Column: The monetary bubble to end all bubbles is coming

BY Terry Burnham *June 29, 2016 at 3:50 PM EDT*

The world's central banks are likely to vastly increase their money creation, resulting in the biggest monetary bubble ever, predicts economist Terry Burnham. Photo by PM Images/Getty Images

Editor's Note: Central banks continue to create new money through quantitative easing. But should they?

That's the question both Harvard economist Terry Burnham and economics correspondent Paul Solman explore in two separate pieces. Below, Terry Burnham warns against quantitative easing. You can read Paul's take on the issue, "Why the Fed should print more money, not less," here.

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I predict, moreover, that we haven't seen anything yet; the world's central banks are likely to vastly *increase* their money creation, resulting in the biggest monetary bubble ever, with perhaps $100 trillion more new money on its way into the global economy. This prediction is not specifically tied to Brexit, the UK's vote to leave the European Union. However, we'll discuss Brexit below in the context of printing money.

Monetary policy today: the loosest in almost a century

There's no debate that central banks around the world have been printing money in historic fashion. (Central bankers prefer to call this quantitative easing: QE, or better yet, large scale asset purchases — LSAPs.) I prefer to call it printing money, though technically, central banks create money electronically — out of thin air.

The European Central Bank is manufacturing more than $1 trillion worth of euros a year. The U.S. Federal Reserve has created over $3 trillion dollars of new money in the last decade (after taking nearly a century to create the first trillion). No one knows exactly what is going on inside China's central bank, but we can be certain that it involves massive liquidity creation. In a world filled with monetary looseness, the Bank of Japan is printing the most money of any major economy relative to the size of its economy.

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What have we gotten in return for monetary easing? The stated goal of monetary looseness is to create jobs and economic growth. By this yardstick, monetary policy is a failure (see IMF downgrades growth forecasts — again).

However, if the goal of printing money is to pay for government expenditures, monetary policy has been an enormous success. Central banks have taken more than $10 trillion dollars from their citizens. Not only have central bankers taken wealth in historic amounts, they have been cheered for their expropriation.

Governments have two ways to pay for their expenditures. They can take the money from their citizens through fees and taxes. Or they can have the central bank create new money. (Borrowing the money can be thought of as a third way, or it can be viewed as simply deferring the choice between taxing and printing).

To understand the seductive allure of printing money, consider the U.S. program of drone strikes in Afghanistan. Some of the missiles that the U.S. fire cost $1 million each. So 1,000 drone strikes costs $1 billion.

The government can fund the $1 billion by taxing people. If the government uses taxes to pay for the drone strikes, the people who pay for the missiles know who they are, and they generally are not happy. The political cost to additional taxes is very high.

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Instead of raising taxes, the Federal Reserve can print an extra billion. In terms of real resources, $1 billion is taken from other uses, made into missiles and exploded. The billion dollars is gone, and it doesn't matter whether it was paid for with taxes or printing money.

Economically, it matters not whether the drone strikes are paid for by printing money or raising taxes. *Politically*, however, the two alternatives are currently perceived to be very different (even by Paul Solman). In fact, when the Fed prints $1 billion to pay for 1,000 drone strikes, who pays?

Yogi Berra famously said he wanted his pizza cut in four slices instead of eight. His "logic" was that he didn't want to gain weight by eating a lot of slices. However, what matters is not the number of slices, but the total amount consumed.

Similarly, printing more money does not alter the size the economy; it simply reduces the value of each dollar. The seductive aspect of having the Fed pay for government expenditures is that, unlike taxes, the cost of printing money is invisible. Almost no one is even aware that they have paid for part of a drone strike.

Given the choice between printing money and taxing people, governments reliably take the easy way out and print.

Japanese Prime Minister Abe makes the easy decision

Relative to its economy, Japan is running the largest government deficit in the industrialized world. It has also been promising to increase taxes to reduce the deficit. If you were Prime Minister Shinzo Abe, which would you choose?

1. Dramatically increase taxes on every voter in the upcoming election, causing pain and outrage, or
2. Nudge the Bank of Japan to cover the deficit by cranking up the monetary presses?

Unsurprisingly, Japan recently canceled (officially, "delayed") pending tax increases. Meanwhile, the Bank of Japan prints money around the clock. Thus, the Japanese government deficit is being covered with brand new yen printed by the Bank of Japan.

Why would Europe take the pain of Greek default and exit when they can simply paper over the problem?

Central banks around the world have made a similar decision to print, not tax. In Europe, the total government debt of Greece is just a few months-worth of ECB printing. Why would Europe take the pain of Greek default and exit when they can simply paper over the problem?

In fact, every time Greek default looms, European leaders agree to continue to defer the problem with more subsidies. The subsidies are paid for with freshly printed euros. And Europe will continue to paper over their Greek problem — and similar problems in Portugal, Italy and Spain as well — as long as printing money is politically permissible.

Brexit and the government response

On June 23, 2016, England voted to leave the European Union. What was the response of the European governments to this historic decision? Here are some of the responses:

1) The Italian government is looking to give $44 billion to Italian banks. Where is Italy going to get the money to give to their banks? The answer is to print money and create more debt.

2) The Bank of England is rumored to be considering even looser money in the form of cutting rates and restarting printing money.

3) Financial markets now wager that the U.S. Federal Reserve is more likely to cut rates in 2016 than to raise them as previously planned. In short, the government response to Brexit is print money and create more debt.

Here’s a lis of the government responses to Brexit that are designed to make it easier to create jobs in Europe.

Europe is in crisis because governments’ response to every problem is to take the easy path of papering over the crises. Predictably, the government response to Brexit is more debt and more printing money.

The current situation: hatred of taxes, love of printing money

In March of this year, ECB President Mario Draghi announced that the ECB would begin directly supporting *companies* by buying their bonds — the IOUs they issue when they borrow money. Previously, all the euro printing had been directed toward buying *government* debt. With the European economy continuing to sputter, however, Mr. Draghi took more dramatic action to give money directly to companies in the hopes that they would use it to expand their operations and increase hiring.

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The problem is that when the ECB lends newly minted money to companies by buying their bonds, it transfers wealth from European savers to companies. How so? Because the more money the ECB lends by buying corporate bonds, the lower the interest rate companies have to pay. Consider that Toyota sold a Euro-bond last week that pays no interest. Zero. Who would buy a bond that pays no interest? The European Central Bank is happy to, but in doing so, it forces savers who would *invest* in corporate bonds to accept a zero rate of interest as well.

Further adding insult to injury, the ECB will only buy the bonds of blue-chip companies. These large, rich companies are precisely the ones that would have no trouble borrowing from private investors. Small companies, which might actually need money to expand and hire people, are excluded from the ECB's bond-buying program.

So the ECB program transfers money from European savers to the largest, richest companies in the world. What was the response to the ECB's bond buying plan? Was there outrage at this transfer of wealth? Did Senators Elizabeth Warren and Bernie Sanders lead "Occupy ECB" marches? No, exactly the opposite happened: Stock markets around the world rallied after the announcement of more European printing.

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Why do stock markets go up when central banks print more money? The answer could simply be that some of that new money is used to buy stocks. Another possibility is that the gains to monetary policy, if any, come immediately, while the pain is spread out over years. Perhaps the correct analogy is drug addiction. Another injection makes the recipient feel better immediately, while increasing the total amount of damage over time. In any event, in the current environment, central bank looseness is rewarded.

In fact, every announcement of monetary easing has been greeted with global cheers. And until the cheering stops, the printing will continue. In fact, if printing money is good for the world and essentially free, why not, you might ask yourself, replace *all* taxes with newly printed money?

Coming soon: the monetary bubble to end all bubbles

Given how easy it is to print, with so few negative political consequences, more money is coming. How much more? Total global printing money in the last decade has totaled the equivalent of about $12 trillion dollars. On the low end, the next wave could be $20 to $30 trillion. However, records are made to be broken, so perhaps central banks will print a $100 trillion of new money. Why wouldn't they?

How will the coming massive round of printing money end? There are two ways that the world can end printing money.

1. **Governments can reform themselves**. Central banks can decide that printing money takes resources from people in exactly the same way taxes do. Even though the world does not currently express outrage at the extraction of wealth via printing money, governments can reform themselves, stop printing, cut spending, raise taxes and act responsibly.

2. **Financial markets can reform governments**. Under this scenario, the political cost of printing money increases to the point where fiscal restraint is less costly to decision makers than printing money. Governments will reform because they are forced by financial crises. The exact form of how the market would end the current easy money bonanza is not clear. However, it must be the case that the reaction to future monetary easing will become negative. The political cost of printing money must exceed the political cost of the alternatives — cutting spending or raising taxes.

Given these alternatives, the most likely outcome is financial crisis. As the crisis unfolds, we should expect people to claim, “NEVER AGAIN.” You can get ahead of the crowd. Say it now. “Monetary policy cannot make us rich; we will never again try to print ourselves to prosperity.” Open the window and scream it:

“NEVER, NEVER, NEVER again.”

And then hope you die before the next round of monetary printing. Many elderly Germans who lived through the 1930s cannot believe the current situation. They are mad as hell, but there are too few of them alive to alter the outcome. The seed of future monetary shenanigans grows with each funeral of people who lived through the prior crises.

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