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Is a revolution in economic thinking under way?

Four years after the start of the Great Recession, the global economy has not recovered, voters are losing patience and governments around the world are falling like ninepins. This is a situation conducive to revolutionary thinking, if not yet in politics, then maybe in economics.

In the past few months the International Monetary Fund, previously a bastion of austerity, has swung in favor of expansionary fiscal policies. The U.S. Federal Reserve has committed itself to printing money without limit until it restores full employment. And the European Central Bank has announced unlimited bond purchases with printed money, a policy denounced, quite literally, as the work of the devil by the president of the German Bundesbank.

This week an even more radical debate burst into the open in Britain. Sir Mervyn King, governor of the Bank of England, found himself fighting a rearguard action against a groundswell of support for “dropping money from helicopters” – something proposed by Milton Friedman in 1969 as the ultimate cure for intractable economic depressions and recently described in this column as “Quantitative Easing for the People.”

King had to speak out because the sort of calculations presented here last summer started to catch on in Britain. The BoE has spent £50 billion over the past six months to support bond prices. That could instead have financed a cash handout of £830 for every man, woman and child in Britain, or £3,300 for a typical family of four. In the United States, the \$40 billion the Fed has promised to transfer monthly, with no time limit, to banks and bond funds, could instead finance a monthly cash payment of \$500 per family – to be continued indefinitely until full employment is restored.

Two weeks ago the British debate on QEP reached a crescendo in a daring speech by Lord Adair Turner, chairman of the Financial Services Authority, and one of the two leading contenders to replace King as governor of the BoE. Turner is a former management consultant famous in Britain for finding imaginative solutions to apparently insoluble issues, from climate change policy to reform of the National Health Service. While he stopped short of publicly endorsing “helicopter money,” Turner hinted strongly in that direction with a call for “still more innovative and unconventional” thinking since QE no longer seems to work. His speech was followed by a spate of editorials in the *Financial Times*, the BBC and other media outlets about helicopter money and the need for serious BoE thinking about such radical ideas.

King felt obliged to counterattack on behalf of traditional central banking. In a speech on Tuesday he set out to “distinguish between ‘good’ and ‘bad’ money creation” and denounced “talk about the possibility that money created by the Bank could be used directly to finance additional government spending, or even that money could be

given away.” But his opposition to QEP was surprisingly halfhearted, focusing not on economic issues but on bureaucratic conventions

“Abstracting from the colorful metaphor of ‘helicopter money,’ such operations would combine monetary and fiscal policies,” he said. “There is no need to combine them. Once the Bank has decided how much money should be created to meet the inflation target, the case for the Government to increase spending or cut taxes to counter a downturn stands or falls on its own merits.”

This division of responsibilities is reasonable and democratic. But it leaves wide open the case of QEP, since cash handouts would surely be more effective to “counter a downturn” than bond purchases for every £1 billion added to the money supply.

Was King’s tepid critique of QEP a hint that he, too, is losing faith in conventional QE and would like politicians to sanction something bolder? If so, the global implications would be enormous, since King is close in his thinking to Fed chairman Ben Bernanke and the Fed. More probably, King, like most incumbent central bankers, is genuinely horrified by the prospect of combining monetary and fiscal policy. But the fact is that monetary and fiscal policy become almost indistinguishable once interest rates fall to zero because there is no real difference between money and government bonds.

Which brings us to an even more radical proposal, closely related to the QEP debate, that emerged recently from the IMF. In a research paper that has gone viral among economists, Jaromir Benes and Michael Kumhof, two senior IMF staffers, describe a reform of monetary management that could potentially restore all the output lost in the Great Recession and simultaneously eliminate the government debt burdens of the United States, Britain and most European countries.

These miracles could be achieved without painful tax increases or spending cuts, by restoring to governments the exclusive right to create money they gradually lost to commercial banks. The monopoly right to create money generates a “seignorage tax,” whose capital value is roughly 100 percent of the U.S. gross domestic product, according to the IMF calculations. Transferring this enormous benefit from banks back to governments would allow most national debts to be paid off.

The radical idea of depriving banks of their money-creating function, like the idea of helicopter money, was first proposed by conservative Chicago economists – Henry Simons and Irving Fisher – in 1936. A distinguished conservative pedigree will not make the loss of seignorage rights acceptable to bank lobbyists any more than it makes helicopter money acceptable to conventional central bankers. But if global economic stagnation continues, public patience with conventional responses will run out – and ideas that now seem revolutionary may become conventional wisdom.