Unlock Your Minds

Bryan Gould - NZ Herald - 2 October 2017

New Zealanders like to think that we are, in most respects, up with - if not actually ahead of – the play. Sadly, however, as a new government is about to emerge, there is no sign that our politicians and policymakers are aware of recent developments in a crucial area of policy, and that, as a result, we are in danger of missing out on opportunities that others have been ready to take.

The story starts, at least in its most recent form, with two important developments. First, there is the now almost universal recognition that the vast majority of money in circulation is not – as most people once believed – notes and coins issued on behalf of the government by the Reserve Bank, but is actually created by the commercial banks through the credit they advance, using bank entries rather than cash, and usually on mortgage.

The truth of this proposition, so long denied, is now explicitly accepted by the Bank of England, and was – as long ago as 1994 – explained in a letter written by our own Reserve Bank to an enquirer, and stating in terms that 97% of the money included in the usually used definition of money known as M3 is created by the commercial banks.

The proposition is endorsed by the world's leading monetary economists – Lord Adair Turner, the former chair of the UK's Financial Services Authority and Professor Richard Werner of Southampton University, to name but two. These men are not snake-oil salesmen, to be easily dismissed. They have been joined by leading financial journalists, such as Martin Wolf of the Financial Times.

The second development was the use by western governments around the world of "quantitative easing" in the aftermath of the Global Financial Crisis. "Quantitative easing" was a sanitised term to describe what is often pejoratively termed "printing money" – but, whatever it is called, it was new money created at the behest of the government and used to bail out the banks by adding it to their balance sheets.

These two developments, not surprisingly, generated a number of unavoidable questions about monetary policy. If banks could create billions in new money for their own profit-making purposes, (they make their money by charging interest on the money they create), why could governments not do the same, but for public purposes, such as investment in new infrastructure and productive capacity?

And if governments were indeed to create new money through "quantitative easing", why could that new money not be applied to purposes other than shoring up the banks?

The conventional answer to such questions (and the one invariably given in New Zealand by supposed experts in recent times) is that “printing money” will be inflationary – though it is never explained why it is miraculously non-inflationary when the new money is created by bank loans on mortgage or is applied to bail out the banks.

But, in any case, the master economist, John Maynard Keynes, had got there long before the closed minds and had carefully explained that new money could not be inflationary if it was applied to productive purposes so that new output matched the increased money supply. Nor was there any reason why the new money should not precede the increased output, provided that the increased output materialised in due course.

Those timorous souls who doubt the Keynesian argument might care to look instead at practical experience. Franklin Delano Roosevelt used exactly this technique to increase investment in American industry in the year or two before the US entered the Second World War. It was that substantial boost to American industrial capacity that was the decisive factor in allowing the Allies to win the war.

And the great Japanese (and Keynesian) economist, Osamu Shimomura, (almost unknown in the West), took the same approach in advising the post-war Japanese government on how to re-build Japanese industry in a country devastated by defeat and nuclear bombs.

The current Japanese Prime Minister, Shinzo Abe, is a follower of Shimomura. His policies, reapplied today, have Japan growing, after years of stagnation, at 4% per annum and with minimal inflation.

Our leaders, however, including luminaries of both right and left, some with experience of senior roles in managing our economy – and in case it is thought impolite to name them I leave it to you to guess who they are - prefer to remain in their fearful self-imposed shackles, ignoring not only the views of experts and the experience of braver leaders in other countries and earlier times, but – surprisingly enough – denying even our own home-grown New Zealand experience.

Many of today’s generation will have forgotten or be unaware of the brave and successful initiative taken by our Prime Minister in the 1930s – the great Michael Joseph Savage. He created new money with which he built thousands of state houses, thereby bringing an end to the Great Depression in New Zealand and providing decent houses for young families (my own included) who needed them.

Who among our current leaders would disown that hugely valuable legacy?

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.