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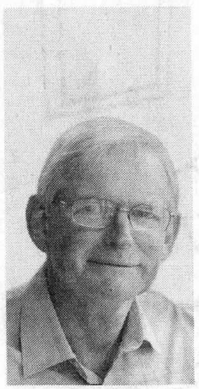
Where to get the money? Just create it

Extra spending now doesn't have to mean a debt burden for future generations

Grant Robertson says low debt gives him fiscal room to move. Photo / Mark Mitchell



Geoff Bertram comment

The Government has embarked on a major programme of fiscal injections to support family incomes and purchasing power, while keeping businesses afloat and workers connected to their jobs.

The cost of this programme was put at $12.1 billion on March 17, raised to a projected $20b on March 27, and is constrained only by a $52b limit passed by Parliament on March 25.

On March 31, Minister of Finance Grant Robertson indicated that the programme would be paid for by an increase in government debt and claimed that low debt was crucial to providing him with fiscal space to act.

But Covid-19, not the government debt position, is creating fiscal space.

Commentators here and overseas have assumed that a large fiscal deficit must mean an increase in government debt, and hence an increased debt-servicing burden on future generations.

These statements may reflect memories of the outcome of the 2007-2010 global financial crisis. But in the present setting they are a product of thinking that treats government as the same as a private-sector business or household that has to fund its spending from an outside source.

But the analogy involves two fundamental analytical errors.

First, neither taxes nor borrowing are required for the additional spending. On the contrary, to be effective in boosting private sector purchasing power during the crisis, the new fiscal spending needs to increase the amount of money in the economy.

Issuing government debt to finance the injection would neutralise much of the boost to overall demand by sucking money back out of the economy just when it is most needed, while imposing a wealth transfer from future taxpayers – mostly the young people who are going to find their employment most adversely affected by this crisis – to today's older, wealthy buyers of the bonds, including overseas investors.

In today's deflationary setting, there is no need for the Government to kill off the short-term monetary effects of its increased spending. In severely recessionary circumstances such as the present, creating money, which neither firms nor households can do, is a valid and viable way to finance government spending.

The taboo on money creation is a political construct, not an economic one. A money-financed fiscal deficit in a non-inflationary setting leaves no necessary burden on future generations – just the benefits of an avoided recession and so a stronger economy.

The idea is utterly mainstream, even conservative. Milton Friedman was an early advocate.

In 2003, then-governor of the US Federal Reserve, the Republican appointee Ben Bernanke, wrote: "Consider a tax cut for households and businesses that is explicitly coupled with incremental central bank purchases of government debt, so that the tax cut is in effect financed by money creation. Under this plan, consumers and businesses have extra cash on hand, but no current or future debt service burden has been created to imply increased future taxes."

Two well-worn arguments are routinely used by arch-conservative opponents of monetisation. One is that co-ordinating monetary and fiscal policy is a violation of central bank independence. Bernanke's 2003 riposte bears repeating: "greater co-operation for a time between the central bank and the fiscal authorities is in no way inconsistent with the independence of the central bank, any more than co-operation between two independent nations in pursuit of a common objective is inconsistent with the principle of national sovereignty".

The second, more substantial, objection is that once the economic crisis has passed, the increased money supply resulting from the fiscal package may (not must) lead to inflationary pressure. In that situation, if it were to materialise, some sort of tax-like burden would fall on some of the population at some stage, through inflation, new taxes, bond sales, restrictions on bank lending, or other means. But that lies in the future.

Right now, if this Government is serious – and it should be – about supporting economic activity through an expansionary fiscal policy, financing extra expenditure by simply issuing money has impeccable support from mainstream economic thinking. More importantly, in the current context, it is the correct, most efficacious way to proceed.

The Government need not remain imprisoned by outmoded, arch-conservative political choices.

Geoff Bertram is a senior associate at the Institute for Governance and Policy Studies, Victoria University of Wellington.

Where to get the money? Just create it
Geoff Bertram

Extra spending now doesn't have to mean a debt burden for future generations

The New Zealand Government has embarked on a major programme of fiscal injections to support family incomes and purchasing power, while simultaneously keeping businesses afloat and workers connected to their jobs.

The cost of this programme of additional fiscal outlays was initially put at $12.1 billion on March 17, raised to a projection of $20 billion on 27 March, and is constrained only by a fiscal limit of $52 billion passed by Parliament on 25 March.

On March 31 Minister of Finance, Grant Robertson indicated that the expansionary fiscal programme would be paid for by an increase in government debt and claimed that low debt was crucial to providing him with fiscal space to act.

But actually it's Covid-19, not the government debt position, that is creating fiscal space.

Commentators both here and overseas have assumed that a large fiscal deficit must mean an increase in government debt, and hence an increased debt-servicing burden on future generations

These statements may reflect memories of the outcome of the 2007-2010 Global Financial Crisis. But in the present setting they are a product of thinking that treats government as analogous to a private-sector business or household that has to fund its spending from an outside source.

But the analogy is a false one. It involves two fundamental analytical errors.

First, neither taxes nor borrowing are required for the additional spending. On the contrary, in order to be effective in boosting private sector purchasing power during the period of the crisis, the new fiscal spending needs to increase the amount of money in the economy.

Issuing government debt now to finance the injection would neutralise much of the boost to overall demand by sucking money back out of the economy just when it is most needed; while imposing a wealth transfer from future taxpayers – mostly the young people who are going to find their employment most adversely impacted on by this crisis – to today's older, wealthy buyers of the bonds, including overseas investors.

In today's deflationary setting, there is no need for Government to kill off the short-term monetary effects of its increased spending. On the contrary, in severely recessionary circumstances such as the present, creating money – something neither firms nor households can do - is a valid and viable way to finance Government spending.

The political taboo on money creation is a political construct, not an economic one. A money-financed fiscal deficit in a non-inflationary setting leaves no necessary burden on future generations – just the benefits of an avoided recession and so a stronger economy.

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In 2003, then governor of the US Federal Reserve, the Republican appointee Ben Bernanke, wrote: "Consider a tax cut for households and businesses that is explicitly coupled with incremental central bank purchases of government debt, so that the tax cut is in effect financed by money creation… Under this plan consumers and businesses have extra cash on hand, but no current or future debt service burden has been created to imply increased future taxes."

Two well-worn arguments are routinely used by arch-conservative opponents of monetisation. One is that coordinating monetary and fiscal policy is a violation of central bank independence. Bernanke's 2003 riposte bears repeating: "greater cooperation for a time between the central bank and the fiscal authorities is in no way inconsistent with the independence of the central bank, any more than cooperation between two independent nations in pursuit of a common objective is inconsistent with the principle of national sovereignty".

The second, more substantial, objection is that once the economic crisis period has passed, the increased money supply resulting from the fiscal package may (not must) lead to inflationary pressure. In that situation, if in fact it were to materialise, some sort of tax-like burden would fall on some part of the population at some stage, through inflation itself, new taxes, bond sales, restrictions on bank lending, or other means. But that lies in the future.

Right now if this Government is serious – and it should be - about supporting economic activity through an expansionary fiscal policy, financing extra expenditures by simply issuing money in the current circumstances has impeccable support from mainstream economic thinking. More importantly, in the current context it is the correct, most efficacious way to proceed. The Government need not remain imprisoned by outmoded, arch-conservative political choices.