Power of printing money

By Bernard Hickey - Sunday Feb 26, 2012

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I am about to commit economic heresy, but at least I'm in auspicious company and it's something our own Reserve Bank and government has done before.

It's time the Reserve Bank of New Zealand started printing money and lending to our government to build houses and infrastructure, particularly in Christchurch.

Even a couple of years ago, this would have been unthinkable to say, even treasonous. I'm sure many readers will still believe such money-printing is dangerous madness guaranteed to debase the currency, create hyper-inflation and empower politicians to go on an even bigger spending spree.

But we've been here before and right now our major trading partners are doing exactly this. We should at least be talking about it.

Back in the very early days of the Reserve Bank, shortly after the first Labour Government was elected in 1935, the bank lent money created out of thin air to the government and producer boards. It was used to build state houses and help fund exports of meat, wool and dairy products.

This first bout of quantitative easing helped pull the New Zealand economy out of the Great Depression of the 1930s although, to be fair, many other policy actions taken by the previous centre-right United-Reform coalition helped rebuild the economy and reduce unemployment.

New Zealand benefited with the rest of the British Empire when the British pound was removed from the gold standard and the local economy rebounded after it devalued its currency against the pound in 1933.

But the creation of the Reserve Bank in 1934 and the drive, led by Labour's John A. Lee, for a state house-building programme led to the Reserve Bank being nationalised and starting to lend to the government.

Fast-forward to the global financial crisis. Now central banks throughout the Northern Hemisphere are doing similar things.

The United States Federal Reserve, the Bank of Japan, the Bank of England, the Peoples' Bank of China and the European Central Bank have printed a combined US$10 trillion ($12 trillion) in the past four years and spent it on all manner of bonds and cash injections into banking systems.

This process, known as "quantitative easing", is often a last resort after interest rates have been cut to almost zero.

Many argue it has been ineffective because the money went straight into the banking system and parked there, or was used to pump up the prices of various assets, including shares, gold and bonds.

Lending this new money directly to governments to spend immediately on infrastructure, goods and services would have been a much wiser idea. China did this most effectively.

However, this also only works when it doesn't create inflation.

This is the crucial question that is now being debated by a relatively new brand of economics known as "modern monetary theory", which says deficit spending from newly printed money is unlikely to create inflation as long as there are unemployed people and assets such as buildings and machinery sitting around doing nothing.

The Reserve Bank has already said such a quantitative easing could be considered, but not yet because it has room to cut its official cash cate further towards 0 per cent from 2.5 per cent.

But isn't it better for our Government to be borrowing from its own central bank than from foreign banks and pension funds? Wouldn't it be better employing the unemployed to build new houses and repair Christchurch's infrastructure than to just sit back and let it happen? Wouldn't it be better to print the money to fund the deficit than choose to sell public assets to do it? It would devalue our currency, but is that such a bad thing when we need to boost our exports?

The big question concerns inflation. At present, New Zealand's inflation is under control and the experience in Japan is that money-printing over decades has not created inflation.

Neither is it creating inflation in Europe or the US at the moment.

Here endeth the heresy and the history lesson.