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Time to think the unthinkable and start printing again

By Martin Wolf

It is the policy that dare not speak its name: the printing press. The time has come to employ this nuclear option on a grand scale. The alternative is likely to be a lost decade. The waste is more than unnecessary; it is cruel. Sadists seem to revel in that cruelty. Sane people should reject it. It is wrong, intellectually and morally.

A recession looms close in the UK and other high-income countries, less than four years after the start of the last one. This would be a disaster for those who would lose their jobs or the young, who would find their hopes of work further postponed.

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A big danger for the UK is a sharp fall in house prices, which would threaten the finances of households and banks. A new recession would also shatter fragile business confidence, which would reduce real business investment, still 20 per cent lower in early 2011 than before the crisis. That would further delay the structural shifts on which sustained recovery depend. With UK gross domestic product still 4 per cent below its pre-crisis peak, this depression would be longer and costlier, in terms of lost output, than the Great Depression of the 1930s, as I noted four weeks ago.

What is to be done? The first task is to abandon what Adam Posen, an outside member of the monetary policy committee, calls “policy defeatism”. As he argued in a new speech: “Throughout modern economic history ... every major financial crisis-driven downturn has been followed by premature

abandonment – if not reversal – of the . . . stimulus policies that are necessary to sustained recovery. Every time, this was due to unduly influential voices claiming some combination of the destructiveness of further policy stimulus, the ineffectiveness of further policy stimulus, or the political corruption from further stimulus."

Up pops Spencer Dale, the Bank of England's chief economist, as if on cue, with arguments that the UK's sharp productivity slowdown indicates a permanent reduction in potential output and its growth. He also suggests that part of the recent productivity shortfall is due to reduced innovation by financially constrained smaller businesses. He offers no evidence for this theory. The striking fact, as Bill Martin at the Centre for Business Research in Cambridge has noted in an important paper, is that productivity slowdowns and output declines have occurred across the board. This makes it likely that the poor productivity reflects weak demand.

It is vital, then, to sustain demand. With fiscal policy set on kamikaze tightening and conventional monetary policy almost exhausted, that leaves "quantitative easing". Mr Posen recommends a great deal more of it, starting with "a minimum of £50bn in gilt purchases in secondary markets" though he now boldly recommends something closer to £75bn or £100bn, in light of the dire external environment. Lowering long-term interest rates would surely provide at least some benefit. But Mr Posen recommends two institutional innovations, as well, aimed at enhancing supply: a public bank or authority for lending to small businesses and an institution for securitising loans made to small and medium enterprises. An alternative would be for a new agency to take the tail risk on normal bank lending to SMEs. That would be a far more sensible way for the government to promote credit to small business than general guarantees to banks.

Personally, I would favour the "helicopter money", recommended by that radical economist, Milton Friedman. This would be a quasi-fiscal operation. Central bank money could pass via the government to the public at large. Alternatively, the government could fund itself from the central bank, directly. Better still, the government could increase its deficits, perhaps by slashing taxes, and taking needed funds from the central bank. Under any of these alternatives, the central bank would be behaving like any other bank, creating money in the act of lending.

In current circumstances, a policy of direct financing of government by the central bank should recommend itself to monetarists and Keynesians. The

former have to be worried by the fact that UK broad money (M4) shrank by 1.1 per cent in the year to July 2011. The latter would have to be pleased that governments could run still bigger deficits without increasing their debt to the public.

Some will argue that a policy of direct financing by the central bank must be inflationary. This is wrong. No automatic link exists between central bank money and the overall money supply. Above all, the policy would be inflationary only if it led to chronic excess demand. So long as the central bank retains the right to call a halt, that need be no serious danger.

A far greater threat is that a prolonged period of feeble demand would undermine supply, impoverish the country and bequeath a legacy of huge public debts. The big risk, in short, is now of a lost decade. Act now. That must not happen.