

Sustento Institute: A New Financial Deal for Christchurch

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CHRISTCHURCH RENEWAL AND NATIONAL DEVELOPMENT

There's a much better way to pay for Christchurch's renewal and for national development too. It's a win-win for the Government and the people of New Zealand.

While the government discusses borrowing yet more debt and bringing in a new tax to pay the costs of rebuilding Christchurch we propose issuing new cash E-notes to do the same job. E-notes are exactly the same as the bank notes we all carry in our wallets and handbags except that they exist only in bank accounts.

The New Zealand Reserve Bank needs no authority to issue new cash. When the commercial banks want cash they buy it from the Reserve bank and pay for it with a cheque issued against their own accounts. The Reserve Bank deducts its costs of producing the cash and passes the profit to Treasury. The profit, otherwise known as seigniorage, is most of the face value of the currency, so selling cash improves the Government's accounts. That already happens every day.

There is no reason at all why the Reserve Bank cannot issue new money in the form of electronic cash or E-notes using exactly the same method. Instead of selling the notes to the banks, the Reserve Bank simply gives the profit, or face value of the electronic E-notes to the Treasury. The issue gets treated in every other respect just like an "ordinary" cash issue.

The economic term for this is quantitative easing which has been used very widely around the world since the Global Financial Crisis began a few years ago, but not in New Zealand and, unfortunately for the rest of the world, not in the form we are proposing. In major economies like Japan and the USA, this process has been carried out by buying securities from banks in return for new money. This has improved the balance sheets of the banks but not helped the economy.

In our proposal the Treasury receives the E-notes from the Reserve Bank and then it simply disburses them in payment for goods and services to improve New Zealand's investment in infrastructure, health and education, including earthquake relief for Christchurch. The process is no different from any other Government spending except that it is paid for using cash instead of using debt and taxes. The money could sit in a Government Infrastructure account until required. The important point is that the new money goes directly into the economy and not onto the balance sheets of the banks.

After the Government has spent the E-notes they will pass into the bank accounts of workers and businesses. The E-notes will then become part of the banks' reserves that increase the liquidity of the banking system without significantly increasing its lending capacity.

By using E-notes the Government will be doing the job the New Zealand banking system should be doing, but isn't: freeing up the money we need to get the country moving again and get people back to work. The banks have failed to do their job in part because they are struggling to prepare to comply with stricter lending requirements under the new international Basel III banking regulations. That's largely why they are being so tough on new lending.

While the banks fiddle with their regulations the New Zealand economy and the economies of many other countries are being destroyed because there is not enough money available to get people working and to increase incomes and consumption.

An E-note injection of at least NZ\$5b is unlikely to be inflationary with current unemployment at close 7%. Our modeling suggests \$5b represents about \$6.5b of new GDP, which would reduce unemployment by around 3%.

The E-note cash injection will help get the country moving again. It will reduce the Government fiscal deficit by, at the very least, reducing dependency on social welfare as well as by providing about NZ\$2.5b in new tax revenue. The new money will fund new infrastructure projects and investments in health and education and assist the rebuilding of Christchurch. It will also save at least \$200m in interest the government would otherwise have to pay if it were to use NZ\$5b of new debt instead of the electronic cash E-notes we are proposing.

The rate of E-note injection will allow its effects to be continuously monitored. If there are no major problems the E-note issue should be extended to include retiring NZ\$ denominated government debt as it matures. That will quickly reduce the Government's debt burden.

Allowing the Government to go back to the failed old ways of tax increases and new debt will simply dig the country further into the economic hole that has been growing for the past thirty years or more.

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