Helicopter Money without Helicopters and without Central Banks[1]

On February 25, 1862 the United States Congress passed the Legal Tender Act. This law authorized, for the first time in US history, the issuance of national paper money by the federal government. Along with an income tax and excise tax increases, paper money issuance played an important role in enabling the United States to finance the surge in expenditures associated with the conflict with the secessionist Confederate States of America. By law, those US notes—popularly known as "greenbacks"—were to be accepted at par in payment of all obligations (legal tender) except import duties which continued to be payable only in gold or silver. The initial issuance of paper money was $150 million but later legislation enabled further increases in the amount outstanding. Current US law limits the amount of US notes in circulation to $300 million, a trivial amount by today's standards. No US notes have been placed into circulation since January 21, 1971.

The Civil War era issuance of greenbacks fits neatly into the definition of "helicopter money" articulated by Bernanke (2016), Turner (2015), and Buiter (2014)[2]. They define "helicopter money" (HM) as a fiscal expansion financed with a *permanent* injection of bank reserves (base money).

During the US Civil War, greenbacks were clearly issued to finance an increase in government expenditures that were anticipated to be financed only partially by increases in future tax revenues and their continued issuance and circulation for more than a century is as close to permanent as I think any reasonable theorist should anticipate in reality.

It is no revelation to point out that in 1862 there was neither a US central bank nor operational helicopters. A more important contrast with 2016 is that during the US Civil War aggregate demand was very high relative to domestic supplies of labor, manufactures, and raw materials. Consequently, price pressures were very evident for "real" reasons. Prior to 1862, the United States was also on a de facto gold standard which exogenously determined the monetary base. The inflexibility of money and credit constrained the ability of markets to equilibrate at higher prices. This constraint was alleviated by the issuance of greenbacks—effectively taking the US off the gold standard during the war.

The Confederate States of America issued a wide variety of paper money during the Civil War. That this was to finance extraordinary expenditures in the absence of an effective tax administration is self-evident and the belief that these notes were to exist in perpetuity became increasingly widespread after the battlefield reverses suffered by the CSA in July 1863 and thereafter. Interestingly, a number of CSA note series contained text inscribed on their front that the CSA would pay the bearer on demand in "dollars", at Richmond (the CSA capital), in some cases with interest, "Six months after the ratification of a Treaty of Peace between the Confederate States and United States of America". Hence Confederate notes must have been well understood to have been contingent claims of uncertain value even in the

[1] This is the first in a series of three companion notes to my post elsewhere: *What is Helicopter Money?*
[2] *What tools does the Fed have left? Part 3: Helicopter Money*, Brookings Institution blog post April; *The Case for Monetary Finance—An Essentially Political Issue*, paper presented at the 16th Jacques Polak Annual Research Conference, IMF, Washington, D.C., November 4-5; and *The Simple Analytics of Helicopter Money: Why it Works—Always,* Economics Discussion Papers, No 2014-24, Kiel Institute for the World Economy.

states of the world where the CSA continued as an operational entity and most certainly worthless in other states of the world. Note the contrast with US notes. The US Congress established a limit on the amount of US notes that could be issued and although those limits were increased over time as the war progressed it became evident that there would at some point come a time when additional issues would no longer be needed. In the CSA case, as the war drew to a close the quantity of CSA notes issued increased exponentially—no limit on their issuance was credible—and the modern day collector can easily judge the approximate date an individual note was issued by the quality of the signature (notes at that time were signed by hand) and the precision of the edge cuts.

Paper money issuance during the US Civil War demonstrates that HM does not require a central bank. Yet, when Congress passed legislation authorizing the issuance of greenbacks during the Great Depression, it needed to take into account the existence of the Federal Reserve.

The idea to finance extraordinary government expenditures with greenbacks arose during the early years of the Great Depression. There were various Depression era proposals to use greenbacks to pay for public works projects, redeem Federal debt obligations, grant low interest loans and advance the payment of the World War I veterans' bonus.[3] Few made their way into legislation. An exception to this general rule is the "Thomas Amendment".

The "Thomas Amendment" to the 1933 Agricultural Adjustment Act directed the Secretary of the Treasury to reach an agreement with the Federal Reserve for expansionary open market operations with US securities and for the Fed to "….purchase directly and hold in its portfolio for an agreed period or periods of time Treasury bills or other obligations of the United States Government in an aggregate sum of $3 billion…"[4]. In the event that such negotiations were to fail, "…or if for any other reason additional measures are required in the judgment of the President…" the Act gave the President the authority to issue "…United States Notes…in the same size and of similar color to the Federal Reserve notes heretofore issued…" limited to a maximum outstanding amount, at any time, of $3 billion.

Greenbacks under the Thomas Amendment were to "…be issued only for the purpose of meeting maturing Federal obligations to repay sums borrowed by the United States and for purchasing United States bonds and other interest-bearing obligations of the United States: *Provided*, That when any such notes are used for such purpose the bond or other obligation so acquired or taken up shall be retired and canceled." The Act also provided for a budgetary appropriation sufficient to enable the retirement of the notes at a rate of 4 percent per year over a 25 year period.

If we analyze the wording of the abovementioned portion of the Thomas Amendment, we clearly see it is discussing what we would consider today "large scale asset purchases"—their composition (Treasuries only), their size, and their permanence—but with a twist. Not only is the Fed to be jawboned into expansionary purchases of government securities but the *Secretary of the Treasury* should be placed in the position of determining the duration of the expansion of the Federal Reserve's balance sheet. The

[3] For a catalogue of Depression era proposals to issue greenbacks, see Reeve, Joseph E. (1943), *Monetary Reform Movements*. Perhaps the most far reaching proposal was that of ex-Senator R.L. Owen who "…proposed issuance of Treasury notes to pay all current government expenses, eliminating taxes…" pp. 65-66.
[4] *Federal Reserve Bulletin*, May 1933, page 317.

equivalent, in contemporary terms, would be were the US Treasury to determine the timing and scope of the unwinding of the Fed's large scale asset purchases rather than the FOMC. In the event this jawboning were to fail, the Treasury was authorized to conduct essentially the same operation although for a more carefully predetermined duration. In that respect, the language stating that the "obligations" purchased by the Treasury would be "retired and cancelled" essentially reflected the will of Congress that the monetary injection be slowly retired at a predetermined pace—4 percent per year over the course of 25 years. In either case, the Thomas Amendment, approved May 12, 1933, was the initial signal that the Federal Reserve's independence was in serious legislative jeopardy.

Viewed in isolation, the Thomas Amendment enabled a significant monetary operation, rather than a monetary financed fiscal expansion. Although the issuance of greenbacks was seen at the time as a radical policy, using them to purchase or redeem government debt would have been simply a debt management operation…substituting "paper money" earning a zero nominal interest rate for "paper bonds" paying, at that time, a positive rate of interest. But here we should note that Buiter (2014) also considers "…an irreversible, monetized open market purchase by the Central Bank of non-monetary sovereign debt"[5] to be HM. Thus, had the US Treasury issued greenbacks to buy back its debt it would have come close to Buiter's criteria even though it did not directly finance a fiscal expansion nor was undertaken by the central bank.

Nevertheless, viewed within the historical context of Roosevelt's first 100 days, which included the de facto abandonment of the gold standard and Congressional pressures for increased spending, an issuance of greenbacks which were designed to be semi-permanent, even if not directly related to a particular spending program, would have effectively played a role in financing the fiscal expansion and thus have satisfied the Bernanke and Turner criteria for being "helicopter money". Interestingly, the original version of the Thomas Amendment would have *forced* Presidential action in the event of an impasse with the Fed. Roosevelt and his advisors fought doggedly to have the original language changed so that his action became "optional" in the final version.

In the event, the Roosevelt administration neither reached an agreement with the Federal Reserve on open market operations nor issued greenbacks. Perhaps either of the two operations would have been too obvious an infringement upon the central bank's independence and would have provided little economic gain for considerable political turmoil. Eventually, the Roosevelt administration was to come up with a much more clever and subtle mechanism to enable the Treasury to emit an unlimited amount of HM—this will discussed in another post and more fully in Klüh and Stella (forthcoming)[6].

In this note I aimed by historical analysis to show that coordination with the central bank is not necessary to employ helicopter money. This is self-evident in the issuance of paper money by the United and Confederate States of America in the 1860s. During the Great Depression, it was clear to fiscal policymakers that cooperation with the central bank to finance increased expenditures was the "first-best" policy—to allow at least the form of central bank independence to remain and avoid the taboo

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[5] *The Simple Analytics of Helicopter Money: Why it Works—Always.* Buiter, Willem (2014), Economics Discussion Papers, No 2014-24, Kiel Institute for the World Economy.
[6] *Believing in Monetary Madness*.

breaking issuance of greenbacks. Notwithstanding, Congress—early on in the Roosevelt administration—was willing to signal through legislation that it was prepared to permit helicopter money in the form of greenbacks were the Federal Reserve not to acquiesce. It was also prepared to legislate the duration of the monetary base expansion or to delegate that power to the Treasury. In either case, it was clear that the Federal Reserve's control over the monetary base would be tenuous during the 73rd Congress (1933-35).

Contrasting the Civil War and the Great Depression it is important to note that in the former there was excess demand, insufficient base money, a desperate need to finance the deficit in the absence of developed securities markets and fears about what paper money would imply for the price level. In the latter there was insufficient demand, sufficient base money, and a desire to see the price level rise to increase farm earnings and reduce real debt levels.

Peter Stella
Stellarconsultllc.com
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