WORKING PAPER NO. 2014-1

STIMULUS WITHOUT DEBT

By

Laurence Seidman

WORKING PAPER SERIES

UNIVERSITY OF DELAWARE | Alfred Lerner College of Business & Economics

DEPARTMENT OF ECONOMICS

STIMULUS WITHOUT DEBT

Laurence Seidman

Chaplin Tyler Professor of Economics

Department of Economics

University of Delaware

Newark, DE 19716

seidman@udel.edu

Forthcoming, *Challenge Magazine*

ABSTRACT

A sobering lesson from the Great Recession is that widespread worry about government debt generates strong political resistance to enacting a fiscal stimulus large enough to overcome a severe recession. Fortunately there is a way to implement fiscal stimulus without increasing government debt. The purpose of this article is to explain the stimulus-without-debt plan, defend it, and urge Keynesian economists to advocate it in today's weak recovery and in future recessions. Under the plan, in a severe recession, fiscal stimulus enacted by Congress should be accompanied by a *"dual-mandate transfer"* from the Federal Reserve to the U.S. Treasury of the same magnitude so that the Treasury does not have to borrow to finance the fiscal stimulus. This article contrasts this stimulus-without-debt plan with alternative stimulus plans.

The standard Keynesian remedy for recession—fiscal stimulus (an increase in government spending and/or a cut in taxes)—generates a short-run rise in government debt. Keynesians have rightly argued that in a severe recession, stimulating the economy is more important than worrying about government debt. Unfortunately, many evidently disagree. A sobering lesson from the Great Recession is that widespread worry about government debt generates strong political resistance to enacting a fiscal stimulus large enough to overcome a severe recession (Seidman 2011, 2012a, 2012b).

Fortunately there is a way to implement fiscal stimulus without increasing government debt. The purpose of this article is to explain it, defend it, and urge Keynesian economists to advocate it in today's weak recovery and in future recessions. In a severe recession, fiscal stimulus enacted by Congress should be accompanied by a *"dual-mandate transfer"* from the Federal Reserve to the U.S. Treasury of the same magnitude so that the Treasury does not have to borrow to finance the fiscal stimulus. This article explains this stimulus-without-debt plan and contrasts it with alternative stimulus plans.

Standard Fiscal-Monetary Stimulus

Standard fiscal-monetary stimulus works this way. To raise aggregate demand for goods and services through fiscal stimulus, Congress cuts taxes and/or raises government spending (transfers and/or purchases) and the Treasury borrows to finance the resulting deficit by selling U.S. Treasury bonds to the public, thereby increasing government (Treasury) debt held by the public. The Federal Reserve then buys an equal amount of Treasury bonds from the public in "the open market," so that the Fed, not the public, ends up holding the increase in Treasury debt.

A crucial point is that the Fed's action does not reverse the increase in Treasury debt: official Treasury debt increases by an amount equal to the deficit that accompanies the fiscal stimulus, whether or not the Fed buys Treasury bonds from the public. Standard fiscal-monetary stimulus entails "monetizing the debt," not preventing debt.

Fiscal Stimulus Enacted by Congress

The first component of the stimulus-without-debt plan is fiscal stimulus (a tax cut and/or increase in government spending) enacted by Congress. Economists disagree about the relative effectiveness—"the multiplier"—of different kinds of fiscal stimulus (tax rebates to households, infrastructure project spending, cash grants to state governments, tax cuts for business, and so on). In this article I will use one particular example of fiscal stimulus-- tax rebates to households—but the reader may want to substitute another kind of fiscal stimulus that the reader believes would be more effective or prefers on other grounds.

My recommendation for fiscal stimulus is a tax rebate for households. A tax rebate was implemented during U.S. recessions in 1975, 2001, and 2008. In 2008 Congress enacted and President Bush signed a tax rebate of $600 per adult and $300 per child with an estimated total expenditure of roughly $100 billion; the rebate was enacted in February and the U.S. Treasury mailed out rebate checks in the summer. A study of the effects of the 2008 rebate using micro data on individual consumer spending and date of receipt of the rebate (Parker, Souleles, Johnson, McClelland 2011) found that the typical individual spent about half the rebate in the three months after receiving it. An earlier study of the 2001 rebate by the same authors (Johnson, Parker, Souleles 2006) using micro data found a similar result.

Lewis and Seidman (2011) found that macro data from the summer of 2008 are consistent with the conclusion from the micro data study. They critiqued in detail the articles by two influential economists, John Taylor (2009) and Martin Feldstein (2009), who claimed that macro data proved that the summer 2008 tax rebates did not boost consumption spending. Taylor and Feldstein claimed that the fact that aggregate consumption stayed constant from the beginning of the summer to the end of the summer proved the tax rebate had no effect. They ignored the obvious point that the strong downward forces in the economy during the summer of 2008—plunging housing prices, stock prices, and consumer confidence—would surely have reduced aggregate consumption during the summer, and the fact that aggregate consumption instead stayed constant through the summer instead of falling was likely due to the summer tax rebate. Moreover, in their regressions testing the impact of tax rebates on aggregate consumption, they failed to include (control for) housing prices, stock prices, or a consumer confidence index. Furthermore, they used monthly rather than quarterly data so their regressions measured only the impact on consumer spending in the weeks, not months, following receipt of the rebate. Finally, they failed to acknowledge that because their data contained very few observations on tax rebates (because rebates were given in only three months in 2001 and three months in 2008), it was hardly surprising that they were unable to reject the hypothesis that the true rebate coefficient was zero—the paucity of observations provided too little precision to reject almost any hypothesis about the impact of the tax rebates.

Meanwhile, some economists (for example, Ramey 2011) have usually made a fundamental mistake in empirically estimating the size of a fiscal stimulus multiplier—the ratio of the change in real output to the magnitude of the particular fiscal stimulus. Those economists have generally run regressions using data from the economy in years of prosperity as well as

years of recession, estimating the average multiplier in all years. But in considering policies to combat a recession, what matters is the size of the multiplier in recession, and from the time the concept of the multiplier was introduced by early Keynesians, it was clearly recognized and emphasized that the multiplier would be small in prosperity when resources are already fully employed and large in recession when unemployed resources are available (Seidman 2012a, 2012b). Yet in recent studies economists have usually reported and used the "average" multiplier values they obtained from their regressions to estimate what the impact of fiscal stimulus would be in a recession.

Monetary Stimulus: A Dual-Mandate Transfer from the Federal Reserve to the Treasury

The second component of the stimulus-without-debt plan proposed here—a particular kind of monetary stimulus-- is *"a dual-mandate transfer"* from the Federal Reserve to the U.S. Treasury. In a severe recession the Federal Reserve Open Market Committee (FOMC) would give a transfer to the Treasury in an amount decided by the FOMC that, in its judgment, would promote the Federal Reserve's dual legislative mandate—enacted years ago by Congress-- of promoting both high employment and low inflation. It must be emphasized that the Federal Reserve would not be buying bonds from the Treasury; the Treasury would not be incurring debt—it would be receiving a transfer. If legal scholars judge that, under the current Federal Reserve Act, the FOMC is not permitted to give a dual-mandate transfer to the Treasury, Congress would need to amend the Act to permit such a transfer in order to implement the policy proposed in this article.

For example, if the FOMC decided on a transfer of $100 billion to the Treasury this year, then Congress could enact a $100 billion fiscal stimulus without any additional borrowing by the Treasury. Note the contrast with a standard fiscal-monetary stimulus of $100 billion which would require the Treasury to sell $100 billion of bonds, thereby increasing federal debt by $100 billion. Under the stimulus-without-debt plan, there would be the same fiscal stimulus of $100 billion and the same injection of $100 billion of money into the economy by the Fed, but no sale of new Treasury bonds and no increase in government debt.

When the Treasury receives a transfer from the Fed, that revenue would be added to tax revenue and fees received by the Treasury to yield total revenue received by the Treasury. This total revenue would be compared to government spending (outlays) to determine the federal deficit. Thus, suppose the budget were initially balanced, and then Congress enacted a tax rebate of $100 billion and received a transfer from the Treasury of $100 billion. Both Treasury outlays and revenue would increase $100 billion so the federal budget would remain balanced. This is the same budget treatment given by state governments to receipt of transfers from the federal government; the state government adds federal transfers received to state tax revenue to obtain total revenue, which is then compared to total state government outlays to determine the state government's deficit. Thus, the stimulus-without-debt plan would not create federal debt or a federal deficit: with the transfer from the Fed to the Treasury equal to the fiscal stimulus, there would be no official deficit and no official increase in debt.

A direct transfer from the Fed to the Treasury in order to achieve stimulus-without-debt was recently proposed in a *Wall Street Journal* op ed by Daniel Arbess (2013) who wrote:

"The Fed has already printed about $2.5 trillion of new money. Overt monetary finance might offer a more direct way to channel that money into the economy than trying to push debt through banks to the private sector. Such an approach would bypass the credit channel and send cash straight to the Treasury where it would be deployed as directed by Congress."

Separation of Powers and Checks and Balances

A crucial feature of the stimulus-without-debt plan proposed here is that it preserves the separation of powers and checks and balances in the implementation of fiscal and monetary policy. The first component—the fiscal stimulus—is under the control of Congress (and the president, whose signature is required unless Congress can obtain a two-thirds majority to over-ride the President's veto) but not the Federal Reserve. The second component—the transfer from the Federal Reserve to the Treasury—is under the control of the Federal Reserve but not Congress (or the president). This preservation of separation of powers and checks and balances should be kept in mind as the stimulus-without-debt plan is contrasted with the following alternative stimulus plans: (1) Helicopter money; (2) Monetizing the debt; (3) Quantitative easing by the Federal Reserve; (4) Transfers from the Federal Reserve to households; (5) Money creation by the Treasury as authorized by Congress. Each will be considered in turn.

Helicopter Money

The stimulus-without-debt plan proposed in this article is not "helicopter money." A crucial aspect of any practical stimulus plan is the exact details of how money is actually obtained by particular households. The first component of the stimulus-without-debt plan proposed in this article is one form of fiscal stimulus: the enactment of a tax rebate by Congress instructing the U.S. Treasury, using its IRS data base of household taxpayers, to send tax rebate checks in dollar amounts specified by Congress through regular mail to households (as it actually did in 1975, 2001, and 2008). The second component of the plan is a transfer from the Federal Reserve to the U.S. Treasury. Both components are practical, and analysis of the effects of the plan can focus on how the public would actually respond to the practical implementation of the two components.

In a discussion of practical stimulus plans, it is unhelpful to call any particular plan "helicopter money" because that phrase ignores whether there will be checks and balances between actual institutions in the practical implementation of the plan.

"Helicopter money" comes from an article by Milton Friedman (1969) in which he asked readers to imagine a helicopter drop of money on an economy that was initially in a classical full-employment equilibrium. In a section entitled "Effect of a Once-And-For All Change in the Nominal Quantity of Money," Friedman wrote:

> "Let us suppose now that one day a helicopter flies over this community and drops an additional $1,000 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. To begin with, suppose further that each individual happens to pick up an amount of money equal to the amount he held before, so

> that each individual finds himself with twice the cash balances he had before. If every individual simply decided to hold onto the extra cash, nothing else would happen…But this is not the way people would behave…We know only that each individual will seek to reduce his cash balances at some rate. He will do so by trying to spend more than he receives…It is easy to see what the final position will be. People's attempts to spend more than they receive will be frustrated, but in the process these attempts will bid up the nominal value of services…" (p4-6, Friedman 1969).

Note two points about this passage. First, Friedman did not use the phrase "cash transfer" or "fiscal stimulus," and his language and section-heading title gave the impression that he viewed his helicopter drop as solely monetary policy, not fiscal policy. But this is incorrect. In our actual society, in contrast to Friedman's imaginary thought experiment, cash transfers (such as tax rebates) to individuals are delivered by checks mailed out by the U.S. Treasury under Congressional legislation authorizing the transfers—by fiscal policy, not monetary policy. Friedman's helicopter delivers a combined fiscal-monetary policy. Second, Friedman made no comment on what would happen if the economy were initially in recession rather than a classical full-employment equilibrium. Keynesian economists would contend that in a recession the additional spending by households would primarily raise real output and employment and have a modest effect on prices.

In an academic article before he became a member of the Federal Reserve Board, Ben Bernanke (2000) made the following recommendation to Japan on how to energize its weak economic recovery from a recession that began in the early 1990s:

> "An alternative strategy…is money-financed transfers to domestic households—the real-life equivalent of that hoary thought experiment, the 'helicopter drop' of newly printed money. I think most economists would agree that a large enough helicopter drop must raise the price level. Suppose it did not, so that the price level remained unchanged. Then the real wealth of the population would grow without bound, as they are flooded with gifts of money from the government…Surely at some point the public would attempt to convert its increased wealth into goods and services, spending that would increase aggregate demand and prices…
>
> "Of course, the Bank of Japan (BOJ) has no unilateral authority to rain money on the population. The policy being proposed—a money-financed tax cut—is a combination of fiscal and monetary measures. All this means is that some intra-governmental cooperation would be required. Indeed, the case for a tax cut now has already been made." (p162-63).

It was not this academic article, however, that led to the nickname "helicopter Ben." Instead, it was the following single sentence from a speech (Bernanke 2002) he gave after becoming a member of the Fed Board of Governors in which he expressed support for a money-financed tax cut, and added:

> "A money-financed tax cut is essentially equivalent to Milton Friedman's famous 'helicopter drop' of money."

Bernanke, however, in his article and his speech, stopped short of advocating a transfer from Japan's central bank to Japan's Treasury. He wrote:

> "The willingness of the BOJ to purchase government securities equal to the cost of the tax cut would serve to reduce the net interest cost of the tax cut to government, which could not hurt the tax cut's chance of passage." (2000, p163).,

Like many others who have favored a combined fiscal-monetary expansion to combat a recession, Bernanke recommended that the Treasury sell government bonds, thereby increasing government debt, but then have the central bank buy an equal amount of government bonds from the public through standard open market operations. Thus Bernanke's plan was not "stimulus-without-debt." His plan was a combined fiscal-monetary expansion with the increase in government debt held by the central bank rather than the public (Seidman 2006).

Monetizing the Debt

The stimulus-without-debt plan proposed in this article does not involve "monetizing the debt" because it creates no debt to monetize: the Treasury sells no bonds, and no additional Treasury bonds are held by either the public or the Federal Reserve; the official federal debt stays constant. By contrast, standard fiscal-monetary stimulus involves "monetizing the debt": the Treasury sells bonds to the public, the Fed buys Treasury bonds from the public, and official Treasury debt increases.

The stimulus-without-debt plan achieves exactly what could be done if there were no independent central bank, and instead Congress directly controlled not only government spending and taxes, but also money creation. In a recession, Congress could set taxes below government spending and authorize the Treasury to create money, rather than sell bonds, to cover the difference. In this direct way Congress could provide stimulus-without-debt.

Of course, the danger of Congress directly controlling money creation as well as spending and taxation would be the absence of separation of powers and checks and balances. It was therefore a wise and crucial step for Congress, a century ago, to establish an independent central bank that would control the creation of money. Congress thereby gave up the power to cover its deficit by creating money. This has provided an important check against Congress setting government spending well above taxes in a normal economy when no stimulus is warranted, creating money to cover the difference, and thereby unilaterally injecting a combined fiscal-monetary stimulus that overheats the economy and generates inflation.

It was, however, unwise for Congress to apparently (if this is the judgment of legal scholars) prohibit the independent central bank from unilaterally deciding to give a dual-mandate transfer to the Treasury. The danger in prohibiting a dual-mandate transfer is that it prevents stimulus-without-debt in a recession or a weak recovery. If legal scholars judge that the current Federal Reserve Act in fact contains such a prohibition, then Congress should amend the Act to specifically authorize a dual-mandate transfer—a transfer that the FOMC judges would promote its dual mandate of high employment and low inflation.

In a recent speech that received much attention, Adair Turner (2013), chairman of Britain's Financial Services Authority who was seriously considered to become the Governor of the Bank of England, called for "overt monetary financing (OMF)" of fiscal stimulus which at

first glance sounded like stimulus-without-debt, but on inspection turned out to be merely monetizing the debt. Turner called for the treasury to finance a fiscal stimulus by selling bonds, and used the term "overt monetary financing" to mean that the central bank would then buy the treasury bonds from the public with new money. It is interesting that Turner regarded "monetizing the debt," which occurs under standard fiscal-monetary stimulus, as a "taboo" in the financial community—a taboo he sought to break down. In his speech he did not call for the central bank to give a transfer to the treasury so that the treasury could finance a fiscal stimulus without borrowing. Maybe he will in a future speech or paper.

Another advocate of monetizing the debt, but not stimulus-without-debt, is Columbia economist Michael Woodford (2013) who recently stated in an interview:

> "The policy that I proposed would require coordination of monetary and fiscal actions, but it could be carried out while preserving the traditional separation of roles. The fiscal authority would make the transfers, issue debt to pay for them, and later tax people to service the debt; the monetary authority would conduct open-market operations in the amounts needed to keep nominal GDP on the target path…"

In his interview he did not call for the central bank to give a transfer to the treasury so that the treasury could finance a fiscal stimulus without borrowing. Maybe he will in a future interview or paper.

Quantitative Easing by the Federal Reserve

Under quantitative easing by the Fed, the Fed buys bonds in the open market and pays bond sellers with checks that the sellers deposit in their banks, thereby increasing bank reserves, which is expected to lead to a reduction in the interest rates that banks offer borrowers, thereby raising borrowing and spending by households and business firms, resulting in more production and employment. To work, quantitative easing must therefore induce households and businesses to incur more debt.

By contrast, the plan proposed in this article sends tax rebate checks to households in order to raises households' ability to spend more without incurring debt. It is expected that households will use some of their rebate to pay down debt, some for saving, and some to increase their spending. Prior to the Great Recession, many households accumulated excessive debt, and the Great Recession has generated a deleveraging process in which many households are gradually reducing their debt to normal—a process that is healthy individual households and for the future of the economy. Quantitative easing tries to prematurely halt this deleveraging process and induce households to start accumulating debt. Such a premature accumulation of debt would not be healthy for households or for the future of the economy, and is unlikely to succeed with many households who are determined to reduce their debt to normal. By contrast, tax rebates enable households to continue reducing their debt while increasing their spending.

Transfers from the Federal Reserve to Households

Transfers from the central bank to households, implemented within the zone of any central bank (for example, U.S., Japan, or Eurozone), has been called "quantitative easing for the people" (Kaletsky 2012). Under Federal Reserve transfers to households, the Fed would give

each household a transfer—for example, $600 per adult plus $300 per child. To implement this transfer, the Fed would somehow have to obtain the addresses of millions of households—presumably from the Internal Revenue Service. Under this plan the Fed, not Congress, would specify the dollar amount that would be sent to each household. It is likely that legal scholars would judge that, under the current Federal Reserve Act, the FOMC is not permitted to give transfers directly to households, so Congress would need to amend the Act to permit such transfers and to permit the Fed to use the IRS data base to mail out checks to households.

It is useful to compare this plan to the stimulus-without-debt plan with a tax rebate of $600 per adult and $300 per child plus a Fed dual-mandate transfer to the Treasury equal to $100 billion--the total dollar amount of the tax rebates. A key difference is who decides the amount of the rebate to each household: the Fed or Congress? The stimulus-with-debt plan preserves a separation of powers in which Congress retains control over the amount sent to each household and the Federal Reserve's decision is limited to the total amount of the dual-mandate transfer it gives to the Treasury. When Congress enacted tax rebates for households in 1975, 2001, and 2008, no one questioned the appropriateness of an elected Congress deciding the specific amounts that would go to each household. By contrast, many would question the appropriateness of an unelected Federal Reserve deciding the specific amounts to go to each household.

In 1999, Harvard economist Greg Mankiw, a leading macroeconomist who later served as Chairman of the Council of Economic Advisers in the Bush Administration, wrote an article in Fortune magazine entitled "Memo to Tokyo: Cut Taxes, Print Money" in which lamented the inadequate fiscal-monetary stimulus during the U.S. Great Depression, and then made this

recommendation for Japan still mired in a weak recovery from a recession that began in the early 1990s:

> "Armed with this bit of history, what should Japanese policymakers do now? The answer is simple: Cut taxes and print money. Better yet, combine operations. Why not print up some 100,000 yen [$1,000] notes, and stick one in the pocket of every Japanese citizen? Some people might put the money under their mattresses—the Japanese are notoriously thrifty, after all—but some will surely spend it and provide the stimulus to aggregate demand that is so sorely needed."

In this paragraph, Mankiw suggested two alternative ways to implement stimulus. The first involved a tax cut enacted by the legislature; to finance the tax cut the treasury would have to sell bonds to the public and the central bank would buy treasury bonds from the public with new money (a standard central bank open market operation). So Mankiw's first suggestion was a standard fiscal-monetary stimulus that would increase government debt. Mankiw's second suggestion is the focus of this section: a transfer of new money directly from the central bank to households. The problem is that many would question the appropriateness of an unelected central bank deciding the specific amounts to go to each household. If Mankiw had been asked to give a third suggestion, he *might* have said: "Let the legislature cut taxes, and then let the central bank give the treasury a transfer of new money equal to the tax cut so that the treasury does not have to borrow." Maybe he will give this suggestion in a future article.

Money Creation by the Treasury as Authorized by Congress

Under this plan, Congress would enact tax rebates for households—for example, $100 billion-- and then authorize the Treasury to create $100 billion of new money to pay for the rebates. Money creation by the Treasury would eliminate the need for the Treasury to borrow $100 billion by selling bonds so there would be no increase in government debt. Nor would there be any participation by the Federal Reserve under this plan. Congress would enact the fiscal stimulus and then authorize the Treasury to create the money to pay for it rather than borrow. Australian economist Richard Wood (2012), in an article entitled "The Economic Crisis: How to Stimulate Economies without Increasing Public Debt," proposed that the treasury or ministry of finance of a nation, not its central bank, create the money to pay for the fiscal stimulus enacted by its legislature.

But if Congress authorizes money creation by the Treasury, then there would be a breakdown of the current separation of powers and checks and balances. By contrast, under the stimulus-without-debt plan, Congress, not the Federal Reserve, would authorize the rebates, and the Federal Reserve, not Congress, would decide the specific amount of money to transfer to the Treasury in order to pursue its dual mandate--high employment and low inflation-- which Congress legislated for the Fed many years ago.

Not Counting Treasury Bonds Held by the Fed as Government Debt

It has sometimes been argued (for example Seidman 2001, 2003) that Treasury bonds held by the Fed should not be officially counted as government debt because the Fed is a special lenient creditor. In contrast to other holders of Treasury bonds, the Fed returns most of the

interest earned on its Treasury bonds to the Treasury. Moreover, the Fed indirectly helps the Treasury pay the principal on bonds as they come due by buying "old" Treasury bonds from the public in the open market, thereby raising the public's demand for newly issued Treasury bonds that enables the Treasury to obtain the revenue it needs to pay principal on maturing bonds.

Despite the Fed's leniency as a holder of Treasury bonds, bonds held by the Fed are officially counted and reported as government debt. Moreover, such counting and reporting may be useful because the Fed may at any time sell these Treasury bonds to the public who will, in contrast to the Fed, expect and demand full interest and principal payments from the Treasury on schedule. Thus, as long as fiscal-monetary stimulus requires the Treasury to sell bonds, this sale will be officially recorded as an increase in government debt, and citizens and policy-makers will worry about whether the government will be able to make full interest and principal payments on schedule on all its bonds including those currently held by the Fed. The only way to prevent worry about government debt when fiscal stimulus is enacted is for the Treasury not to sell new bonds.

Money Creation Instead of Government Debt

Several decades ago James Buchanan, who later received a Nobel prize for his contributions to public choice economics, argued that Keynesian economists should have called for financing a fiscal stimulus by money creation instead of borrowing. By advocating borrowing, Keynesian economists provoked opposition to fiscal stimulus from classical and public choice economists, policy-makers, and citizens who rightly (Buchanan believed) worried

about government debt. Buchanan recognized, of course, that money creation provoked opposition due to worry about inflation. Buchanan and Wagner (1977, p31-34) wrote:

> "Deficits could be financed in only one of two ways, either through government borrowing (the issue of public debt) or through the explicit creation of money (available only to the central government). But public debt, in the classical theory of public finance, transfers burdens onto the shoulders of future generations. And money creation was associated, historically, with governmental corruption along with the dangers of inflation…
>
> "Retrospectively, it remains somewhat surprising that the Keynesians, or most of them, chose to challenge the debt-burden argument of classical public finance rather than [adopt] the money-creation alternative…Within the strict assumptions of the Keynesian model, and in the deficient-demand setting, the opportunity cost of additional government spending is genuinely zero. From this, it follows directly that the creation of money to finance the required deficit involves no net cost; there is no danger of price inflation. In the absence of political-institutional constraints, therefore, the idealized Keynesian policy package for escape from such economic situations is the explicit creation of budget deficits along with the financing of these by pure money issue…On his own grounds, the Keynesian economist could have made a much more effective case for deficit financing by direct money creation."

The stimulus-without-debt plan heeds Buchanan's suggestion. While preserving a separation of powers and checks and balances, the plan finances fiscal stimulus by money

creation rather than government debt, thereby eliminating the main source of political opposition to *standard* fiscal-monetary stimulus—worry about government debt.

Worry about Inflation

The stimulus-without-debt plan should eliminate worry about government debt, but it may provoke more worry about inflation. Is there any reason to believe that political resistance to a large fiscal stimulus in a severe recession would be less if worry about inflation replaces worry about government debt? There is.

When the economy plunges into a severe recession caused by a collapse in aggregate demand, automatically tax revenue falls, unemployment benefits rise, and government debt rises as the Treasury is forced to borrow to cover the difference between falling tax revenue and rising government expenditures. Any severe recession is accompanied by a sharp rise in government debt so that government debt rivals the recession as a source of worry for the citizenry. With government debt already rising, many resist standard fiscal stimulus which would further raise government debt in the short run. But when the economy plunges into a severe recession caused by a collapse in aggregate demand (rather than by a 1970s-like supply shock from a sudden large rise in the world price of oil), inflation does not rise—it may even decline. During the Great Recession, there has been little worry about inflation because the recession in fact did not raise inflation.

Would the stimulus-without-debt plan actually raise inflation? Under the plan, the magnitude of the fiscal stimulus and Fed transfer to the Treasury is set with the aim of raising aggregate demand for goods and services back up to normal, not above normal. As long as

demand is not raised above normal, inflation is unlikely to rise. The economy cannot fully recover from recession unless demand returns to normal. Of course, the magnitude chosen for the stimulus may turn out to be too large or too small—if too large, demand would rise above normal and some inflation would be generated; if too small, demand would remain below normal and so would output. Any recovery of demand after recession, whether generated by stimulus policy or "naturally" by "market forces," risks generating some inflation if it becomes too strong.

Let's consider several particular worries about inflation and provide a response to each.

Worry: "The stimulus-without-debt plan asks the Federal Reserve to 'print money,' and 'printing money' is inflationary." Reply: "The plan asks the Fed to write a check exactly the way it writes checks under its standard open market operations. The only difference is who receives the Fed's check. Under the plan, the recipient of the Fed check is the U.S. Treasury; under standard open market operations, the recipients of Fed checks are members of the public who are selling Treasury bonds that they bought in the past. Check writing is what the Fed routinely does when it conducts open market operations.

Worry: "The stimulus-without-debt plan asks the Fed to give a transfer to the Treasury, something the Fed has been prohibited from doing because it has been judged 'inflationary.'" Reply: "Not if the Fed only gives a transfer when aggregate demand for goods and services is below normal, and sets the magnitude of the transfer with the aim of raising demand back up to normal, not above normal. Inflation is defined as rising prices for goods and services. Prices are determined by demand and supply for goods and services. As long as demand is not raised above normal, prices are unlikely to rise above normal."

Worry: "By giving a transfer to the Treasury rather than buying Treasury bonds, the Fed will find it harder to go into reverse once demand in the economy threatens to rise above normal,

because the Fed won't obtain Treasury bonds it can later sell in order to withdraw money and raise interest rates to prevent the overheating of the economy." Reply: "The Fed already has a large inventory of Treasury bonds from its standard open market operation so it can sell these bonds to withdraw money and raise interest rates. If necessary, the Fed can also raise reserve requirements on banks which would compel banks to keep reserves rather than make loans, thereby raising interest rates (Siegel 2013). Finally, some including Bernanke (2009) have suggested that the Fed can also use its new tool, raising the interest rate the Fed now (since 2008) pays on bank reserves, to induce banks to raise the interest rate they charge borrowers, thereby restraining the economy.

Worry about Fed Independence

Worry: "Under the stimulus-without-debt plan, Congress will set the magnitude of its fiscal stimulus, and will then pressure the Federal Reserve to provide a transfer to the Treasury equal to the amount of the fiscal stimulus. Therefore, under this plan the Fed will sacrifice its independence. It will be compelled to provide the money Congress wants."

But under the stimulus-without-debt plan, Congress authorizes the Fed to provide a transfer to the Treasury only if the Fed judges that this transfer would advance the Fed's mandate, prescribed by Congress many years ago, of promoting high employment and low inflation. Moreover, under the plan the Fed is called upon to set the magnitude of its transfer to the Treasury to promote the dual mandate according to the Fed's judgment.

Of course, some in Congress may try to pressure the Fed to provide the magnitude of transfer to the Treasury that they would like. But the same is true today of interest rates and Fed

open market operations: there are some in Congress who may try to pressure the Fed to adjust interest rates or open market operations to their liking. Nevertheless, despite such pressure from some members of Congress, the Fed has generally maintained its independence about adjusting interest rates and open market operations. It seems just as likely that the Fed would maintain its independence in deciding whether to give a transfer to the Treasury, and if so, how much the transfer should be.

In his academic article in which he referred to helicopter money and proposed a combined fiscal-monetary expansion for Japan (involving an increase in Treasury debt that would end up being held by the central bank), Bernanke (2000) made an important point concerning the independence of the Bank of Japan (BOJ), Japan's central bank:

> "The policy being proposed—a money-financed tax cut—is a combination of fiscal and monetary measures….By the way, I do not think that such cooperation would in any way compromise the BOJ's newly won independence, as some have suggested. In financing a tax cut, the BOJ would be taking voluntary action in pursuit of its legally mandated goal, the pursuit of price stability. Cooperation with the fiscal authorities in pursuit of a common goal is not the same as subservience." (p163).

Bernanke's point about central independence applies equally to the stimulus-without-debt plan. The central bank would be taking voluntary action—giving a dual-mandate transfer to the Treasury-- in pursuit of its dual mandate.

Worry about the Fed's Balance Sheet

How would the stimulus-without-debt plan affect the Fed's conventional accounting balance sheet? If the Fed buys a Treasury bond in the open market, it obtains an asset, but if the Fed gives the Treasury a transfer, it obtains no asset. According to conventional accounting, the Fed's "net worth" or "capital"—defined as assets minus liabilities-- would therefore be lower if the Fed gives the Treasury a transfer instead of buying Treasury bonds.

For a household, firm, or governmental unit, it is important to worry about whether its "liabilities" (what it owes others) listed on its conventional accounting balance sheet are greater than its "assets" (what it owns or is owed by others). But there are at least two problems with using a conventional accounting balance sheet to evaluate the Federal Reserve in the same way it is used to evaluate a firm, household, or other governmental unit. First, Congress has given the Federal Reserve the power to create money by writing checks and standing ready to print and provide cash (Federal Reserve notes), a power not available to a firm, household, or other governmental unit. Second, one of the large liabilities listed on the Fed's conventional balance sheet—Federal Reserve notes-- differs in an important way from the liabilities listed on the balance sheets of firms, households, and other governmental units. Let's consider these two problems in turn.

First**,** the Fed has been authorized by Congress to do something that is prohibited for private firms, households, and other governmental units: the Fed can create money by writing checks and standing ready to print and provide cash (Federal Reserve notes). This does not necessarily mean the Fed can always create all the money it needs to meet all its financial obligations. The Fed is constrained by Congress to take actions that promote high employment, low inflation, and the financial stability of the economy. It is possible that, in some

circumstances, these constraints may limit the ability of the Fed to meet all its financial obligations by creating money. But the power to create money surely gives the Fed an important tool for meeting its financial obligations not available to firms, households, and governmental units. A conventional accounting balance sheet alone is therefore inadequate to evaluate the financial position of the Federal Reserve.

Second, on the Fed's conventional accounting balance sheet, the quantity of Federal Reserve notes outstanding is listed as a liability, and is usually the largest liability on the Fed's balance sheet. This made sense historically when the Federal Reserve promised to pay gold to holders of Federal Reserve notes if the holders requested gold. But this rationale no longer holds because the Fed no longer promises to pay holders of Federal Reserve notes gold or anything else. Thus, it is no longer obvious whether Federal Reserve notes are still a genuine liability of the Fed—or even if they are still a liability, whether they are as burdensome as other liabilities.

Despite these two problems with applying a conventional accounting balance sheet to the Fed, there will no doubt be concern about any plan that reduces the conventionally measured net worth or capital of the Fed. Advocates of the stimulus-without-debt plan should emphasize these two problems, object to the use of the conventional Fed balance sheet to pass judgment on the stimulus-without-debt plan, and call for new and better ways to evaluate the financial position of the Federal Reserve.

Conclusion

The stimulus-without-debt plan proposed in this article has two components: (1) fiscal stimulus--a tax rebate for households—enacted by Congress; (2) monetary stimulus-- a dual-

mandate transfer from the Federal Reserve to the U.S. Treasury. The plan would raise aggregate demand for goods and services, thereby stimulating the economy without raising government or household debt while preserving the separation of powers and checks and balances in the use of fiscal and monetary policy.

REFERENCES

Arbess, Daniel (2013). "Bring on the 'Helicopter Money'." *Wall Street Journal* op ed, May 14.

Bernanke, Ben (2000). "Japanese Monetary Policy: A Case of Self-Induced Paralysis?" *In Japan's Financial Crisis and Its Parallels to U.S. Experience*, eds. Ryoichi Mikitani and Adam Posen. Washington, DC: Institute for International Economics.

Bernanke, Ben (2002). "Deflation: Making Sure 'It' Doesn't Happen Here." Remarks to National Economists' Club, Washington DC, November 21.

Bernanke, Ben (2009). "The Fed's Exit Strategy." Wall Street Journal op ed, July 21.

Buchanan, James, and Richard Wagner (1977). *Democracy in Deficit: the Political Legacy of Lord Keynes*. New York: Academic Press.

Feldstein, Martin (2009). "Rethinking the Role of Fiscal Policy." *American Economic Review Papers and Proceedings* 99(2): 556-559.

Friedman, Milton (1969). "The Optimum Quantity of Money." In *The Optimum Quantity of Money and Other Essays* (Chicago: Aldine).

Johnson, David, Jonathan Parker, and Nicholas Souleles (2006). "Household Expenditures and the Income Tax Rebates of 2001." *American Economic Review*, 96(5): 1589-1610.

Kaletsky, Anatole (2012). "How about Quantitative Easing for the People?" August 1. http://blogs.reuters.com/anatole-kaletsky/2012/08/01/how-about-quantitative-easing-for-the-people.

Lewis, Kenneth, and Laurence Seidman (2011). "Did the 2008 Rebate Fail? A Response to Taylor and Feldstein." *Journal of Post Keynesian Economics*, 34(2): 183-204.

Parker, Jonathan, Nicholas Souleles, David Johnson, and Robert McClelland (2011). "Consumer

Spending and the Economic Stimulus Payments of 2008." NBER Working Paper 16684 (January), forthcoming in the *American Economic Review*.

Ramey, Valerie (2011). "Identifying Government Spending Shocks: It's All in the Timing." *Quarterly Journal of Economics* 126(1): 1-50.

Seidman, Laurence (2001). "Reviving Fiscal Policy." *Challenge* 44(3): 17-42.

Seidman, Laurence (2003). *Automatic Fiscal Policies to Combat Recessions*. Armonk NY: M.E. Sharpe.

Seidman, Laurence (2006). "Learning about Bernanke." *Challenge* 49(5): 19-32.

Seidman, Laurence (2011). "Great Depression II: Why It Could Happen and How to Prevent It." *Challenge* 54(1): 32-53.

Seidman, Laurence (2012a). "Keynesian Fiscal Stimulus: What Have We Learned from the Great Recession?" *Business Economics* 47(4): 273-284.

Seidman, Laurence (2012b). "Keynesian Stimulus versus Classical Austerity." *Review of Keynesian Economics*, Inaugural Issue: 77-92.

Siegel, Jeremy (2013). "Fed Must Revert to Tested Reserves Policy." *Financial Times* op ed, March 27.

Taylor, John (2009). "The Lack of an Empirical Rationale for a Revival of Discretionary Fiscal Policy." *American Economic Review Papers and Proceedings* 99(2): 550-555.

Turner, Adair (2013). "Debt, Money, and Mephistopheles: How Do We Get out of This Mess?" Group of 30, Washington D.C., May (based on a speech given on February 6).

Wood, Richard (2012). "The Economic Crisis: How to Stimulate Economies without Increasing Public Debt." Center for Economic Policy Research (CEPR) Policy Insight No. 62, August.

Woodford, Michael (2013). "Helicopter Money as a Policy Option." May 20 interview reported by VOX. http://www.voxeu.org/article/helicopter-money-policy-option.