Funding the Future

Creating money does not, by itself, cause inflation

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This comment was made on this blog by someone whom I presume is a right-wing troll in response to my suggestion that we should not worry about £3 trillion in national debt. There were many fairly similar comments. They felt coordinated. That happens:

Yes of course the Govt can technically print money to replay its debt but the more sterling that is printed the more the effect is felt in inflation and weakness in Sterling. Both are akin to a "default in kind" as purchasing power is reduced. So yes you are technically correct but disingenuous also as there are significant negative effects which you fail to highlight.

I asked the person making the comment to supply evidence to support their claim. So far, they have not.

And this is a reply to that comment, also posted on the blog:

I think this is an important statement, because it's what the majority of people, especially on the right, argue with "printing" money is bad and will lead to negative XYZ.

I think if a clear explanation of why it wouldn't, then it would be easier to counter the ingrained belief of, just "printing" more money will make the situation worse not better. Now, can you suggest the appropriate response the second statement say is needed.

I put some time into a reply to that comment and posted a slightly shorter version of this, which some have suggested I should turn into this post:

Thank you for your comment.

You highlight one of the most important misunderstandings to address.

Creating money does not, by itself, cause inflation. If it did, every act of government spending would be inflationary because all government spending creates new money.

Bank lending would also necessarily cause inflation because commercial banks create new money when they lend.

Neither claim is true.

Inflation of the sort money creation can induce occurs when the ruling attempts at additional spending create demand that the economy cannot meet at existing prices.

That might happen because the economy is already operating at full capacity, because essential resources are scarce, or because supply cannot expand sufficiently quickly.

In those circumstances, creating still more demand can certainly be inflationary.

But suppose the government creates money to employ people who would otherwise be unemployed, build houses when construction capacity is available, invest in renewable energy, improve transport or increase productive capacity. The additional spending is matched by additional economic activity. In those cases, there is no reason why that spending, which creates new money, should produce inflation.

In fact, investment that increases productive capacity can reduce inflationary pressure in the longer term.

The same applies to sterling. There is no mechanical relationship whereby creating another £1 billion causes sterling to fall by some corresponding amount. Exchange rates reflect productivity, trade performance, relative inflation, interest rates, expectations, political stability and international demand for currencies and assets.

So the constraint on government spending is real, but it is not money. It is the availability of people, skills, energy, materials, technology and productive capacity.

That is the crucial distinction. “Printing money causes inflation” is the wrong rule. Spending beyond the economy’s capacity to respond can cause inflation. Those are very different propositions.