Finding The Money

Bryan Gould - July 4th 2018

So, the chickens are coming home to roost – and with a vengeance. The tragedy for the new government is that the chickens were bred and raised by the previous government, and are only now flying in, in large numbers and with hefty price tags.

We are now getting some idea of the price that has to be paid for those "business-friendly" policies that were celebrated for their success in producing a "surplus" (at least for the government).

That price includes large numbers of underpaid public servants – nurses, teachers, midwives, care workers, Inland Revenue workers – and underfunded public services – health care, schools, keeping our water and rivers clean, and bio-security at our borders. The bio-security failure alone will cost the current government around $900 million – the amount awarded by the courts for the previous government's negligence in allowing PSA to decimate the kiwifruit industry (and that's to say nothing of the cost of the myco-plasma bovis outbreak).

Through no fault of its own, the new government is having to pay up for the mess made by its predecessor, and that costs money that cannot, it seems, be easily found. Every dollar paid to clean up the mess is said to be a dollar less for the government's real aims – to improve our public services, to rescue our environment, to save families from poverty, to provide recent housing for everyone.

But is that really the case? There may be other shortages – labour or land, or skills or technology, or materials – but a shortage of money should not be one of them. How do we know that? Because, as an increasing number of experts recognise, and as our own experience teaches us, the government of a sovereign country need never be short of money.

This is because money, in a developed economy, is what the government says it is. Indeed, it is often called fiat money because it exists only by the say-so of the government – and, as the economist, Ann Pettifor, says, that means that "we can afford what we can do."

Most of the money in our economy sits in bank accounts, and a large proportion of that money is created by the banks when they makes loans, usually on mortgage. The fact that the commercial banks create over 90% of the money in circulation out of nothing is still disputed by some (including by those who should know better) but is now attested to by the world's central banks, by top monetary economists (such as Lord Adair Turner, former Chair of the UK's Financial Services Authority and a leading advocate of "helicopter money") and by leading economic journals such as the Financial Times and The Economist.

This raises the question – if the banks are allowed to create money out of nothing (and then to charge interest on it), why should governments be inhibited about doing so? And indeed, they are not so inhibited – governments all around the world have over recent years pursued policies of "quantitative easing", and on a very large scale – and "quantitative easing" is just another way of describing the creation of new money.

The money created in this way has been directed to building up the balance sheets of the banks in the wake of the Global Financial Crisis, but there is no reason why it should not be applied to other (and more productive) purposes – as it has been in many countries, as well as New Zealand, in the past. Japan, for example, both today and immediately after the Second World War, used this technique to get their economy moving and to build the strength of their manufacturing industry ; in doing so, they followed the precepts of the great Japanese economist, Osamu Shimomura, who is virtually unknown in the West.

The Chinese government today follows similar policies. President Roosevelt in the US did likewise, before the US entered the Second World War, so as to build the strength of American industry and military capability; and, in New Zealand, Michael Joseph Savage authorised the Reserve Bank to issue interest-free credit in the 1930s so as to take us out of recession and finance the building of thousand of state houses.

All that inhibits our current government from using this technique is the fear that some will disapprove and regard it as taking risks with inflation. But, as John Maynard Keynes observed, "there may be good reasons for a shortage of land but there are no good reasons for a shortage of capital." He went on to say that, if an increase in the money supply is applied to productive purposes so that output is increased, it cannot be inflationary.

As the new Labour-led government faces financial constraints not of its own making, why not emulate Michael Joseph Savage and authorise the issuing of interest-free credit to be applied to investment in stimulating new production? The Provincial Growth Fund would seem to be an ideal vehicle; funding investment in new infrastructure in this way would free up financial resources that could then be applied to current expenditure, such as paying the nurses and teachers what they deserve.

Bryan Gould was elected in 1994 to the House of Commons as Labour MP. He was a member of Labour's Shadow Cabinet and contested the Labour Party leadership in 1992. He returned to New Zealand to become Vice-Chancellor of Waikato University in 1994, a position from which he has now retired.