

# Our economic system is on life support. But who are we really saving?

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Pumping new money into the economy without altering power relations will only exacerbate existing inequalities.

30 March 2020

In recent weeks governments around the world have injected extraordinary sums of money into the economy to support businesses and households in the face of the coronavirus pandemic.

In the UK, the government has committed to paying up to 80% of the wages of workers impacted by the outbreak (subject to a cap of £2,500 per month), and has provided £330bn of financial support for businesses. Similar measures have been announced across Europe.

In the US, President Trump has signed the largest ever financial stimulus package worth \$2tn, which includes plans to send cheques of \$1,200 to every American earning less than \$75,000 per year. Such measures would have seemed unthinkable only a few weeks ago.

Given this, people may be forgiven for asking: where on earth are governments finding the money to pay for all this? After all, for years we have been told that “there is no magic money tree”.

Tax hikes are not on anyone’s agenda – doing so at a time when household and businesses are already struggling would only make things worse. This leaves two other options: borrowing money from financial markets, and printing new money. It’s clear that most governments intend to pay for their new commitments through a combination of both.

National treasuries have already started issuing large quantities of government bonds, most of which will be purchased by financial institutions. Crucially though, central banks have announced plans to purchase some of these bonds on the secondary market using newly created electronic money. This practice is not new – it has been happening since the financial crisis through a process called ‘quantitative easing’ (QE).

But we are now about to witness QE being unleashed on an unprecedented scale. In the US, the Federal Reserve has pledged to buy a potentially ‘unlimited’ amount of government debt. In Europe, the European Central Bank (ECB) has launched a €750bn ‘emergency’ bond purchasing programme. In the UK, the Bank of England has committed to purchasing £200bn of bonds, and indicated that more could be in the pipeline.

Unlike in 2008, some governments are also openly talking about cutting out the middle

men in financial institutions who intermediate (and profit from) this process. This means that we could see central banks purchasing government bonds directly from national treasuries (also known as ‘the primary market’), or allowing governments to run up large overdrafts at their account at the central bank. Both would amount to direct monetary financing of government spending – something that has long been taboo in the economics profession.

Given this sudden abundance of money, the obvious question is: why did we have to put up with a decade of austerity? The truth is: we didn’t. Austerity was always a political choice that was fuelled by right-wing ideology and bad economics. As I wrote back in 2017:

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“You may have noticed that issues of ‘affordability’ never arise when the spending relates to activities like going to war or bailing out the banks. That’s because for a country like the UK which has its own central bank and borrows in its own currency, financing government spending is never a problem. The claim that there is no “magic money tree” is simply a convenient way to mask an ideological crusade to shrink the state.”

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Now, a decade after austerity began, we are paying the price for this ideological crusade. Our healthcare systems are woefully under resourced, and our public institutions are ill-equipped to respond to the challenges we face.

Of course it is welcome that governments are now loosening the purse strings to help people and businesses get through this crisis. Human lives should always come before economic dogma.

But we must be careful not to fall into the trap of assuming that central banks can solve all our problems. As with any policy intervention, it is essential to ask: cui bono?

A good starting point is to consider how the coronavirus pandemic has impacted the flow of money through the economy. As the economist and former trader Gary Stevenson has outlined in detail, this exercise helps to reveal who stands to gain from the present course of action.

In normal times, the economy is driven by household spending. Some of this spending is on essential goods like housing, utility bills and food, while the rest represents discretionary spending on things like entertainment, leisure and travel. Importantly, richer households spend proportionally far more on discretionary spending than poorer households.

This spending generates revenues for businesses, who in turn use some of these funds to pay wages to their workers. In countries like the UK and the US, where capitalists and landlords have significantly more bargaining power than workers, most of the money workers earn ends up flowing to the ownership class in the form of rents, mortgage payments and bills. In normal times, these income flows would fund lavish discretionary spending habits, and the cycle would then continue.

How has the coronavirus impacted this flow of money? While spending on essential goods has been maintained, discretionary spending has collapsed. Restaurants, bars, theatres, cinemas and cafes have all closed, while domestic and international travel has ground to a halt. This collapse in discretionary spending has led to a collapse in business income, which means that many companies can no longer afford to pay their workers’ wages.

It is worth considering what would happen here if governments did not intervene in some way. Landlords would soon find that many of their tenants couldn’t afford to pay their rent; banks would witness large-scale loan defaults; and companies would see their revenues and profits fall sharply. The ownership class would take a serious economic hit.

That’s not to say that workers wouldn’t also suffer: the shock would likely result in large-scale layoffs, an unprecedented spike in unemployment and a dramatic rise in general hardship. This is not a desirable outcome.

In order to stop this from happening, governments and central banks have stepped in to plug the income gap, and they are filling this gap with newly created money.

Who wins and who loses from this overall? Even



in countries with the most generous employee compensation schemes, workers are only being compensated for 80% of their wages. But most of this will be required to pay for essential expenses, meaning that overall most workers will be left worse off.

*The flipside of this is that the income streams for the ownership class – rents, interest and corporate income – are protected.*

But crucially, because the discretionary spending of the rich has collapsed (they are no longer going to nice restaurants or spending money on holidays), they will now have much more money left over each month. So while the bank balances of working people will shrink over the coming months, the bank balances of the asset owning rich will increase dramatically. This is the key to understanding where all the new money that is being injected into the economy will end up. It is not gross incomes that matter, but net incomes (i.e. how much money people have left after their essential expenses have been paid).

As Stevenson notes:

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*"The government has created new money to replace the lost spending of the rich, so that working people can continue to pay their bills to the rich."*

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What is being presented as a bailout for working people is, in practice, a bailout for the wealthy. Who will pay for this? When the crisis eventually subsides, governments – now saddled with debts higher than at any time during peacetime history – will inevitably face calls to implement austerity to pay off the debt burden. Once again, the burden will fall on ordinary people.

As Christine Berry writes: "The costs of the crisis, then, are still being borne largely by workers and small businesses – albeit subsidised by the state, and thus by future citizens – it's just that some of those costs are being deferred. As yet, no sacrifices have been demanded of banks, landlords or profitable corporations."

None of this should be surprising. After all, we live under an economic system that delivers unequal outcomes by design. Pumping more money through this system will simply result in more money flowing to those already at the top.

What makes things different this time is the sheer scale of the sums involved. Governments are injecting unprecedented amounts of money into the economy, often for good reason. But unless steps are taken to prevent it, this will simply be hoovered up by the ownership class.

What can be done to prevent this? According to Stevenson and a growing number of economists, the most effective policy would be an emergency wealth tax. This would ensure that those with the broadest shoulders contribute to resolving the crisis, and would also provide a mechanism to claw back any wealth that is accumulated from the government's response to the crisis. Policies such as rent freezes, debt jubilees and attaching robust conditions to any corporate bailouts could also help spread the burden more fairly.

Regardless of the precise solution, the lesson is clear: pumping new money into the economy without altering power relations will only exacerbate existing inequalities. We made this mistake in 2008 – it's essential that we don't make it again.

<https://www.opendemocracy.net/en/oureconomy/our-economic-system-life-support-who-are-we-really-saving/>



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