The 'magic money tree' politicians don't want to talk about

Simon Wilson - Senior Writer - NZ Herald - 11 Sep, 2020

"New Zealand has a money tree and you can find it in a building at the bottom of The Terrace in Wellington".

It's the question we're not supposed to ask, because we're not supposed to know the answer. How come the Government can just rustle up all this debt? When it allocates billions to urgent Covid-related priorities, where's it getting all that money?

The answer is, it comes from a magical money tree.

And while politicians of almost every stripe tell us this tree doesn't exist, right now economists and financial commentators are busily debating how much we should let it grow.

The phrase "there is no magical money tree" was made famous by Theresa May, former British PM. She used it in a televised election forum in 2017 to explain to a nurse why she hadn't had a pay rise for eight years.

In fact, during those same eight years, the Bank of England's money tree grew almost half a trillion pounds' worth of money. To be exact, £453,000,000,000, all of which got spent on things that were not the salaries of nurses in the National Health System.

New Zealand has a money tree and you can find it in a building at the bottom of the Terrace in Wellington. The Reserve Bank's tree has grown $32 billion in recent months and before the Covid crisis ends that's expected to become $100b.

Money trees became popular during the global financial crisis that began in 2008, when governments around the world decided printing money was the best way to save local economies.

The most common way to do it was, and still is, for central banks to create new money and use it to buy Government bonds from private banks, which those banks are then expected to distribute, mainly through loans, into the productive economy.

These days printing extra money goes by the fancy name "quantitative easing" (QE), but don't be fooled: QE is no different from plucking bank notes from a magical money tree.

Unfortunately, QE has had some unintended consequences. One concerns corporates, several of which, despite the economic ravages of Covid, have reported good profits. The wage subsidy was instrumental in that. As a

Government intervention tool that kept workers in employment, small and medium enterprises (SMEs) afloat, and many larger companies from savage cutbacks, it's been invaluable. That's good.

But some corporates are doing so well they're paying dividends to their shareholders. Lobbyists acting as proxies for those same shareholders have habitually and loudly encouraged the Government to pay down debt and cut spending, in order to put aside for a rainy day. But few large companies created their own rainy day funds.

The wage subsidy, then, which cost $13.6b, became a mechanism by which corporates could reward their shareholders with dividends. That's called a wealth transfer. The pain was socialised – we all paid through taxes – but the profit was privatised.

The magical money tree has resulted in other wealth transfers too. It holds interest rates permanently low, which is a big help to everyone trying to run a budget, but it's an even bigger help to those with the means to invest in equities and assets. The sharemarket is doing very well out of the pandemic, and so are property and "collectables" like art and classic cars.

The wealthiest among us aren't taking overseas holidays, which increases their disposable income here. But nor, in many cases, are they using all that extra money to make things, grow things or otherwise employ people and rebuild the economy. They're leaving it in the bank, or they're buying houses.

It doesn't help the economy. It's like they're just stuffing their money under the floorboards.

The Government knows this and so does the Reserve Bank. So does the National Party: leader Judith Collins has said it's wrong. But both National and Labour have ruled out tax reform aimed at capital gains, land or other places to store wealth. That means the inequalities made worse by monetary policy and current tax settings remain in place.

Adrian Orr, governor of the Reserve Bank, addressed the issue this week in an interview with my colleague Liam Dann.

He said it was "utterly wrong" to say current monetary policy was increasing inequality, which is true in the sense that the bank doesn't set tax policy. But that magical money tree is still transferring wealth to the wealthy.

He added, "If we are feeling wealthier, we have a higher propensity to consume and invest." That sound a lot like trickle-down economics, which we've had 40 years to learn doesn't really happen.

The people who really do consume more when they feel wealthier, thus keeping money circulating in the economy where it can do some good, are the less well off. That's because poor people don't really have a choice: they have to spend whatever they have. Orr knows this.

But his position is that what happens at the top end isn't the most important thing. "The critical thing for monetary policy is to do our best to ensure low and stable inflation, because those on fixed incomes, whether on benefits or not… pay the biggest social cost for high inflation." That's true, they do.

But it brings us back to the money tree. If a core goal of monetary policy is to ease the pain of the less well off, why not do more of it?

Raise benefits, get more people onto the Living Wage, spend more on the poor. These are not revolutionary ideas, but too often we treat them as if they are.

And as we smother the debate with rhetoric about how countries, like households, can't spend beyond their means, we turn away from a genuinely revolutionary question lurking beneath it all. Why not?

That $100b the Reserve Bank is growing for us and will turn into debt: do we even need to pay it back?

With QE, remember, the Reserve Bank buys Government bonds. The money for that doesn't come from loan sharks swimming in murky waters off our shores. It's the Government buying its own debt.

A school of economic thinking called Modern Monetary Theory (MMT) suggests that we only pretend we need to pay it back, in order to dampen spending demands. MMT says we're all Theresa May's nurse but we don't need to be.

Economists everywhere are furiously debating this right now. Conventionally, there are some good reasons to reduce debt: for example, rainy day funds will always be valuable, and the Government's debt ratings impact many other parts of the economy. Besides, if the Government defaults on itself, all hell might break loose with everyone else we owe money to.

But it's not simple. Countries are not like households: in a country's economy, the goal is not to balance income and spending but to keep the money circulating, endlessly, generating jobs as it goes. When a Government creates debt to itself in order to allow that, it's not a bad thing that has to be stopped.

MMT hasn't had any real world testing and there's a chorus of voices warning that it shouldn't. I don't profess to know.

It's clear, though, that regardless of whether MMT is right, QE is not a wonder cure with no downsides, and the way we usually think about debt and money is wrong. It hasn't worked.

Adrian Orr says the end goal of all this is "economic wellbeing and prosperity for all people, now and into the future", and I say, good. So let's have some more honest conversations about that tree and how to use the stuff growing on it.

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What Simon Wilson is effectively saying is that Social Credit has been right all along – except that Social Credit advocates ‘Direct Monetary Financing’ (funding government directly), not ‘QE’ (government issuing bonds (debt) to the private sector (mostly commercial banks) and the Reserve Bank buying those bonds from them – giving the private sector additional profits).