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Abstract

Today, the world economy is at the brink of a major recession at zero lower bound. The recession has been fomented by the underconsumption induced by (i) the increasing income inequality, which is inherent in the neoliberal policymaking followed the last third of a century, and (ii) the declining wages being brought about by the increasing globalization and hence, international competition. And, the zero lower bound has been the aftermath of continuous interest rate reductions to confront the latent recessionary trends by stimulating investment but by increasing at the same time the prices of assets, bonds, and housing inciting several kinds of "bubbles" and inhibiting investment. The policy of "quantitative easing" in the place of interest rate reductions, a surrogate only of the latter has proved to be so far, for the simple reason that the money injections involved to spur business and household demand, are channeled towards the banking system, which withholds and does not pass on the money to the public. A money gift policy in the sense of transferring money directly to the public as a permanent asset for the private sector but not liability for the public sector, activating subsequently the Pigou effect, is advocated herein to be a viable policy alternative out of the current deadlock, *ceteris paribus*.

Keywords: Global recession, Underconsumption, Zero lower bound, Quantitative easing, Money gift/rain

1. Introduction

The concept of liquidity trap, which today is attributed with the term Zero Lower Bound (ZLB), refers to the infinite elasticity of money demand at zero or so nominal interest rate under recession conditions. Households want to hold only money and not assets, to buy the goods and services recession has taken away from them. And, this problem of insufficient demand is an equilibrium state of affairs, because underconsumption causes pessimism on the part of investors. Pessimism, deterring them to invest and help recovery by borrowing from banks that are reluctant to lend anyway, because of the low interest rate and low thereby return to lending.

Under this investor-bank "non-interaction", channeling cash into the market indirectly though the banking system as is typically done by the Central Bank would only change the circulation velocity, leaving unaffected the real economy: Monetary policy is completely ineffective. So, many economists believe that the best way to end a liquidity trap is a money gift directly to households, to be spent *à la* Pigou effect and spur subsequently investment. This is a special case of economic policy since it can be classified as both monetary and fiscal, and does not form part of the statutory responsibilities of a Central Bank.

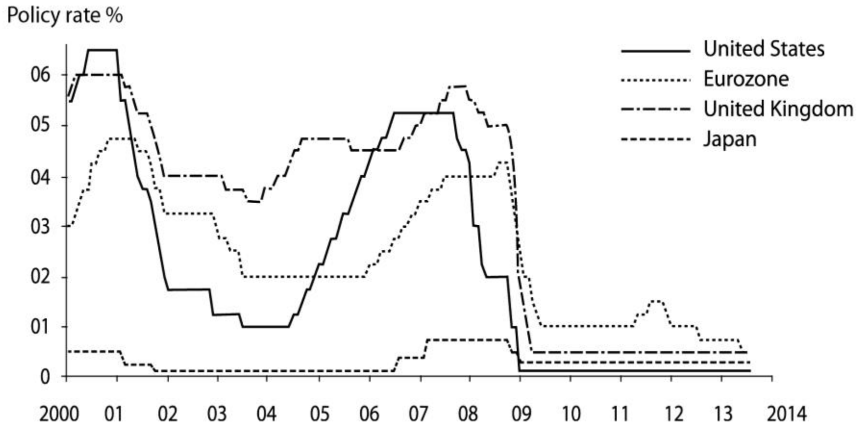

Figure 1: The Course of the Interest Rate: Source: www.tradingeconomics.com

The concept of liquidity trap is intertwined with the Great Crash of 1929, while Figure 1 shows that all major economies today operate in an environment of ZLB although not as serious as in the Great Crash. For example, it is noteworthy that although the very low interest rates in the US and UK increased profits there by 5% in 2012, investment remained stagnant, due presumably to the uncertainty surrounding the prospects for economic recovery, and to stricter lending requirements. At the same time, $630 billion in net interest income was lost together by households in these countries though the loss might have been mitigated by increased asset prices.

Anyway, as first pointed out by Governor Ben Bernanke of the US Federal Reserve (Fed), the policy of money gift or “money rain” or “helicopter money” is the only solution to the current global recession. John Maynard Keynes proposed burying bottles of banknotes in old coal mines, that when excavated (like gold), the cash found would act as new wealth, stimulating demand through the Pigou effect. And, Milton Friedman (1969, p. 4) too, acknowledged the attractiveness of the direct transfer of money to households, comparing it to a helicopter drop of money. This policy is feared to be inflationary, but Figure 2 shows that under the present at least circumstances these fears are groundless. The movements in money supply in the eurozone of 17 do not seem to be linked to the course of prices and this, for the trends in recent economic history, which are discussed in the next section and make the exercise of a money gift policy imperative at least today. The third section concludes this tract with further remarks on the subject.[1]

2. Recession and Policy

The central idea behind the neoliberal restrictive monetary policy, with public sector restructuring and tax cuts, which was launched in the 1980s primarily in the USA, UK and Germany against stagflation was (a) the favorable treatment of capital to boost growth, and (b) the widening economic inequality to reduce consumption and therefore restraint inflation (see e.g. Gills 2011). And, indeed, this program succeeded so much that the basic principles of the advancement of the euro area in 1998-9 were based on it. Just

[1] A recent theoretical and empirical discussion of recession as a general equilibrium phenomenon is provided by Gonchar et al. (2015). The discussion herein might be viewed as one of broader political economy considerations, including policy recommendations.

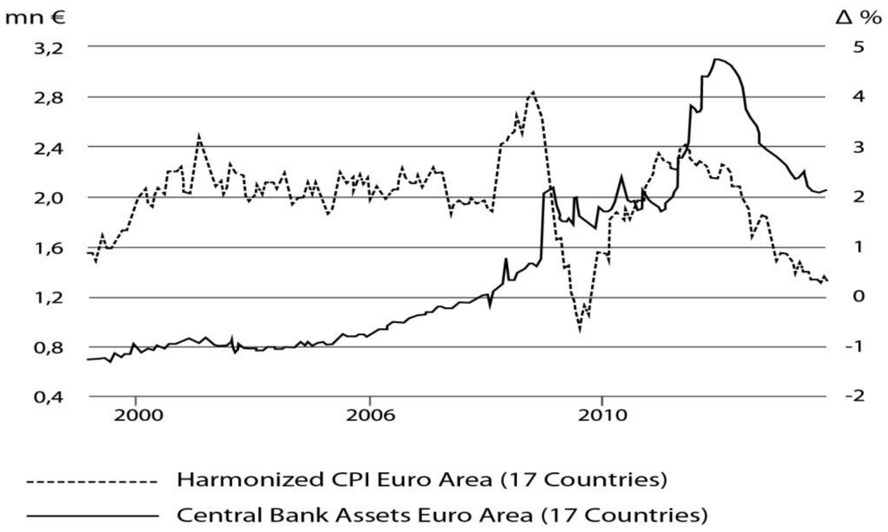

Figure 2: Money Supply and Inflation: Source: research.stlouisfed.org

then, around 2000, began to manifest themselves the recessionary tendencies inherent in underconsumption (see e.g. Cripps et al. 2011), and it seemed that this trend had to be confronted by reducing interest rates initially and later and until today by quantitative easing (QE).

The decrease in rates shown in Figure 1, was supposed to make investment cheaper but simultaneously increased the prices of stock, bonds, and housing, resulting in stock and housing market bubbles, which in turn discouraged the investments that the reduction of interest rates was aiming in the first place. And of course the problem of inequality could not be addressed in the context of neoliberalism – of enhancing the role of the private sector by making the rich richer to invest more – becoming subsequently worse, increasing underconsumption even more. Undrconsumption that was strengthened by the declining wages brought about by the increased competition accompanying the expansion of globalism. The result was the postponement of the recession. As, for example, Irwin (2014) reports for the United States, GDP is still well below its potential, and there is nothing extraordinary in job growth.

When Bernanke spoke of the money gift policy, it was the 2002, foreseeing the impasse that would result from an interest rate policy, which was launched by the Governor of the Fed, Alan Greenspan. But when he took over the Fed he chose policy of QE via the purchase of government bonds, which of course is an open market operations policy. He chose to inject cash in the economy through the banking system and not directly to the household. Yet, banks chose in turn not to channel this money to the public but "play" with it and preserve the risks for financial bubbles. From this point of view, QE is just a different way of obtaining the same goal that the interest-rate reduction policy had, which policy, as Figure 1 shows, was never abandoned.

Thus, the bubbles were not avoided with greater that of Lehman Brothers in 2008-9, the income inequality was widened so much that "today's [wealth-to-income] ratios appear to be returning to the high values observed in Europe in the eighteenth and nineteenth centuries (600–700%)" (Piketty and Zucman 2014, p. 1255), the underconsumption is what has been keeping prices constant whereas their increase would strengthen production incentives and corroborate growth, and the problem generally of stimulating demand has become as urgent to address as ever. Consequently, anything else than effective the QE announced by President Mario Draghi of the European Central Bank (ECB) is expected to be with regard to eurozone. The reduction in interest rates and quantitative easing only short-term results may have, simply postponing the onset of recession.

As Dobbs et al. (2013) put it: “There is widespread consensus that the conventional and unconventional monetary policies that world’s major central banks implemented … prevented a deeper recession and higher unemployment than there otherwise would have been. These measures, along with a lack of demand for credit as a result of the recession, contributed to a decline in real and nominal interest rates to ultra-low levels that have been sustained over the past five years.”

Many, including Bernanke and Draghi apparently, consider QE as a way of helicopter money drop. This is true to the extent that the public sees this money as a net increase in the present value of its wealth given the consolidated private and public sector budgets intertemporally; intertemporally, because the household should not be expecting a cancelation of the money gift in some future time. Only then the helicopter money will be an asset for the private sector, without being a liability for the public sector, permanently, inciting subsequently the operation of the Pigou effect (Buiter 2005, 2014).

Therefore, the failure of QE as a form of money gift and hence, as a means of stimulating demand through the Pigou effect, should be attributed to the behavior of the banking system as the recipient of the gift that did not pass it on to its customers, arriving as a consequence at today’s ZLB. Lowering the interest rate to attract investment unjustifiable by underconsumption anyway, is lowering at the same time the profitability of lending and it is “natural” to be redirecting excess bank liquidity to “playing” in the financial markets. The risk of bank failures is thereby increased, necessitating the introduction of own-capital regulation to minimize potential bank-failure induced bank runs. The increasing emphasis on such regulation is the outcome of this precisely sequence of events. QE only strengthens excess liquidity, exacerbating the problem. And, regarding the Eurozone which just now launched the QE punishing with negative interest rate banks that deposit money in the ECB instead of distributing it to the public, this does not mean that banks will use the money as prescribed and not use them in another way[2].

Meaningful is only the original concept of helicopter money, i.e. a direct transfer of money to the public as net wealth, bypassing the banking system. Only then a ZLB can be avoided independently of the origin of underconsumption, which today is neoliberalism and globalization. Banks could be instructed for example to increase by some amount the bank account balance of those who do not belong to the richest 20% of the population, with the condition to spend this amount for some categories of goods and services supporting growth, as proposed by Blyth and Lonergan (2014), and with the type of expenditure being monitored through debit

[2] Note that QE is one only method of conducting expansionary monetary policy and so, such a policy should not be identified always with QE. For example, the 2nd May 2013 cut of the main interest rate to 0.5% (down from 0.75%) by ECB and the extension of the term of its cheap loans to banks until at least 2014 to increase the quantity of money and the supply of loanable funds, are taken by some to be a form of QE. But, this is not the case. QE is as defined by Bernanke.

cards issued for that amount, might be added. Conceptually, institutionally, and practically, such a policy is neither monetary nor fiscal, but the monetary part of the intergenerational public finance (Buiter 2005).

3. Further Remarks

These issues were not raised for the Eurozone as pressing as in the US and other OECD countries in 2000, because of the good performance of the German economy and international confidence in the German warranty of the new euro. Yet, the Lehman crisis in 2008-9 revealed not only latent recessionary tendencies but also the friability of the economy in the South of the Eurozone, which now makes the eurozone crisis far worse than elsewhere. Draghi's QE only temporary relief can provide; much more so when any QE now has to be exercised in view of a global debt, which according to International Monetary Funds' (IMF) 2014 *World Economic Outlook*, has grown by $57 trillion since 2007, having raised the ratio of debt to GDP by 17 percentage points. This is why the call for a genuine money gift policy becomes every day and stronger not only for the US and EU, but for OECD and the whole world in general.

For example, for Greece, which is the weaker link of Eurozone, such a policy may prove to be a panacea either inside or outside the euro area according at least to this author's opinion. It is estimated that the debt burdening each person in that country is now 30000 euro. Given a balanced government budget and unchanged wage structure, a money gift of 20000 euro to each of them through debit cards distributed by the tax authority, would produce the 30000 euro debt after the period required to have the full effect of a multiplier equal to 1.5, *ceteris paribus*.[3] Moreover, the country would enter this way a growth phase with the minimum reliance on its ill banking system, leaving it at the same time room to restructure towards more efficiency.

Anyway, globalization may be a natural more or less trend of the world economy, but neoliberalism is not. The strengthening of the role of the private sector by favoring the rich confers also to them the political power needed to resist against any policymaking that would hurt their interests, turning subsequently neoliberalism into a regime. This is the heart of the problem of fighting underconsumption nowadays, namely that insufficient demand has to be confronted policy-wise within the context of the regime and not on purely economic grounds. A money gift policy has become necessary as a surrogate of an openly expansive fiscal policy, in a self-financing though way as proposed e.g. by DeLong and Summers (2012). Such a policy would not hurt the interests of the private sector, but the term and only "fiscal" has become politically anguishing (see e.g. Blyth and Lonergan 2014).

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[3] The multiplier value 1.5 is, of course, hypothetical. A nice review of "helicopter money as a policy option" by Reichlin et al. in CEPR's Policy Portal "Vox" on 20 May 2013, expands on possible ways of applying such a policy in practice.

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