Article in CFR Magazine: Give Away Money to Stimulate Economy

Mark Blythe, a professor at Brown University, and Eric Lonergan, a hedge fund manager living in London, have conjured the ultimate solution to a stagnant economy: Central banks should give away free money.

These two authors of a lengthy and allegedly erudite article in the September/October 2014 issue of *Foreign Affairs*, published by the Council on Foreign Relations (CFR), appear to be living in an alternate universe, as their suggestion, if it were fully implemented, would push the world's economy back to the Dark Ages.

The article, entitled "Print Less but Transfer More: Why Central Banks Should Give Money Directly to the People," rests on the false assumption that the economy is stagnant because people aren't spending, and the authors propose a solution: Central banks should provide sufficient new spendable currency to the masses.

The fact that anyone would take these suggestions seriously reflects, unfortunately, the basement level of economic understanding among observers.

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It was Chicago economist and Professor Milton Friedman who originally suggested the idea of a negative income tax, wryly referring to it as "helicopter money" — money that is "dropped" to the masses. When former Federal Reserve chairman Ben Bernanke suggested the same thing, he became known as "Helicopter Ben." But he was merely reiterating a suggestion by the father of current economic foolishness, John Maynard Keynes, who, in the 1930s, proposed burying bottles of bank notes in old gold mines which, once unearthed (like gold), would create new wealth and spur on new spending.

Old fallacies die hard.

The authors declare,

> Economic growth is stagnating while inequality gets worse. It's well past time, then, for US policymakers — as well as their counterparts in other developed countries — to consider a version of Friedman's helicopter drops. In the short term, such cash transfers could jumpstart the economy…. The transfers wouldn't cause damaging inflation, and few doubt that they would work.

Something drastic is needed, according to the authors, because current strategies to stimulate the stagnant economy just aren't working. The traditional methods of stimulation include lowering the reserve requirements so that banks can loan more money, thus increasing the supply of money in the economy. The second way is to lower interest rates to make borrowing money more attractive. The third way is to purchase government bonds. When that new money enters the economy through government spending, it stimulates economic growth.

Or at least, according to Keynesian theory, it's supposed to. Unfortunately, say the authors, such remedies have failed to work, resulting in the present recovery from the Great Recession to be the slowest and weakest of any on record since the end of WWII.

The worthies at *Foreign Affairs* have failed to take into account two major factors: The first is that spending does not stimulate the economy; production does. When producers are given the incentive to find out, through experimentation and trial and error, what people would buy if offered to them, they alone can stimulate the economy. The classic example being, of course, Steven Jobs' creation of the iPhone, which didn't even exist before he developed it, nor did people even know they needed it until he created it and offered it for sale.

The other fallacy in the authors' reasoning is the complete absence of any mention of something called "velocity of spending": the propensity of people to spend money if they had it. According to the Federal Reserve, the velocity of money is at record lows, as uncertainty over the economy and a desire of consumers not to spend but to save, have slowed price increases for goods in the real world to a trickle. (Click here for confirmation.)

The authors referred to the failed experiment called Abenomics in Japan. There, Japan's central bank "has tried to use its own policy of quantitative easing to lift its stock market. So far, however, Tokyo's efforts have failed to counteract the country's chronic underconsumption…. There is little evidence that this policy has increased spending."

They have a plan:

> Central banks, such as the Fed, should hand consumers cash directly…. The government could distribute cash equally to all households or, even better, aim for the bottom 80% of households in terms of income. Targeting those who earn the least would have two primary benefits. For one thing, lower income households are more prone to consume so they would provide a greater boost to spending. For another, the policy would offset rising income equality.

Voilà! Two problems solved with one solution.

The authors utterly reject any idea that recessions are an attempt by the economy to remove excesses that caused the boom in the first place:

> Unless one subscribes to the view that recessions are either therapeutic or deserved, there is no reason government should not try to end them if they can, and cash transfers are a uniquely effective way of doing so…. They would also help address income inequality — without skinning the rich.
>
> All it will take to change course is the courage, brains, and leadership to try something new.

In sum, the authors recognize that the current prescriptions for curing the economy's current ills haven't worked. And so, more is recommended. If the analogy of a drug addict is apt (incomplete, yet still useful), what the authors are proposing then is to cure the patient's drug addiction by giving him a massive overdose.

Tyler Durden, at Zero Hedge, could scarcely believe what he was reading. He wrote that Keynesians, "unwilling actually to admit they have been wrong, urge doing more of the same that has led to the current financial cataclysm."

Anthony Wile, over at The Daily Bell, said that the article in *Foreign Affairs* "reads more like a satire or parody than a serious suggestion…. The idea that *Foreign Affairs'* writers and editors believe that freely handing out currency is going to strengthen the economy and solidify goodwill for the current central banking system is either naïve or sinister."

There are numerous unanswered questions from a practical point of view. Who, specifically, would receive the new currency? How much would they get? How would those who are excluded from the flood of new currency feel about being excluded? What if the amount of money given doesn't work in stimulating the economy? Is there an upper limit to how much new currency will be allowed to flood the economy?

The basic question which the authors left unanswered, not to mention addressed, was: What happens to an economic system based on a highly liquid currency where the currency is essentially free (meaning worthless)?

If the currency becomes worthless, what happens is simple: The economy stops working because the division of labor that makes the current modern economy possible in the United States and in other developed countries fails.

The primary reason the United States economy works so well is because of the division of labor, with laborers knowing they can easily exchange their efforts for a medium that then can be exchanged for the goods and services they want and need. If that medium is destroyed, how many individuals in a country of 318 million have the skills to become self-sufficient? The question answers itself. The implementation of such a draconian (and some say insane) idea would result in the depopulation of the United States by at least 90 percent, according some estimates.

So the only other alternative, according to Wile, is that these two worthies are plainly and simply naïve. Perhaps the Council on Foreign Relations is sending up a trial balloon to test the economic understanding of the populace. Perhaps it's a trial balloon to see if central bankers would sign on to the idea.

Practical implementation, however, would have to overcome immense legislative pushback. For one thing, there is legislative pressure currently afoot in Congress to audit the Fed, and this foolhardy idea, if attempted, would add significant fuel to that movement. Only in the ivory towers of elite educational institutions such as Brown University and international hedge fund managers could such an idea gain purchase. A fair conclusion one may draw from this exercise in insanity and futility is that the proposal of the writers, in their attempt to revive a dormant economy, would have the exact opposite effect. To think that they intend the 90 percent depopulation of the United States as a result of their policies is simply beyond comprehension.

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