Taking Corbynomics Seriously

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Fiscal austerity has become such a staple of conventional wisdom in the United Kingdom that anyone in public life who challenges it is written off as a dangerous leftist. Jeremy Corbyn, the current favorite to become the next leader of Britain's Labour Party, is the latest victim of this chorus of disparagement. Some of his positions are untenable. But his remarks on economic policy are not foolish, and deserve proper scrutiny.

Corbyn has proposed two alternatives to the UK's current policy of austerity: a National Investment Bank, to be capitalized by canceling private-sector tax relief and subsidies; and what he calls "people's quantitative easing" – in a nutshell, an infrastructure program that the government finances by borrowing money from the Bank of England.

The first idea is neither extreme nor new. There is a European Investment Bank, a Nordic Investment Bank, and many others, all capitalized by states or groups of states for the purpose of financing mandated projects by borrowing in the capital markets. The rationale for this type of institution derives from what that great socialist theorist Adam Smith called the state's responsibility for the "erection and maintenance" of those "public works and institutions," which, while of great advantage to society, would not profit private enterprise.

In other words, the state should always have an investment function. Delegating that function to a dedicated institution may have advantages for the presentation of the public accounts.

Today's particular economic circumstances provide a second reason for establishing a National Investment Bank. In slump or even semi-slump conditions, a higher-than-normal proportion of private savings are held in cash or its nearest equivalent (short-term treasury bills). A National Investment Bank could draw out these "idle savings" by issuing bonds for infrastructure development.

Offering a small premium on government securities, such bonds would likely attract long-term investors like pension funds, which otherwise face zero or even negative real returns. For example, with a fiscal outlay of €21 billion ($23.3 billion), the European Investment Bank is set to finance investments worth at least €315 billion by 2017.

"People's quantitative easing" is a more unorthodox – and a more interesting – version of this idea. Under conventional quantitative easing (QE), the central bank buys government securities from banks or corporations and relies on the extra cash that it "prints" to stimulate private spending. But studies suggest that much of this money goes into speculative activity, risking asset bubbles, rather than being channeled into productive investment.

An alternative would be to distribute the central bank's newly issued money directly to housing associations, local councils, or national or regional investment banks – any organization that could carry out infrastructure projects. This is what Corbyn proposes.

This idea of monetary financing of fiscal deficits (borrowing from the central bank, rather than from the bond markets) has a reputable pedigree. In a lecture to the Cass Business School in February 2012, Adair Turner, former Chairman of the UK Financial Services Authority, proposed it as an option if further borrowing from the markets were politically or financially impossible.

Corbyn's proposal, unlike orthodox monetary financing, would not add to the national debt – a major advantage. Orthodox QE – let's call it "monetization one" – is intended to be reversed, with taxation used to raise the money to redeem the government bonds held by the central bank. The expectation of future tax hikes could drive people to save part of the new money, rather than spend it. Unorthodox QE ("monetization two") avoids this problem, because the central bank's borrowing will not be repaid; central-bank assets net out against government liabilities. That is why it should not be excluded *a priori*.

There is a strong case for monetization two in the eurozone, which faces zero growth and deflation. Indeed, while the QE program unveiled by the European Central Bank in January consists mainly of sovereign-debt purchases, the ECB will also buy debt issued by the European Commission and the European Investment Bank – key elements of monetization two. It will thus help to finance infrastructure investment.

But it is hardly the case that the UK economy, currently growing at close to 3% a year, needs a further QE program of any kind right now. The government can borrow all it wants from the bond markets at near-zero interest rates. Outsourcing such borrowing power to a National Investment Bank is merely a way to signal that any additional borrowing will be used for investment, not for current spending.

There are two solid arguments for activating such an institution in the UK today. First, the share of private investment in GDP is still below its pre-crash level of around 11% of GDP. This suggests that investors lack confidence in the durability of the recovery.

Second, depending on the institution's mandate, a state-led investment program offers a way to rebalance the British economy away from private speculative activity to long-term investment in sustainable growth, and away from the south-east to the midlands and the north of England. In short, it offers a way to address the problem of "private affluence and public squalor" that John Kenneth Galbraith identified in the 1950s.

Corbyn should be praised, not castigated, for bringing to public attention these serious issues concerning the role of the state and the best ways to finance its activities. The fact that he is dismissed for doing so illustrates the dangerous complacency of today's political elites. Millions in Europe rightly feel that the current economic order fails to serve their interests. What will they do if their protests are simply ignored?

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