Funding the Future

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I am grateful to Helen Schofield for drawing my attention to an open letter John Maynard Keynes wrote to President Roosevelt in 1933 on the way in which economic recovery might be achieved. He said (and the language is of the time):

The object of recovery is to increase the national output and put more men to work. In the economic system of the modern world, output is primarily produced for sale; and the volume of output depends on the amount of purchasing power, compared with the prime cost of production, which is expected to come on the market. Broadly speaking, therefore, an increase of output depends on the amount of purchasing power, compared with the prime cost of production, which is expected to come on the market. Broadly speaking, therefore, an increase of output cannot occur unless by the operation of one or other of three factors. Individuals must be induced to spend more out of their existing incomes; or the business world must be induced, either by increased confidence in the prospects or by a lower rate of interest, to create additional current incomes in the hands of their employees...; or public authority must be called in aid to create additional current incomes through the expenditure of borrowed or printed money. In bad times the first factor cannot be expected to work on a sufficient scale. The second factor will come in as the second wave of attack on the slump after the tide has been turned by the expenditures of public authority. It is, therefore, only from the third factor that we can expect the initial major impulse.

We might now want to refine this a little. Not all consumption is now seen as beneficial, after all. And we also know that investment has to be directed towards sustainability. But is anything both issues add focus to Keynes' conclusion, which was and remains the only one available. It is as true now that:

public authority must be called in aid to create additional current incomes through the expenditure of borrowed or printed money.

Keynes was, of course, literally talking about printing. Again, times have changed. We know we no longer need do that. Credit creation is what matters now. We also now know that additional borrowing very often requires the creation of additional credit money in the first instance. For both reasons the emphasis would now have to be in credit creation by the government i.e. new money injection by its spending into the economy.

And there is a caveat to that as well, because we have, of course, seen significant credit creation in the last decade by the government through the quantitative easing programme, but there is a problem with that. The QE programme was not aimed at boosting incomes or at job creation to achieve that aim. If it had an aim it was to change investment decision making. That supposedly should have increased direct funding of economic activity, but there is no evidence that it has. Funds have instead gone into speculation. Bank balance sheets might be in better shape as a result, but that is not what Keynes was prescribing. We need more income now. QE as we have known it is not the answer in that case.

Keynes was right in 1933. with minor contextual change his advice remains right now. We need more government-created money to assist recovery now. The greatest fear is that this is not what the government intends as its paranoia about balancing budgets and supposedly sound finance kick in as this year progresses. We may yet see that we're not all Keynesians now.