**CHAPTER 1**

**WHAT IS “*STIMULUS-WITHOUT-DEBT”*?**

*“Stimulus-Without-Debt”* is a policy to combat a recession by using fiscal and monetary stimulus to raise aggregate demand for goods and services without raising government debt or private debt.

The phrase “without debt” means “without government debt or private debt.” Standard fiscal stimulus raises aggregate demand for goods and services by cutting taxes and/or increasing government transfers or purchases; it requires the Treasury to borrow by selling government bonds. Standard monetary stimulus reduces interest rates in order to induce households and/or businesses to borrow and spend more on goods and services. Standard fiscal stimulus is stimulus with more government debt, and standard monetary stimulus is stimulus with more private debt. This book proposes a way to generate stimulus—an increase in aggregate demand for goods and services--without more government debt or more private debt.

Concern about excessive government deficits and debt is pervasive among policy makers and the general public. In the past, all fiscal stimulus plans sufficient to combat a severe recession have caused a substantial short-term increase in government deficits and debt. By contrast, the stimulus plan proposed here would not raise government deficits and debt either in the short run or the long run. This should remove a key obstacle to obtaining the support of policy makers and the general public for the stimulus plan.

The plan for stimulus without debt in a recession has three elements: (1) Congress would authorize the U.S. Treasury to mail tax rebate checks to households in amounts specified by Congress; tax rebates would be the main component of the fiscal stimulus package though some complementary components might also be included; (2) The Federal Open Market Committee (FOMC) of the Federal Reserve would independently decide to have the Fed write checks for transfers to the U.S. Treasury (not loans that the Treasury must repay to the Fed) so the Treasury would not have to issue any new debt to finance the tax rebates; (3) The Fed would adjust its standard open market operations and other actions to promote its goals of low inflation, high employment, and well-functioning credit markets. *If* the Fed’s transfer to the Treasury injects more money into the economy than the Fed desires, the Fed would reduce its other injections of money; for example, the Fed might cut its open market purchase of bonds.

The first element, tax rebate checks mailed to households, has been implemented in the United States in the recession years 1975, 2001, and 2008, each time enacted with bipartisan political support in Congress. In chapter 3, I will discuss other kinds of fiscal stimulus that might be included in a fiscal stimulus package along with tax rebates. The second element, transfer checks from the Federal Reserve to the Treasury to finance the tax rebates (or any fiscal stimulus package) in a recession would be new. To remove any doubt about whether the Fed is permitted to write transfer checks to the Treasury in a recession, Congress must enact an amendment to the Federal Reserve Act explicitly stating that the Fed is permitted to do this in a recession. The third element, adjusting its standard open market operations and other actions to promote its goals of low inflation, high employment, and well-functioning credit markets, is what the Fed has been instructed to do by Congress and what the Fed has been trying to do for decades.

**The Aggregate Demand Problem in a Recession**

The bursting of the housing bubble in 2007 and 2008 caused a plunge in consumer wealth and confidence (measured by the monthly consumer confidence index) which in turn reduced consumer *demand* for goods and services. So did the plunge in the stock market in 2008. Business firms reacted to the plunge in consumer demand by cutting demand for investment goods—why expand plant and equipment to produce more if consumers won’t buy the additional product? In response to the plunge in consumption and investment demand, firms cut back production and employment. To combat a recession, policies must be enacted to *increase aggregate demand for goods and services*.

It must be emphasized that in 2007 and 2008, when the economy plunged into the deepest recession since the Great Depression, there was *no increase* in government regulation of business or tax rates. Hence, the plunge into recession was *not* due to any new government actions that discouraged the *supply* of goods and services.The deep recession was due to a plunge in aggregate *demand* for goods and services, and the solution required policies to stimulate an increase in aggregate demand for goods and services.

**Tax Rebates to Households**

The purpose of having the U.S. Treasury mail a tax rebate check (a rebate of the income, payroll, and sales tax paid by the household in the previous year) to every household in a recession would be to increase their consumption spending and thereby stimulate production of goods and services. Strong evidence for a significant impact of tax rebates on consumption spending will be presented in depth in chapter 2. A tax rebate to households is one type of fiscal stimulus (tax cuts and/or government spending).

A tax rebateis a giving back to each taxpayer some of the taxes (income, payroll, and sales) that the taxpayer paid in the previous year. A tax rebate is *not* a grant or gift or welfare from the Treasury to the taxpayer. Its rationale is expressed by the following hypothetical communication from Congress to taxpayers:

“In light of the unexpected economic recession, we have therefore decided to give back a portion of the taxes you paid last year to help you cope with the recession and to boost your spending on goods and services which will stimulate production and employment.”

Why focus on tax rebates to households rather than other kinds of fiscal stimulus? There are at least eight reasons. First, every household would receive a rebate check in the mail from the U.S. Treasury so every voter would actually see a concrete *personal benefit* from this kind of fiscal stimulus. Second, the inclusion of every household would cause most voters to regard tax rebates as a *fair* way to implement fiscal stimulus. Third, tax rebates clearly increase household spending on *all* *goods and services* rather just a subset of goods and services, so all businesses would recognize that rebates boost customer demand for their goods or services. Fourth, with tax rebates, there would be *no shovel-ready problem*. Fifth, with tax rebates there would be *no increase in the size of government*: rebates simply give spending power to millions of individual consumers whose spending stimulates the private sector. Sixth, rebates *have been enacted with bipartisan support* three times (1975, 2001, and 2008). Seventh, tax rebates to combat a recession are clearly *temporary* and require a new vote by Congress to be continued; the tax rebates of 1975, 2001, and 2008, were each automatically terminated after just one year because Congress did not vote to renew them (I would argue that the tax rebate of 2008 *should* have been renewed in 2009 and 2010 given the severity of that recession). Eighth, as will be documented in chapter 2, *rebates work*—a significant portion of rebates are spent within a year of being received. For all of these reasons, tax rebates to households are an ideal instrument for fiscal stimulus in the recession.

There is a good reason why tax rebates were able to pass with bipartisan support three times (1975, 2001, and 2008). Both conservatives and liberals, Republicans and Democrats, have differing long-term agendas for government spending and taxation. For example, conservatives generally want permanent tax cuts, while liberals want permanent increases in social insurance and education programs. Each side does not want a supposedly temporary anti-recession stimulus which would advance the agenda of the other side if it became permanent. Tax rebates are obviously and inherently temporary. They do not favor the long-term agenda of either side. This is undoubtedly one reason that tax rebates were enacted in 1975, 2001, and 2008 with bipartisan support whereas most other proposals, such as permanent tax cuts, or permanent increases in social insurance or education programs, have received partisan support and opposition. The tax rebate does not favor one side’s long term agenda over the other. It is neutral towards long-term agendas.

The details of the design of a tax rebate in recession will be discussed in the last section of chapter 2.

**Transfer Checks from the Fed to the Treasury in a Recession**

The purpose of the Fed’s check to the Treasury in a recession is to enable the Treasury to pay tax rebates to households (or other fiscal stimulus) without borrowing. The Fed’s check to the Treasury would be *a transfer, not a loan*; the Fed would *not* receive Treasury bonds in return for its check. If the Federal Open Market Committee (FOMC) judges that amount of tax rebates chosen by Congress is appropriate to the severity of the recession, then the FOMC can decide to make its checks equal to the aggregate amount of the tax rebates so that the rebates result in no increase in the deficit or debt of the federal government.

For example, if this plan had been implemented in the three years 2008, 2009, and 2010, in each year the Treasury might have been authorized by Congress to mail out $450 billion in tax rebate checks to households in June and in December. Then each June and December the Federal Reserve would have written a transfer check to the Treasury for $450 billion so that the paying of tax rebates would not have required any new borrowing by the Treasury--the fiscal stimulus would not have required any new sale of U.S. bonds. Thus, thanks to the Fed’s transfers to the Treasury, the fiscal stimulus would not have increased the federal debt. There would have been no increase in official federal debt.

**What the Federal Reserve Should Do under Stimulus-Without-Debt**

When the Federal Reserve wants to stimulate demand for goods and services, it tries to lower interest rates with the hope that consumers and businesses will respond by borrowing more in order to spend more on goods and services. The Fed lowers interest rates that banks charge as follows. The Fed buys U.S. Treasury bonds from investment firms (and other institutions) that bought Treasury bonds previously but have now decided to sell. When the Fed writes checks to buy the bonds, it is injecting money into the economy. When the sellers of these bonds receive checks from the Fed, they deposit the checks in their banks. The banks try to lend these funds in order to earn interest. To try to get potential borrowers to borrow the funds, the banks lower the interest rates they charge consumers and businesses.

Under the stimulus-without-debt policy, the Fed injects money into the economy a new way. Instead of injecting money only by buying Treasury bonds (or other bonds) from investment firms (or other institutions), the Fed now also injects money by writing checks to the U.S. Treasury which mails out rebate checks to households. Thus, the Fed should cut its purchase of U.S. Treasury bonds.

For example, if there had been no fiscal stimulus to combat the recession, suppose the Fed would have wanted to inject $600 billion into the economy in the first half of this year to try to stimulate aggregate demand for goods and services. Then the Fed would have wanted to buy $600 billion of Treasury bonds. If there is a $450 billion fiscal stimulus in the first half of the year, and the Fed it now writes checks for $450 billion to the Treasury, it should cut its purchase of bonds down to $150 billion (a cut of $450 billion) if it still wants a total money injection of $600 billion. But with the fiscal stimulus raising aggregate demand for goods and services, the Fed will now want a lower total injection of money. If the Fed now wants a total injection of $500 billion, it should cut its purchase of bonds down to $50 billion (a cut of $550 billion).

Thus, under stimulus-without-debt, the Fed should inject less money into the economy because the fiscal stimulus is now combating the recession, so the Fed should cut its purchase of Treasury (and other) bonds by more than the checks it writes to the Treasury. If the stimulus-without-debt policy had been implemented in 2008, 2009, and 2010, the Fed would have injected less money into the economy than it actually did, and its purchase of Treasury bonds (and other bonds—in particular, mortgage-backed bonds) would have been much lower than it actually was. I will return to the details of this in chapters 4 and 5.

**Fear of Government Debt as a Limit to Fiscal Stimulus in Recession**

Olivier Blanchard, who left his long-time position as professor of economics at MIT during the Great Recession to become Chief Economist of the International Monetary Fund, wrote the following section in chapter 9 (“The Crisis”—his description and analysis of the Great Recession) in the 6th edition (2013) of his intermediate macroeconomics undergraduate textbook (p196). After explaining why monetary policy alone may be too weak to combat a severe recession, he argued that fiscal policy also has limits:

“*The Limits of Fiscal Policy: High Debt*

“So, even if monetary policy has reached sharp limits, isn’t fiscal policy the solution? The answer is that fiscal policy also has limits. The problem is that, if the demand for goods does not recover over time by itself, if people or firms do not eventually become more optimistic and increase spending, the government must continue to run deficits to sustain higher demand and output. Continuing large deficits lead, however, to steadily higher public debt. In advanced countries, the ratio of government debt to GDP has increased from 46% in 2006 to 70% in 2011; in the United States, the ratio has increased from 42% in 2006 to 72% in 2011. High debt implies that, sooner or later, either taxes will have to increase, or spending will have to decrease, or the government will be unable to repay the debt. And when investors become worried about repayment of the debt, they start asking for higher interest rates on government bonds, making it even harder for the government to repay the debt. These worries are already leading to higher interest rates on government bonds in a number of European countries. They have not yet led to higher interest rates on government bonds in the United States. But the risk that interest rates might rise in the future is forcing the U.S. government to look for ways to begin to reduce its budget deficit now. This limits the contribution of fiscal policy to demand and to the recovery.”

In a paper presented at the American Economic Association’s annual conference in January 2010 that received a lot of attention, Carmen Reinhart and Kenneth Rogoff, the authors of *This Time is Different: Eight Centuries of Financial Folly* (2009), wrote the following (p573):

“Our main result is that whereas the link between growth and debt seems relatively weak at ‘normal’ debt levels, median growth rates for countries with public debt over roughly 90 percent of GDP are about one percent lower than otherwise; average (mean) growth rates are several percent lower.”

After presenting their evidence, they ended with these concluding remarks (p577-78):

“The sharp run-up in public sector debt will likely prove one of the most enduring legacies of the 2007-2009 financial crises in the United States and elsewhere. We examine the experience of 44 countries spanning up to two centuries of data on central government debt, inflation and growth. Our main finding is that across both advanced countries and emerging markets, high debt/GDP levels (90 percent and above) are associated with notably lower growth outcomes…Seldom do countries ‘grow’ their way out of debts. The nonlinear response of growth to debt as debt grows towards historical boundaries is reminiscent of the ‘debt intolerance’ phenomenon…As countries hit debt tolerance ceilings, market interest rates can begin to rise quite suddenly, forcing painful adjustment.”

Reinhart and Rogoff have been challenged on their assertion that public debt over 90 percent of GDP harms economic growth (for example, Herndon, Ash, and Pollin 2014). But even if their 90 percent threshold is invalid, their paper reflects the concern that many economists have about the possible harm that may result from high government debt. This concern is one reason many economists oppose large fiscal stimulus in a recession.

**Stimulus without Debt versus Standard Fiscal-Monetary Stimulus**

Under standard fiscal-monetary stimulus, to raise aggregate demand for goods and services through fiscal stimulus, Congress cuts taxes or raises government spending (transfers or purchases), and the Treasury borrows to finance the resulting deficit by selling U.S. Treasury bonds to the public (domestic and foreign), thereby increasing government (Treasury) debt held by the public. The Federal Reserve then buys an amount of Treasury bonds from the public in “the open market,” equal to, or a substantial portion of, the amount of the fiscal stimulus package so that the Fed ends up holding all or most of the increase in Treasury debt. A crucial point is that 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.

For example, if the FOMC decided to have the Fed write a $450 billion transfer check to the Treasury in January and in June, then Congress could enact $450 billion in tax rebates to households to be mailed out in January and in June without any additional borrowing by the Treasury. Note the contrast with a standard fiscal-monetary stimulus of $450 billion which would require the Treasury to sell $450 billion of bonds to the public in June and in December, thereby increasing federal debt by $450 billion in January and in June. Under the stimulus-without-debt plan, there would be the same amount of fiscal stimulus-- $450 billion in tax rebates to households in June and in December-- but no new Treasury bonds and no increase in government debt.

When the Treasury receives a transfer check 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 $450 billion, mailed out in June, and received a transfer check from the Treasury of $450 billion in June. Both Treasury outlays and revenue would increase $450 billion in June 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 check from the Fed to the Treasury equal to the fiscal stimulus, there would be no official deficit increase and no official increase in debt.

Under the current separation of powers, a central bank can create money but not implement fiscal stimulus, while the legislature (Congress), through the Treasury, can implement fiscal stimulus but cannot create money. As Caballero of MIT (2010) observed with reference to the U.S.:

“The economy is barely muddling through. While some of this is unavoidable given the magnitude of the finance shock that is slowly working its way out of the system, macro-policy still has an important role to play in preventing a relapse. Unfortunately, the Federal Reserve has the resources but not the instruments, while the U.S. Treasury has the policy instruments but not the resources. It stands to reason that what we need is a transfer from the Fed to the Treasury.”

A direct transfer from the Fed to the Treasury in order to achieve stimulus-without-debt was 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.” 1

**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 tax rebates to households (a type of 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 check 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 should not be called “helicopter money.” First, the Fed may decide to partly offset the money supply effect of its check to the Treasury by a cut in the Fed’s open market purchases of bonds or other assets so the increase in the money supply may be smaller than the Fed’s check to the Treasury. The phrase “helicopter money” implies that the plan would cause the money supply to increase by the amount of the Fed’s check to the Treasury which is false.

Second, 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 Internal Revenue Service (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 check 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 at full employment. 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…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 his helicopter drop is 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 households 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 expansion. Second, Friedman made no comment on what would happen if the economy were initially in recession rather than full employment. In a recession, the additional spending by households would primarily raise real output and employment and have a moderate 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 standard combined fiscal-monetary stimulus 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.

In a 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.

Another advocate of monetizing the debt, but not stimulus-without-debt, is Columbia economist Michael Woodford (2013) who 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.

*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.

But in a severe recession households and business firms are usually extremely reluctant to run up more debt. In his 1948 first edition (and subsequent editions) Samuelson gave these lessons from the experience of the Great Depression (p353-54):

“*The Inadequacies of Monetary Control of the Business Cycle*

*“*Today few economists regard the Federal Reserve as a panacea…In terms of the quantity theory of money, we may say that the velocity of circulation of money does not remain constant. ‘You can lead a horse to water, but you can’t make him drink.’ You can force money on the system in exchange for government bonds…but you can’t make the money circulate against new goods and new jobs…You can tempt businessmen with cheap rates of borrowing, but you can’t make them borrow and spend on new investment goods.”

In a recent book, Mian and Sufi (2014) contend that a huge run-up of household debt was a major cause of the Great Recession of 2008 and the Great Depression of 1929. Their argument and evidence will be examined in chapter 4. Just prior to each collapse, heavily indebted households became unwilling to borrow more in order to continue their spending, and spending collapsed. Standard monetary stimulus—lowering interest rates—was unable to stimulate consumer spending because deeply indebted households were trying to pay down some of the debt they incurred during the run-up.

The stimulus-without-debt plan proposed here has the Treasury mail tax rebate checks to households in order to raise households’ ability to spend more without incurring more household 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 for individual households and for the future of the economy. Koo (2014) has called this kind of recession a “balance-sheet” recession. 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 Federal Reserve 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, in a severe recession the Fed would give each household a transfer—for example, $2,000 per adult plus $1,000 per child. To implement this transfer, the Fed would 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.

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 he 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 considered 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.”

In a recent article entitled “Print Less but Transfer More: Why Central Banks should Give Money Directly to the People,” in *Foreign Affairs* (2014), Mark Blyth and Eric Lonergan wrote:

“*MAKE IT RAIN.* Governments must do better. Rather than trying to spur private-sector spending through asset purchases or interest-rate changes, central banks, such as the Fed, should hand consumers cash directly. In practice, this policy could take the form of giving central banks the ability to hand their countries’ tax-paying households a certain amount of money. The government could distribute cash equally to all households or, even better, aim for the bottom 80 percent of households in terms of income.”

It is useful to compare this plan to the stimulus-without-debt plan with a tax rebate of $2,000 per adult and $1,000 per child plus a Fed transfer to the Treasury equal to $450 billion (assuming $450 billion is the estimated 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-without-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 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.

*Money Creation by the Treasury as Authorized by Congress*

If there were no independent central bank, and instead Congress directly controlled not only government spending and taxes but also money creation, then 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. Under this plan, Congress would enact tax rebates for households—for example, $450 billion-- and then authorize the Treasury to create $450 billion of new money to pay for the rebates. Money creation by the Treasury would eliminate the need for the Treasury to borrow $450 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. Congress would directly control money creation as well as spending and taxation. This would enable Congress to set government spending well above taxes in a normal economy when no stimulus is warranted, and create money to cover the difference, thereby unilaterally injecting a combined fiscal-monetary stimulus that overheats the economy and generates inflation. By contrast, under the stimulus-without-debt plan, Congress, not the Federal Reserve, would authorize the tax rebates to households, and the Federal Reserve, not Congress, would decide the specific amount of money to transfer to the Treasury.

*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.

**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 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 recession caused by a collapse in aggregate demand, inflation does not rise—it may even decline. During the Great Recession, there has been little worry by the general public 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 us 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. Under the plan the Fed would probably cut its open market purchases of bonds below what it otherwise would have been so that the money supply increases by less than the Fed’s transfer to the Treasury.

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. Moreover, the plan increases the money supply less than the amount of the Fed’s check to the Treasury because the Fed is likely to cut its open market purchase of bonds if it makes a transfer to the Treasury.

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: It is true that the plan will reduce the bonds the Fed has available to sell in order to withdraw money from the economy should a boom develop. The Fed, however, 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, Bernanke (2009) and others have suggested that the Fed should 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: “Underthe 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, the Fed provides 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. Under the plan the Fed is called upon to set the magnitude of its transfer to the Treasury to promote this 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 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 transfer to the Treasury-- in pursuit of its mandate set by Congress to pursue high employment and low inflation.

**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 ahousehold, 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. This accounting problem is discussed in chapter 6.

**Why Not Use Standard Monetary Stimulus Alone to Combat a Recession?**

My answer to this question will be given at greater length in chapter 4. Here I will just give the 1948 response of a Nobel-prize-winning traditional Keynesian, Paul Samuelson. In the first edition to his influential college textbook, with the actual experience of the Great Depression clearly in mind, Samuelson (1948) gave the explanation shared by early Keynesians concerning fundamental weakness of standard monetary policy in a severe recession (p353-354):

“*The* *Inadequacies of Monetary Control of the Business Cycle*

“Today few economists regard the Federal Reserve as a panacea for controlling the business cycle. Purely monetary factors are considered to be as much symptoms as causes, albeit often symptoms with aggregating effects that should not be completely neglected.

“By increasing the volume of their government securities and loans and by lowering Member Bank legal reserve requirements, the Reserve Banks can encourage an increase in the supply of money and bank deposits. They can encourage but, without taking drastic action, they cannot compel. For in the middle of a deep depression just when we most want Reserve policy to be effective, the Member Banks are likely to be timid about buying new investments or making loans. If the Reserve authorities buy government bonds in the open market and thereby swell bank reserves, the banks will not put these funds to work but will simply hold the reserves. Result: no 5 for 1, “no nothing,” simply a substitution on the bank’s balance sheet of idle cash for old government bonds. If banks are the public are quite indifferent between gilt-edged bonds—whose yields are already very low—and idle cash, then the Reserve authorities may not even succeed in bidding up the price of old government bonds; or what is the same thing, bidding down the interest rate.

“Even if the authorities should succeed in forcing down short-term interest rates, they may find it impossible to convince investors that long-term rates will stay low. If by superhuman efforts, they do get interest rates down on high-grade gilt-edged government and private securities, the interest rates charged on more risky new investments financed by mortgage or commercial loans or stock-market flotations my remain sticky. In other words, *an expansionary monetary policy may not lower effective interest rates very much but may simply spend itself in making everybody more liquid*.

“What if interest rates are finally lowered? A number of questionnaire studies of businessmen’s behavior suggest that the level of interest rates is not an important factor in their investment decisions. Particularly in a deep depression when there is widespread excess capacity, *investment is likely to be inelastic with respect to the interest rate.* The same is even more true about people’s decisions on how much of their incomes to spend on consumption.

“In terms of the quantity theory of money, we may say that the velocity of circulation of money does not remain constant. ‘You can lead a horse to water, but you can’t make him drink.’You can force money on the system in exchange for government bonds, its close money substitute; but you can’t make the money circulate against new goods and new jobs. You can get some interest rates down, but not all to the same degree. You can tempt businessmen with cheap rates of borrowing, but you can make them borrow and spend on new investment goods [footnote: The banking authorities—unlike the fiscal authorities—deal only in secondhand assets, in transfer items. They are powerless to act directly on people’s incomes and on production] .”

Samuelson’s passage expresses the view of the traditional Keynesian economists who dominated the economics profession in the 1940s, 1950s, and 1960s such as Keynes and Nobel prize winners Tinbergen, Samuelson, Hicks, Klein, Tobin, Modigliani, and Solow; and current traditional Keynesians such as Blinder and Nobel prize winners Krugman, Stiglitz, Akerlof, and Shiller.

To explain most recessions, traditional Keynesians focus on aggregate demand for goods and services: if aggregate demand falls, output and employment will fall. Aggregate demand can fall for a variety of reasons, including the bursting of a stock market or housing bubble, or a retrenchment in spending by consumers or business managers in reaction to their own excessive spending and the running up of excessive debt, a psychological shift of consumers or business managers from optimism to pessimism, and from confidence to anxiety. Standard monetary stimulus—an injection of “high powered money into the banking system—can lower interest rates and increase bank reserves, but in a deep recession, will be too weak to stimulate a sufficient rise in demand for goods and services, and fiscal stimulus (tax cuts and/or increase in government purchases or transfers) is essential to generate a strong recovery.

New classical economists and even new Keynesian economists differ from traditional Keynesians in key respects. New classical economists contend that the economy will automatically recover quickly from recession as long as the central bank keeps the money supply from contracting; and that fiscal stimulus doesn’t work while generating harmful government deficits and debt. New Keynesian economists are Keynesian in their view that keeping the money from contracting is not enough to generate a quick recovery from a deep recession. But prior to the 2008 recession, most new Keynesians believed that active standard monetary stimulus would be sufficient to generate an adequate recovery from a deep recession, and that fiscal stimulus was either unnecessary or would not work. The experience of the 2008 recession converted some new Keynesians economists to traditional Keynesian economics as they came to realize that fiscal stimulus is essential for overcoming a deep recession.

**What Should Have Been Done in the Great Recession?**

By the beginning of 2008 it was clear that the economy was falling into a recession. At that time, however, the severity of the recession was not widely anticipated. But by the middle of 2008, it was evident that the recession would be substantially worse than had been expected at the beginning of 2008. By the fall of 2008, it was clear that the economy was plunging into a severe recession. What fiscal/monetary stimulus was applied in 2008, 2009, and 2010? What should have been applied in 2008, 2009, and 2010?

In early 2008, a fiscal stimulus bill of about $150 billion passed Congress with bipartisan support and was signed by President Bush. It consisted primarily of a tax rebate for households ($100 billion), but also contained investment bonuses for business firms ($50 billion). With annual GDP generally forecast to be roughly $15,000 billion, the fiscal stimulus was about 1 percent of GDP. A reasonable rough estimate of a *tax rebate* multiplier *in recession* is 1; a *tax rebate* multiplier is less than a *government purchases* multiplier because consumers save a portion of the rebate. Thus, this 1 percent of GDP tax rebate stimulus would be estimated to raise real GDP about 1 percent. With an Okun’s relationship (output to unemployment) estimate of 2 to 1, this 1.0 percent increase in GDP would be estimated to reduce the unemployment rate 0.5 percent--for example, at the end of 2008 from 7.0% to 6.5%. Although enacted in early 2008, the tax rebate checks were not sent to households by the U.S. Treasury until the summer of 2008.

The estimate of 1 for the tax rebate multiplier *in recession* warrants a comment. Some economists (like Barro) contend that empirical analysis shows that the multiplier for tax rebates or even for government purchases is close to zero. These economists fail to recognize that the multiplier is much larger when the economy is in a recession or in a weak recovery than it is in a fully-employed economy, because when consumer demand increases due to the rebate, producers can easily find unemployed workers to hire and underutilized machines to use, so output increases significantly. These economists have mistakenly tried to measure the multiplier when the economy is at full employment, found it to be small (near 0), and then claimed it would also be small in a recession or weak recovery. The tax rebate multiplier (or the government purchases multiplier) is likely to be at least 1 when the economy is in a recession or in a weak recovery.

By the summer of 2008, and certainly by the fall, it was clear that another much larger fiscal stimulus would be needed in 2008. By summer, fiscal stimulus advocates were calling for the prompt enactment of a much larger stimulus package. But the President failed to propose, and Congress did not enact, another fiscal stimulus in 2008. This was a policy failure of enormous magnitude. After the shocking bankruptcy of Lehman Brothers in September, attention was rightly focused on immediate rescues of financial firms to prevent a financial panic. What was unjustified, however, was the failure to even consider the enactment of a large fiscal stimulus in the second half of 2008.

The election of November 2008 meant that a pro-fiscal-stimulus president would take office in mid-January, and pro-fiscal-stimulus legislators would have a majority in both the House and the Senate in the new Congress. With remarkable speed, in early January the soon-to-be-president and the new Congress began developing a two-year fiscal stimulus package which was enacted into law in mid-February. The two-year stimulus package would inject about $750 billion--$375 per year (2.5 percent of GDP) into the economy in 2009 and another $375 billion (2.5 percent of GDP) in 2010. Over the three years 2008, 2009, and 2010, the fiscal stimulus was $900 billion ($150 + $375 + $375), 6% of GDP over three years, or an average of 2% of GDP per year. With a multiplier of 1, the stimulus would have raised GDP by 2% per year. With an Okun estimate of 2 to 1, the stimulus would have made the unemployment rate 1 percentage point lower than it otherwise would have been—for example, at the end of 2010, 10% instead of 11%.

Suppose instead of a fiscal stimulus of 1% of GDP in 2008, 2.5% in 2009, and 2.5% in 2010 (an average of 2% per year), Congress and the President had enacted and implemented a fiscal stimulus three times as great--6% of GDP each year (3 times greater than the 2% of GDP each year that, on average, was actually implemented over the three years).

With a multiplier estimate of 1, the 6% of GDP fiscal stimulus would have raised GDP in each year 6% above what it otherwise would have been, and with an Okun estimate of 2 to 1, reduced the unemployment rate *3 percentage points* below what it otherwise would have been each year--for example, *at the end of 2010 the unemployment rate would have been 8% instead of 11%.*

Suppose the entire fiscal stimulus had taken the form of tax rebates. With 300 million people, $450 billion (3% of GDP) each June and December (6% of GDP for the year) would have supported a rebate of $1,500 per person (for example, $2,000 per adult, $1,000 per child), so twice a year a family of 2 adults and 2 children would have received a $6,000 rebate check.

Without the Fed transfer to the Treasury of $450 billion (3% of GDP) each June and December, this fiscal stimulus would have raised the annual deficit by 6% of GDP. But with the Fed transfer the Treasury, the fiscal stimulus would have caused *no* increase in the annual deficit and *no* increase in government debt.

In 2008 the Fed wanted to increase the money supply to achieve low interest rates to combat the recession, and in 2009 and 2010 the Fed wanted to maintain the higher money supply and lower interest rates. In the absence of Fed transfers to the Treasury, the Fed increased the money supply and reduced interest rates through loans to financial institutions and purchases of bonds in the open market. If the stimulus-without-debt policy had been in effect, the Fed would have injected $900 billion of high-powered money each year (from 2008 through 2010) through its transfers to the Treasury. Thus, given its injection of money through transfers to the Treasury, the Fed would have reduced the volume of its loans and purchases of bonds in the open market.

**Brief Summary**

The plan for stimulus without debt in a recession has three elements: (1) Congress would authorize the U.S. Treasury to mail tax rebate checks to households in amounts specified by Congress; tax rebates would be the main component of the fiscal stimulus package though some complementary components might also be included; (2) The Federal Open Market Committee (FOMC) of the Federal Reserve would independently decide to have the Fed write checks for transfers to the U.S. Treasury (not loans that the Treasury must repay to the Fed) so the Treasury would not have to issue any new debt to finance the tax rebates; (3) The Fed would adjust its other actions (standard open market purchase or sale of Treasury securities and other assets, its making of loans, etc.), taking account of its transfers to the Treasury, in order to implement the monetary policy that the Fed judges promotes its goals of low inflation, high employment, and well-functioning credit markets.

The first element, tax rebate checks mailed to households, has been implemented in the United States in the recession years 1975, 2001, and 2008, each time enacted with bipartisan political support in Congress. The second element, transfer checks from the Federal Reserve to the Treasury to finance the tax rebates (or any fiscal stimulus package) would be new. The third element, the Fed adjusting its other actions to promote its goals of low inflation, high employment, and well-functioning credit markets, is what the Fed has trying to do for decades.

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