

Column: Why the Fed should print more money, not less



Business and Economics Correspondent

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In the current economic environment, central banks certainly should create new money in order to make the necessary investments that will benefit their citizens and economies in both the short and long runs, writes economics correspondent Paul Solman. Photo by Jason Lee/Reuters

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

That's the question both economics correspondent Paul Solman and Harvard economist Terry Burnham explore in two separate pieces. Below, Paul explains why central banks continue to do so. You can read Terry's column, "The monetary bubble to end all bubbles is coming," [here](#).

In 1998, having already spent more than a decade as the PBS NewsHour's so-called "business and economics correspondent," I was granted an unpaid semester's leave to go back to school, taking (among other courses) microeconomics. My teacher at Harvard's Kennedy School was Terry Burnham. So it is with humility that I contest my former teacher's "coming monetary bubble," and contest it vigorously.

I don't disagree with Professor Burnham's first point: that the world's major central banks are likely to print their tails off in the near future and that their response to Brexit tends to prove the point. Moreover, who could argue that the U.S. should use money to explode drones — unless it has to?

But in the current economic environment, central banks certainly *should* create new money — not only to shore up the world banking system short-term in a time of tremulous uncertainty, but more importantly, in order to make the necessary investments that will benefit their citizens and economies in both the short and long runs and, as always, prevent financial crises.

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The core of my argument is simple enough. Politicians are *not* making indispensable investments by the normal means: either taxing or borrowing. And investments *need to be made*.

Instead of exploding drones — a loaded example if ever there was one — consider the government expenditure without which an economy literally, if only eventually, falls apart: filling potholes. I can't testify to its accuracy, but one estimate puts the average annual cost for vehicle repairs due to rough pavement for individual motorists at \$377. Given the state of my own car, that sounds about right.

Here is another: the failure to spend \$1 in road repair typically results in \$7 of cost five years later. Think about potholes and the reason is obvious. A small pothole is easy to fill; a large one, not so much. That's because the longer you leave a vulnerable pothole to the whims of Father Nature, the more it will crumble — in three dimensions. To illustrate, if somewhat dramatically: if it doubled every month, a minuscule 2" x 2" x 2" pothole (8 cubic inches of empty) would become a 16" x 16" x 16" crater — 29 cubic feet — between Nov. 1 and April 1.

Writ large, that's what has been happening to America's infrastructure, and why the American Society of Civil Engineers believes it will cost \$3.6 trillion dollars by 2020 to fix it.

Politicians right and left acknowledge the infrastructure problem. Both Hillary Clinton and Donald Trump have done so. Trump clearly has other priorities, but he has mentioned a "trillion-dollar rebuilding plan" which would be "one of the biggest projects this country has ever undertaken." Clinton, more concretely, has proposed a \$275 billion five-year infrastructure investment plan. But where, critics ask, is the money to come from?

"The answer is simple," you might be thinking: "Just borrow the money." And you would have a point. Right now, interest rates in this country are historically (some would say *absurdly*) low — down near zero, in fact, assuming any future inflation at all. Many experts are saying the borrowing rate is actually *negative*, since the U.S. can borrow money for 10 years at an interest rate of about 1.5 percent per year, the current "yield" on a 10-year Treasury note and many experts forecast inflation, over that same period, to be substantially higher. If it is, the government would be filling potholes *and* making money — by borrowing today to fill those holes and then paying back the loan in 10 years with money that will be worth less than it is at the moment.

Problem is, there's been so much handwringing and scarifying about a current budget deficit and the cumulative total of all past deficits — "the national debt" (*America is becoming Greece!*) — that no politician besides Clinton seems willing to put forth a suitably ambitious and credible proposal for addressing the infrastructure problem. The last estimate of Trump's tax cut plan alone — forget about promised investments — would balloon the debt by nearly a trillion dollars a year for a decade. How, skeptics wonder, could he possibly both cut and spend so extravagantly? And were he to try, would Congress let him?

So then how *does* a government invest in our present these days, not to say our future?

In a developed world economy of significant underemployment, government spending is an attractive option.

Its central bank creates new money. In America, that bank is the Fed, which uses the new money to buy the IOUs the U.S. Treasury issues when it borrows money: Treasury bills, notes and bonds. The Treasury can then spend the money on infrastructure. (Or, yes, on drones.)

There is a further justification for this admittedly roundabout way to fund government — so-called "public goods" — investments. What better investment opportunities than public goods *are there* nowadays? The great companies of our era are not building railroads, steel mills or auto factories, but software instead: search engines like Google; websites like Amazon; apps like Uber. Firms like these cost next to nothing to get started and not nearly as much to grow, compared to the giants of the past. And as a percentage

of sales, they employ far fewer human beings. In a developed world economy of significant — some would say *massive* — underemployment, which in turn generates negligible wage growth and ever-greater economic inequality, government spending is an attractive option.

But isn't Terry Burnham right to bemoan the declining value of the dollar? Surely, if the Fed triples the supply of dollars in less than a decade, the dollar should fall by something like 75 percent, no? All else equal?

Well, *theoretically* yes, but as usual — and this is what makes economics so slippery — all else is not even vaguely equal. Since the world is *not* investing in big projects as it once did — or even in small projects like home mortgages, because of the defaults of the Crash of '08, and for a host of other reasons — the global economy is awash in savings: the retained profits of companies and individuals who think they have nowhere to profitably invest it. Those savings wind up in banks which — and here's the punchline — *redeposit the money...* at central banks like *the Federal Reserve*.

Since the much-maligned money explosion, post-crash, skeptics warned, again and again, that inflation was just around the corner. *It never happened.*

Yes, the circle is closed. The Fed has created some trillion new dollars. And almost all of it has wound up back at Fed, sitting there. Small wonder the dollar hasn't lost three-fourths of its value, has lost almost none of its value at all. No wonder inflation is so low, Social Security's cost-of-living adjustment has been *zero* in three of the past seven years. The newly created money that terrifies Terry simply hasn't circulated through the economy at all.

Since the much-maligned money explosion, post-crash, skeptics warned, again and again, that inflation was just around the corner. You could almost hear it coming. And once inflation took off, interest rates would follow suit, further undermining the world's economies.

It never happened. Indeed, in the wake of Brexit and all the wanton money creation of which Terry writes, what's happened to interest rates? They are at historic lows throughout the Western world. And by that I literally mean: the lowest ever recorded, at least here in the U.S. That's because people and businesses are sitting on their wealth instead of circulating it by spending and investing. What would *you* do if you were a central banker? Do nothing?

“But wait,” you might be thinking; “what if all the new money *does* begin to circulate?” What if investment opportunities *do* present themselves, that is; if projects large and small again seem viable, loans less risky to make?

Well in that case, the Fed has various technical options — more than you want to know, really. But the obvious one is to start *shrinking* the money supply to cool down an overheating economy. That's what it's always done — in a famous Fed phrase, “take

away the punchbowl just as the party gets going.” You worried about an economic party anytime soon? As my grandmother used to say, we should live so long.

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In the meantime, economic growth slogs along as firms and individuals save too much and don’t actually invest, their money idling away the years in banks, which redeposit it at *central* banks like the Fed. Governments *should be* borrowing and investing, but for political fears — fears of the sort that Terry is voicing — they’re not.

So central banks “print,” trying to goose their economies as best they can. They do so in an era where economists rightly worry more about *deflation* than *inflation* — an era where prices go *down* instead of up and spur a downward spiral in spending, hiring and ever lower wages. That’s what leads to a Depression. In such a time, I can’t for the life of me see what’s wrong with printing money.