

# Funding the Future

## Explaining the accounting of why the UK only has debt o...

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I have noted that when my explanation of [why the UK owes much less debt](#) (see [also here](#)) than the Tories claim [was posted on the Liberal Conspiracy web site](#) some of the right wingers who inhabit that space suggested I could not consolidate accounts. As a result they claim my conclusion was wrong: they said the debt owed by the government could not be cancelled by the fact that the debt was owned by the Bank of England because I ignored the liabilities of the Bank of England to repay the cash it had used to buy the government issued gilts. Well, they are, of course wrong and let me explain why the accounting behind my claim is exactly right.

Let's start with the government issuing a gilt for £100 million. It creates a loan (the gilt) for £100 million that is a credit in its accounts and it then has £100 million in cash (a debit balance).

In accounting terms this looks like this:

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Government Accounts	
<hr/>	
Cash	
<hr/>	
Dr £'m	Cr £'m
<hr/>	
100	
<hr/>	
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Government Accounts

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Gilt Loans

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Dr £'m Cr £'m

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100

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Then it spends that cash on buying an asset (or a lot of assets!). The accounting then looks like this:

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Government Accounts

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Cash

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Dr £'m Cr £'m

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100 100

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## Government Accounts

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### Fixed Assets

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Dr £'m Cr £'m

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100

Now there's no cash. The £100s balance out to nothing. The accounts balance though. There's an asset of £100 million balanced by a liability of £100 billion for the gilt. There's just no cash left.

Now let's suppose the Bank of England does a quantitative easing programme, as of course it has. Let's look at the double entry of that.

First it creates the cash:

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Bank of England

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Cash

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Dr £'m Cr £'m

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100

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Bank of England

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Promise to repay account

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Dr £'m Cr £'m

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100

Remember that this is a bank making cash out of thin air. It has effectively 'printed' cash. So it has created £100 million in cash, which is a debit entry in its books. What's the matching liability since you can't have anything but double entry in the accounts? Well, it is, of course, a liability and for ease I've called it the 'promise to repay account'. Why? Because that's what it says on a bank note: the Bank of England promises to pay it. It's that promise that represents the liability. The fact that if someone went to the Bank of England and asked for repayment of their £10 note they'd be given another one does not change the promise to pay. £10 is owing - but it's payable with the money that's just been printed. That's what legal tender means: it's cash made out of thin air. The liability will not be paid: it's pure gain, but that's what happens when you make cash out of thin air. This then is a very different liability from the government's gilt. That will be repaid, in cash. And it carries interest. The Bank of England will never repay on its promise and the liability carries no interest.

Now let's suppose that the cash that has been created is used to buy the gilts the government has issued. It's pretty simple double entry. It looks like this:

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Bank of England

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Cash

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Dr £'m Cr £'m

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100 100

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Bank of England

---

Promise to repay account

---

Dr £'m Cr £'m

---

100

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Bank of England

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Gilt asset account

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Dr £'m Cr £'m

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100

The cash has gone: it has been paid to the previous owners of the gilts. The two 100's balance out to zero. That cash has now entered the economy and left the Bank of England. That is how the cash enters the economy in a quantitative easing programme.

The net result is that now the Bank of England owns £100 million of gilts (the debit balance) matched by a liability of £100 million in the 'promise to pay the bearer' account which will in reality never be paid.

Now what I have then suggested is that we should consolidate the resulting accounts of the government and Bank of England since the government owns the Bank of England. Let's look at what the accounts look like before we consolidate. The government accounts now look like this:

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Government Accounts

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Fixed Assets

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Dr £'m Cr £'m

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100

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## Government Accounts

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### Gilt Loans

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Dr £'m Cr £'m

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100

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The government has £100 million of assets and owes £100 million in gilts.

The Bank of England accounts look like this:

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### Bank of England

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Promise to repay account

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Dr £'m Cr £'m

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100

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### Bank of England

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Gilt asset account

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Dr £'m Cr £'m

---

100

The Bank owns £100 million of gilts and has made a promise to pay £100 million.

Now let's be clear about what happens when you consolidate: you cancel out trading between the consolidated parties but as I have ignored interest for ease there is no trading to get rid of here. And second you cancel assets and liabilities owing between the consolidated entities, which are the government and Bank of England in this case. What is cancelled out? Well it's the gilts: they are debt after all. The government owes £100 million to the Bank of England in this example but since the Bank of England is owned by the government then it is like owing debt to itself - or if you like, it's like a husband owing a wife when they agree they really share all their property in common. So it can simply be cancelled out.

The net result is that the accounts really look like this. The two gilt accounts balance each other out to zero and we're left with:

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Government Accounts

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Fixed Assets

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Dr £'m Cr £'m

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100

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Bank of England

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Promise to repay account

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Dr £'m Cr £'m

---

100

So the government has now got assets paid for with a promise to pay - it's printed the money to pay for the asset. It's used the subterfuge of owning the Bank of England and printing money to achieve the result but let's not deceive ourselves, this is the result. But, [as I have explained](#), it can do that precisely because there is both no risk of inflation now because of the state of the economy and because the economy needs

that cash - there is a shortage of cash at present that is threatening to close down economic activity and create deflation if this new cash were not created by the Bank of England now.

So, what's the conclusion? First, the double entry works: the critics are simply wrong. They forgot there's an asset. Incidentally, it doesn't also actually matter if it was spent on the running costs of the NHS instead for double entry purposes; there would still be a debit. I use an asset to indicate it's better that liabilities are matched by assets and that the current account be balanced if possible. That's the logic of the Green New Deal. But I stress, either way my double entry works and my critics are guilty of doing single entry accounting - which is always a mistake.

Second, the economic logic is right: the national debt has to be stated net of quantitative easing gilt repurchases or the figure is simply mis-stated.

Third, this radically changes the whole economic narrative, completely. But that's another blog. The point here is that technically I have to be right.

Having said which, I know the assets repurchased may not have been paid for at the price they were issued at: I accept that's leakage in the matter but it does not change the fundamentals of the argument one iota, it just means that the banks pick up some subsidy on the way (which fact will, I suspect surprise no one). But we still have not got debt of £1 trillion. Very soon we'll have national debt of less than £700 million and what is more we're only borrowing about £35 million or so a year on average.

And we need to recognise that if we're to have an honest economic debate.