Funding the Future

It is time we had joined up economic policy, and indepe...

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In 2010 I wrote this in a paper co-authored with Colin Hines on what we thought should be the future of quantitative easing:

> The quantitative easing programme might be considered a short term success, but as we note, the benefit has been captured almost entirely by the financial services sector whilst further asset boom and bust cycles are, at least potentially being recreated with resultant risk to the economy. These are undesirable long run outcomes when the real aim is to get the UK economy working again. For that reason we cannot support a further round of quantitative easing in the form used in 2009.

More than a decade on, quantitative easing is still funding government deficits, the financial sector is still the main beneficiary, and asset and bust cycles have become one continuous boom (so far, but wait and see). What is more, the UK is not working again, economic activity has never appeared to be stimulated by QE, and the climate crisis, which is the issue requiring the greatest investment of real resources within the economy has not had anything like the funding that it needs.

This week the world's central bankers are meeting, largely virtually, in Jackson Hole in the USA, as they do each year. The big question being asked is when will QE end? All eyes are on the US Fed, but other central banks should not be ignored.

Most mainstream economists think the time to end QE is now. If QE’s aim, as I also noted in 2010, was to reduce interest rates - which it indisputably has done ever since its introduction - then they want an end to QE as they want rates to rise.

Those mainstream economists have two reasons for wanting rates to rise. First, they are in the pay of those who will benefit from a rate increase, who are otherwise called the wealthy.

Second, on behalf of that same clientele they are worried about inflation, which they think the ending of the pandemic will unleash. The problem for this theory is that there is no sign to the end of the pandemic as yet, and the chance of any unleashing appears remote. This will not stop them arguing their case though.

There is, of course, a better case to make. This is that there is every reason to end QE with its bias towards inflating financial sector asset prices. More than enough such stimulus has been delivered. The US stock markets ended on record highs yesterday, and only QE can explain that since underlying value is hard to find within them. So QE as we have known it needs to draw to a close.

But, and I make the point very strongly, we are not in a situation where there is room for the government to disappear from markets. There are three reasons to think otherwise.

First, governments are still going to be running deficits for some time to come (and much longer than they forecast) at what would, until recently, have been considered record levels.

Second, the interest rate required to attract bond holders if all QE support for government was withdrawn is not known, but if a government was so unwise as to risk finding out by throwing itself, wholly unnecessarily, on the mercy of the bond market once again it may be that the rate in question would precipitate a mortgage interest payment crisis and in turn large scale mortgage defaults, a property crisis and in turn a banking crisis followed by a recession of a significant scale. When all that can be controlled by continued government self funding that seems a wholly unnecessary risk to take.

Third, there is very obviously an urgent need for a strong fiscal stimulus for the economy in a great many countries. Whatever he might be doing internationally, Biden is leading the way on this in the USA, and is right to do so. The urgent need is for investment in climate change, related infrastructure, training and the long term jobs young people, in particular, now need to feel part of a society that actually values them. There is no reason why that fiscal stimulus cannot be supplied by government. All that is required is the willingness to fund the deal.

So, what is the required funding? Tax can, and should, only play a limited role in this. We still have a weak economy unable to provide work for all who want it, and with obvious investment required to fill those jobs that are available. More tax is not what is needed now.

Much finance could be supplied directly. In the same 2010 paper that I have already noted, Colin Hines and I created the concept of Green QE - where instead of government created money being used to randomly buy back government bonds already issued into the financial markets that power to create and direct the use of money was instead targeted on the provision of funding for a Green New Deal via a Green Investment Bank. It would be the bonds of that Bank that Green QE would acquire rather then general government gilts. The result would be that funding for the employment, climate and other goals of society would be available.

That process would still fund government spending though, as QE does quite obviously now, however much the Bank of England denies it. But it would do it quite specifically. The 'middle person' of the financial markets would be taken out of the equation, because evidence now proves that they cannot be relied upon to fund the required investments that our society needs.

This form of QE could act as the capital in the process of change that is now essential. The use of this structure adds a governance hierarchy too that simply running an overdraft at the Bank of a England, as modern monetary theory suggests possible, could not by itself. And that capital should be recognised as such in government spending. This does not fuel deficits: this is spending to create assets.

Alongside that is the power that tax has to be used to mitigate the harm QE has caused. Inequality has increased rampantly as a consequence of QE. The wealthy are very much wealthier. Many are sitting on great piles of cash. QE has massively inflated the value of their savings. So, as Colin and I gave again pointed out, the tax reliefs on savings need to change so that these savings are redirected to funding the Green New Deal, and as I have noted this morning, tax really does have the power to do this.

In other words, we can do fiscal stimulus without the sort of QE we have had, and we can correct some of the harm it has caused when doing that fiscal stimulus. All that worries me is that this type of thinking may not get on the table at Jackson Hole. Central bankers are still far too narrow in their thinking, limited by the fact that in the UK, at least, their remit is still far too narrow. And that is not good for the world. It is time we had joined up economic policy, and independent central banking hooked on conventional QE is not good for that. It is time for change.