Emmanuel I.S. Ajuzie, Ph.D.
Associate Professor
Economist/State Making Specialist
Lincoln University
Jefferson City, MO 65109

Quantitative Easing: Is it the Solution to all Our Economic Problems?

The Fed has been trusted with the responsibility of keeping inflation and unemployment low. Because of the inverse relationship between the two, policy makers have not always found it easy to carry out both assignments. For example as unemployment goes down, inflation is triggered and vice versa.

The Fed is trying to use quantitative easing to reduce long-term interest rate and inflation, most importantly long-term interest rate. It does so by attempting to increase money supply as Fed buys securities from their holders. As this reduces interest rate, Fed hopes that financial institutions will begin to give loans to borrowers who would use the money to create jobs and hire workers.

Two things are not lining up in the argument. First, it is said that inflation is a monetary phenomenon, meaning that increase in money supply without reciprocal increase in goods and services would produce inflationary pressures, which may lead to increase in interest rate. Second, as long as consumers do not have the financial resources to buy goods and services, it would be difficult to hire workers to produce what no one is buying. No business would like to produce when consumers are not buying what is produced, resulting in the high unemployment rate we can't seem to shake off.

The main culprit behind consumers' inability to purchase is the high cost of gas. It acts as additional tax on consumers' disposable income, and reduces their ability to buy additional goods and services. I have written and published papers, which have been given to those in authority to do something to reduce gas prices through the control of oil speculatory behavior. Nothing seems to be working even though we tend not to have shortage of crude oil to necessitate the rise in prices.

It is high gas price that is causing what minor inflationary pressure we have in the economy. The importation of goods and services has helped to dampen inflationary pressures, which would have otherwise been worse.

In summary, quantitative easing will not do much to spur hiring. Instead, it is consumer spending that will lead to job creation at this juncture. The businesses and financial institutions that are getting the money Fed is spending are using it to buy up more securities in stocks and bonds and not loaning it out to stimulate job creation and economic growth. I am the first to say that it is not usually done intentionally. It is not a proper financial decision for businesses to hoard billions of dollars when they could invest the money into wealth creating ventures, such as oil. As long as the value of imports of goods and services remain above or within the bound of equation 15 in my paper on "Import Response and Inflationary Pressures: The Quantity Theory of Money Revisited," inflation will not be a major economic problem in this economy. Any rise in inflation, due sometimes to the influx of imported goods and services, would be very temporary, about two to three months and dissipate. Without inflation, long term interest rate, which the Fed is working hard to keep down, will not be a major concern. This has continued since the time of Chairman Greenspan when I started stressing this point to him. We are in a situation when inflation will remain mild and dissipate quickly, giving no reason to increase short-term interest rate unless it is to cause financial institutions to start releasing funds for business investment. The dilemma is that whereas lending institutions would like to lend at higher interest rate, businesses would not want to borrow and invest at higher interest rate. The effect will be a continuously stalling job creation and economic growth. So, what do we do to stimulate the economy? We pursue policies to spur consumer demand for the products that are sitting on the shelves of businesses and/or manufacturer. As consumers start spending, workers would be needed to produce new products. As interest rate remains low, businesses will begin to borrow for private investment. Banks will be forced to start lending to these businesses even at the low interest rate.

Specifically, a further tax cut to middle class Americans will do the trick. It will increase their disposable income and give them the power to spend more. Even though these consumers would tend to save a portion of the increase in their disposable income, they would spend enough to spur private business investment and hiring as long as interest rate remains low, which will be the case following above discussions.