Anatole Kaletsky is an award-winning journalist and financial economist.

August 1, 2012

How about quantitative easing for the people?

Through an almost astrological coincidence of timing, the European Central Bank, the Bank of England and the U.S. Federal Reserve Board all held their policy meetings this week immediately after Wednesday's publication of the weakest manufacturing numbers for Europe and America since the summer of 2009. With the euro-zone and Britain clearly back in deep recession and the U.S. apparently on the brink, the central bankers all decided to do nothing, at least for the moment. They all restated their unbreakable resolution to do "whatever it takes" – to prevent a breakup of the euro, in the case of the ECB, or, for the Fed and the BoE, to achieve the more limited goal of economic recovery. But what exactly is there left for the central bankers to do?

They have essentially two options. They could do even more of what the Fed and the BoE have been doing since late 2008 – creating new money and spending it on government bonds, in the policy known as "Quantitative Easing." Or they could admit the policies of the past three years were not working, at least not well enough. And try something different.

There is, admittedly, a third option – to do nothing, on the grounds that public bodies should stop interfering with the private economy and instead leave financial markets to restore economic prosperity and full employment of their own accord. This third idea is based on the economic theory that if governments and central bankers leave well enough alone, "efficient" and "rational" financial markets will keep a capitalist economy growing and automatically return it to a prosperous equilibrium after occasional hiccups. This theory, though still taught in graduate schools and embedded in economic models, is implausible, to put it mildly, especially after the experience of the past decade. In any case, experience shows that the option of government doing nothing in deep economic slumps simply doesn't exist in modern democracies.

Returning, therefore, to the two realistic alternatives, central bankers and financiers are overwhelmingly in favor of the first: keep trying the policy that has failed.

While QE might still help in the euro zone, since the ECB is the only entity that can guarantee that Italy, Spain and France will not go into a Greek-style default, the U.S. and British situations are very different. The U.S. and British governments control their own currencies and therefore face no risk of default. What, then, would be the benefit of more QE in the U.S. or Britain?

So far $2 trillion has been created by the Fed and £375 billion by the Bank of England, but where has all this new money gone? It has certainly not appeared in my wallet or bank account – nor has it fattened yours, unless you happen to be a bond trader or banker. The fact is that all the new money has been spent on buying bonds. QE has thus inflated bond prices and boosted bank profits, but achieved little else.

The one economic benefit of QE has been to help governments finance the huge deficits caused by recession without having to raise taxes, slash public spending or face Greek-style bankruptcy. In this sense, QE has certainly prevented the U.S. and Britain from suffering worse outcomes, but it has failed to stimulate employment or economic growth. This is exactly what Japan has experienced for 20 years – and as in Japan, additional rounds of QE now will merely act as an anesthetic, perpetuating stagnation but discouraging more effective stimulus measures.

One such radical measure is too controversial for any policymaker to mention publicly, although some have discussed it in private: Instead of giving newly created money to bond traders, central banks could distribute it directly to the public. Technically such cash handouts could be described as tax rebates or citizens' dividends, and they would contribute to government deficits in national accounting. But these accounting deficits would not increase national debt burdens, since they would be financed by issuing new money, at zero cost to government or to future generations, instead of selling interest-bearing government bonds.

Giving away free money may sound too good to be true or wildly irresponsible, but it is exactly what the Fed and the BoE have been doing for bond traders and bankers since 2009. Directing QE to the general public would not only be much fairer but also more effective.

Suppose the new money created since 2009, instead of propping up bond prices, had simply been added to the bank accounts of all U.S. and British households. In the U.S., $2 trillion of QE could have financed a cash windfall of $6,500 for every man, woman and child, or $26,000 for a family of four. Britain's QE of £375 billion is worth £6,000 per head or £24,000 per family. Even if only half the new money created were distributed in this way, these sums would be easily large enough to transform economic conditions, whether the people receiving these windfalls decided to spend them on extra consumption or save them and reduce debts.

Distributing money to the general public was the one response to intractable recessions and liquidity traps that united Milton Friedman and John Maynard Keynes. Their main difference was that Friedman proposed dropping dollar bills out of helicopters, while Keynes suggested burying pound notes in chests that unemployed workers could dig up. Unfortunately modern economics, based as it is on simplistic and misleading assumptions about self-stabilizing markets, has forgotten the insights of these great students of deep economic slumps. In today's world of electronic money, we would not even need Friedman's helicopters or Keynes's ditchdiggers. Just a few lines of computer code – plus some imagination and courage from our central banks.