



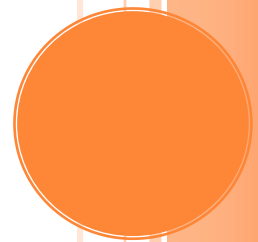
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**Modern Money Theory and Helicopter Money:
Debunking the Myths**

Student Research Internship Report

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Modern Money Theory and Helicopter Money: Debunking the Myths

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The COVID – 19 pandemic has undoubtedly had an adverse and disruptive effect on almost every aspect of the world, with the unprecedented global economic crises near the top of the list. With policy makers and governments looking to pursue extraordinary measures to combat the crises, Modern Money Theory, a subject that has been on the periphery of economic discussion has recently taken center stage even among its critics.

With Governments around the world dramatically expanding their budgets as a response to the crisis, a deficit of almost 10 percent of the GDP has become routine. As economists and policy makers scramble to look for ways to ease the global financial crisis, an incorrect comparison seems to have been drawn between Modern Money Theory and the use of Helicopter Money as a monetary policy by linking the two as a way to simply turn on the printing presses and ‘print more money’, which opens up the road to inflation or even hyperinflation as an impending consequence. A comment by Williem H. Buiter of Columbia University that says, “much of the U.S. response (to the pandemic) will come in the form of ‘helicopter money,’ an application of (MMT) in which the central bank finances fiscal stimulus by purchasing government debt issued to finance tax cuts or public spending increases” shows the aforementioned ideology. The comparison of the two, however, could not be more wrong as MMT does not support ‘helicopter drops’ or quantitative easing and does not prescribe a helicopter money alternative to financing a fiscal stimulus package.

Let us first understand the idea behind helicopter money and then explore the MMT policies and conclude why the two are incorrectly compared.

First mentioned by renowned economist Milton Freidman, a Helicopter drop is an expansionary fiscal or monetary policy which is financed by an increase in the money supply in the economy. This could be done through an increase in government spending or a tax cut and involves printing large sums of money and distributing the same to the population in order to stimulate the economy. The term ‘helicopter drop’ is often used as a broad term to refer to unconventional measures to jump start an economy in a deflationary period. A helicopter drop

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is also often looked at as an alternative to Quantitative Easing, however, it should be noted that while helicopter money looks to increase the money supply through distribution of currency to the public, quantitative easing does so by purchasing government or other financial securities from the open market in order to encourage lending and investing to boost the economy. While helicopter drops make money directly available to the public leading to an increase in consumer spending, quantitative easing has no direct impact on them, and the effects of QE can be reversed through the sale of securities whereas the effects of helicopter money remain theoretically permanent and irreversible.

MMT however is conceptually different from both QE and helicopter money and neither one should be confused with the other. Although, both QE and MMT involve a purchase of government bonds, it should be noted that when talking about QE, we assume that the Central Bank would sell the bonds purchased before their maturity, which will require the Government to ultimately raise money, mainly through taxes, to settle the debt to its private holders.

A fundamental message of MMT is that a country that is a sovereign issuer of its currency and does not tie its value to another currency, has no financial constraints on government spending, the United States being one such nation. This gives a government the ability to borrow money from the Central Bank, without the need for interest or repayment of the government bonds that the central bank has acquired. This allows MMT to meld monetary and fiscal policy together with the removal of any existing constraints on the same.

We know that taxation and government policy, the two elements of fiscal policy are what affect the quantum of reserve money with the commercial banks. These reserves are responsible for providing adequate funds for interbank transactions and also influence the interbank money market interest rates that are important for achieving the final inflation target as agreed upon by the government and central bank. Government transactions of money flowing in through taxes and out through government spending take place throughout the year, the net effect of which leads to either an increase or decrease in the reserves.

In the case of the United States, the US treasury which is the spending arm of the government and the Fed which is the government's bank, work together so that the treasury can spend and tax the authorized amounts. The Fed is responsible for ensuring that all the Treasury checks clear and that any bond auctions move forward without any setbacks.

However, being the banks' bank, the Fed also needs to ensure that steps are taken to avoid any disruption to the financial system by the Treasury spending and taxing. This is due to the

possibility of banks left either deficient or flooded with reserves as the payments move in and out of private bank accounts.

The Treasury issues bonds and then sells them through auctions. The Fed is responsible for ensuring a sufficient supply of reserves to pay for the aforementioned issued bonds through either lending or its own purchase. The approved banks and financial institutions who are the primary dealers required to participate in such auctions will continue to do the same. Essentially, everything will be operating the way it does when there is no pandemic to deal with and there is no requirement of conducting 'helicopter drops' or turning to the printing presses.

MMT simply emphasizes the fact that the Fed does not face any constraints when it comes to its ability to buy assets or lend funds. Advocates of MMT have consistently insisted that we stop attaching strings (such as increased taxation or spending cuts) to spending bills.

When talking about definitive policy suggestions, a universal job guarantee program which could act as an economic stabilizer in times of crisis has always been supported and talked about by MMT economists. A creation of jobs and employment opportunities in place of cash has been one of MMT's solution to an economic depression.

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