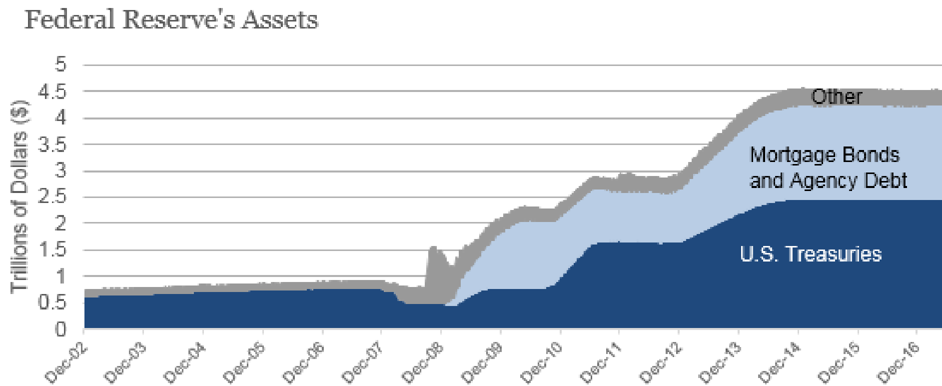
It also could be assigned responsibility for developing practical ways to distribute currency to people. The entity could transfer money to existing bank accounts and furnish the unbanked with debit accounts. Another option might be to delegate some of the distribution to the IRS – as Congress did with Covid stimulus checks.

A more ambitious model could assign these functions to a bank chartered to provide or organize basic, affordable banking services for lower-income and working-class Americans lacking access to them. In this way, all Americans could have access to basic financial services. Such an institution could offer small loans for emergencies or provide infrastructure to complete a universal retirement savings system. Next thing you know, it might offer a people's credit card with reasonable fees and less than usurious interest rates!

Balancing the Fed's Books – The Fed's balance sheet is a place of great complexity and mystery typically approached by a numerate priesthood with appropriate expertise. Things that the Fed issues money to pay for become its assets. Until the Great Recession, Fed assets mainly consisted of government securities, bank reserves, and loans extended to member banks through its repo and discount window. When the Fed buys government securities or extends loans through its discount window, it pays by crediting the reserve account of the member banks through an accounting or book entry. When member banks wish to convert their reserve balances into hard cash, the Fed provides them dollar bills.

Novel strategies to stabilize the economy have brought other types of assets to the Fed. Purchases of troubled mortgage-backed securities to muffle the aftershock of the 2008 financial collapse and, recently, corporate bonds during the Covid-19 pandemic have swelled the value of Fed assets to just over $7 trillion.

Figure 2 – The Federal Reserve's Assets



Source: Federal Reserve Board

Some of the entries on the Fed's balance sheet are precise, others estimated. Money in circulation -- more than half somewhere outside the country -- and reserves that banks keep at the Fed make up most of its liabilities. Functioning as a regulator, the central bank requires commercial banks to hold onto a certain amount of deposits, rather than lend them out or invest them, in case of mass customer withdrawals. The reserve ratio is currently 10 percent. So, for every $1 deposited at a bank, $0.90 can be loaned out but $0.10 must be kept on hand. Reserves count as assets for commercial banks, and, reciprocally, liabilities for the central bank.

The Fed's unique balance sheet reflects its multiple, sometimes overlapping, functions. Though its board of governors, 12 regional reserve banks, and open market committee, the Federal Reserve System 1) helps stabilize the economy and financial system, 2) works to control inflation and promote employment, 3) conducts monetary policy, 4) regulates and supervises key financial institutions, 5) acts as the U.S. government's bank, and 5) performs banking functions in the marketplace.

Multiple Functions: Symbiosis with the Financial Sector

To carry out these tasks, the Fed is organically tied to the private banking and financial sector – for example, by holding bank reserves. Its directors face many potential conflicts of interest. While overseeing bank solvency and liquidity, the

Fed also performs bank functions and influences bank reserves to impact the overall money supply. While acting as the bank for the U.S. government, it influences national economic policy and supplies liquidity as the backup currency for foreign countries. Although the Fed is also charged with protecting consumer and worker interests on paper, it is not structurally conjoined to the general population or workforce in ways comparable to its nexus with the financial sector.

Figure 3 – Structure and Functions of the Federal Reserve System

Source: Federal Reserve Board of Governors

New Ways to Balance the Books

In a recent Cato Journal article entitled “Against Helicopter Money,” economist Kevin Dowd argues that the risks of unleashing inflation and usurping congressional control over fiscal policy outweigh advantages of the Fed distributing money directly to consumers. The Fed cannot simply print “free” money without repercussions and ‘buggering up’ its balance sheet. Interestingly, the article also presents ways to balance the Fed’s books while distributing money to consumers. One way would be for the Fed to reassess the value of its gold holdings closer to market value, which it has done before.

> At the end of 1971, the “official” price of the U.S. stock of gold in Fort Knox was raised from $35 an ounce to $38 an ounce, and two years later it was raised again to $42.22 an ounce, a value that still stands. On both occasions, the asset value of the “gold certificates” held by the Fed—its claims to the gold held in Fort Knox—was increased, so its liabilities had to rise by the same amount. The U.S. Treasury “General Account” at the Fed was then credited with the amount of the increase in the value of U.S. gold

> holdings, so that the Treasury could spend that amount without having to collect taxes or sell bonds. (Dowd, 2018.)

Reassessing gold or other assets might allow the Fed to issue currency of equal amount to consumers.

Another way to get money direct to consumers is through debt monetization. Here the Treasury issues a bond and sells it to the central bank, which in turn pays for the bond with newly issued base money. The bond is then used by the Treasury to make payments in pursuance of government fiscal policy objectives. It is interesting to note that this maneuver blends monetary policy with fiscal policy. Bonds acquired by the Fed to issue helicopter money could be short or long-term, depending on circumstances and goals.

Adding to the Fed's Stimulus Toolbox

Some who see helicopter money as a raid on congressional territory and a risk for hyperinflation concede that, under specific circumstances, it could provide short-term stimulus, especially when the Fed has few options left. This may be such a time. Inflation has been relatively low for a long time and promises to stay low given the contraction in business activity resulting from the Covid-19 pandemic.

In an Aug. 24 letter, a San Francisco Federal Reserve Bank analyst reported that after the onset of Covid-19, the U.S core inflation rate remained at particularly low levels—approximately a full percentage point below the Federal Reserve's 2% target. Consistent with findings of other researchers, Fed data indicate that the drop in core inflation "is mainly attributable to large declines in consumer demand for goods and services stemming from Covid-19, which have more than offset any upward inflation pressures due to supply constraints in some sectors."

On Aug. 27, the Chairman Jerome Powell announced that the Fed would significantly raise its inflation target to a long-term average -- rather than ceiling -- of 2 percent. The move indicates that the Fed is prioritizing economic stimulus and job creation over the risk triggering of high inflation. Expansionist, and possibly novel, monetary policies may continue to find favor alongside with low short-term interest rates.

Best Bang for the Buck: Prodding Demand at the Middle and Bottom

Unlike the Great Recession, which was triggered by excessive risk taking within the financial sector, the current downturn is the result of a shock from outside the economic apparatus. Pumping more money through banks into an economy already laden with uninvested capital does not seem a promising strategy. Even with rock-bottom interest rates, businesses will likely be leery of borrowing to expand when so many people out of work simply have less money spend. The case has strengthened for a more Keynesian strategy to lift demand by providing money to consumers (and small businesses) to keep economic activity from nosediving until the pandemic can be brought under control. If a cure or vaccine is developed by early next year, stimulus measures need only be short-term, thereby lowering the risk of triggering inflation.

Moderating Economic Inequality

Targeting stimulus to lower- and middle-income families would also moderate widening inequality, possibly preventing feedback loops that might worsen disparities in coming years. Fed policy of keeping interest rates near zero in response to the Covid-induced recession has made bonds less attractive. Prices of equities -- primarily belonging to the wealthy -- have risen while essential workers and others with low wages have absorbed most of the economic loss.

As of Aug. 17, Congress, the executive branch, and the Fed had approved Covid stimulus measures amounting to almost $11 trillion – or more than half of U.S. GDP. Most of the aid – and virtually all the Fed's $7 trillion share – is entering the economy through the banking system or business sector. Only a small fraction goes directly to taxpayers. As of this writing, late summer negotiations between the White House, Senate, and House have failed to produce an agreement on further stimulus. In times when political polarization leads to chronic gridlock in Congress – as has been the case for many years – giving the Fed a tool to distribute a preauthorized packet of money directly to consumers could be helpful both in reducing human misery and propping up the economy. Monetary expansion though households needing to pay rent and buy food would likely yield more stimulus than sending it through layers of financers (each collecting a fee or subsidy) in hope that businesses will borrow to refit infrastructure or expand operations.

A scholar reviewing this paper observed that there is an element of helicopter money in the CARES Act: "Congress authorized a $1,200 check to all individuals in families earning less than a certain amount and the Fed made sure that the government could finance that spending on very easy terms by buying large amounts of government bonds in the secondary market." (Personal correspondence with Desmond Lachman of the American Enterprise Institute.)

From a conceptual point of view, one could say the same about the stimulus legislation's $600-a-week federal unemployment insurance supplement. Even if leaders of the Fed, Treasury, and Congress did not consult directly in fashioning these measures – which one would presume they had – a degree of coordination could be accomplished through tacit observation of each other's actions. Whether sufficient resources were sent directly to individuals is another question.

Coordinating Monetary and Fiscal Policy

Repeated crises may lead more to question the orthodoxy that fiscal and monetary policymaking should be strictly segregated – one the purview of elected officials and the other under the direction of the central bank. As noted above, strategies such as debt monetization already combine monetary and fiscal elements. During the nation's greatest crisis of the last century, the Fed worked closely with the Treasury to sell war bonds and operated with far less independence. As policymakers continuing searching for new stimulus tools, channels for negotiation and coordination between the Fed, executive branch, and Congress may become more useful.

Multiplier Effects

Funneling new money through lower-to-middle income households could well have a more immediate impact than traditional indirect ways of creating money though the banking system for another reason. The total impact on economic output, or multiplier effect, of a batch of "helicopter money" might be more in the ballpark of a fiscal action than a monetary one. So far, the fiscal response to the Covid crisis in many ways has echoed the government's response to the Great Recession. And it will likely have a significant impact on future output, according to an analysis published by a San Francisco Federal Reserve Bank.

> The Covid-19 fiscal response has many key similarities to that during the Great Recession. Evidence from past fiscal stimulus yields three important implications. First,

> the marginal propensity to consume out of individual transfers is particularly high when unemployment is high and liquidity constraints bind, implying fiscal multipliers near or above one. Second, the marginal propensities to spend out of federal transfers by state and local governments are particularly high during times of fiscal strain, suggesting at least a dollar-for-dollar pass-through to spending. Third, the fiscal multiplier on government spending when monetary policy is by the zero lower bound is around 1.5. Overall, the evidence suggests that the output boost from the current fiscal response is likely to be large. (Wilson 2020).

Authors of a recent paper, published by the same regional bank, found that fiscal stimulus' multiplier effects vary greatly across time and countries. Their main finding is that fiscal multipliers can be large when monetary policy is "less activist." Monetary policy presumably is less active when traditional tools no longer work.

The sensitivity of fiscal and monetary policy to one another underscores the need for branches of government to coordinate. With input from elected officials, giving the Fed a new channel to distribute money directly to people could be useful in this regard. If hyperinflation is a primary risk posed such a strategy, why not give the Fed a way to exert finer control over its money pump while also giving elected officials more explicit channels for consultation during economic crises?

Given where the country is today, what's more likely to keep the economy afloat until medical technology can come to its rescue? Having the Fed buy bonds on the open market? Adjusting inflation targets or bank reserves? Or sending workers enough money to pay the rent and buy food?