

The real potential of QE: how we could turn our economy...

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I've said this before, and lots of people say I'm wrong, but I'm going to repeat it anyway. I argue that quantitative easing is actually about writing off government debt whilst the Tories say they have to impose cuts, and that fact has dramatic implications for economic and social policy in this country.

Let me explain this using this table:

Total UK national debt in March 2008 - before Lehman's fell over and the crisis really hit - was £527 billion. To that date for a period of a decade Labour had near enough balanced its books: sure it had borrowed to invest, but current income had very largely equalled current spending over the decade to 2007.

That all changed in 2008. As the table shows (all data being based on Treasury data up to date to 2012 budget) deficits then began to rise, significantly. That's because tax revenues collapsed: spending did not go out of control. The net result was, however, that in four years nominal national debt almost doubled because £495 billion of government borrowing had to be put in place.

That borrowing, amongst other things, brought the Labour government down. The Tories said we had to stop it because it was putting a millstone round the neck of future generations. They have used it as an excuse to cut public services, privatise the NHS, place a debt burden on all students for generations to come by massively increasing student fees and so loans (even though they claim that this is a disaster if applied to the country as a whole) and to slash benefits and pensions. And the process has only just begun: 80% of the cuts have yet to happen.

They said they had to do this to keep the markets happy. They said interest rates would sky-rocket if they did not cut. They said we'd be like Greece. They said our economy would collapse. Well, we might be in recession but none of those things have happened. Some of us said they wouldn't.

There are a number of reasons for that: one is called quantitative easing. It's an awkward term. Some call it printing money, but that's crude short hand. The reality is that when its using quantitative easing the Bank of England buys in previously issued government debt (called gilts) from banks, pension funds, insurance companies and so on. The aim is to put cash back into the economy and the logic is that since the cash it has used to buy government bonds will, inevitably, end up in banks those banks will then have to lend it on to get the economy going again.

Well, the banks didn't lend as much as expected, that's for sure; but it's also certain that without QE the money supply would have fallen very heavily as lending was so weak ([and cash is made by banks through lending](#)) so without QE we'd be in a much bigger mess than we are now: the only debate is how much bigger a mess.

There are three questions to now answer about this process. The first is where does the cash come from that the Bank of England uses to buy the bonds? The answer is "out of thin air". The Bank of England makes it, electronically. That's why QE is euphemistically called printing money. Actually, since about 97% of all money is made in this way there's nothing odd about this. I explain [how this happens, day in and day out here so I won't repeat it](#). People panicked at first at the idea of this: they said inflation would go through the roof. It has, of course, fallen since QE began. So much for the foresight of those who panicked.

Second, the question is what happens to the bonds that the Treasury buys? Well, it simply puts them on its balance sheet - or rather on the balance sheet of the special purpose vehicle it has created for this exercise (because that's the way all deals are done now). The net effect is the same. At March 2012, as I note above, £325 billion had been spent on QE gilt purchases. That did not cancel £325 billion of debt as not all bonds trade at their face value: but near enough we'll say that bonds of about that value were by March 2012 owned by the Bank of England paid for with new cash: it's a fair claim. And the simple fact is that now the Bank of England has these gilts on its balance sheet that is where they will stay. They'll have to. This year we need to sell at least another £120 billion of new debt and it looks like it won't be much less each year for some time to come given the Tories complete failure to stimulate demand. So the bonds that have been bought (now £375 billion, by the way) are not going to be sold back into the market any time soon. In fact, I'll quite confidently predict, they may never be sold back, ever. There just isn't going to be the demand to let them be re-sold at any time for many years to come.

That means these bonds - and those that will be repurchased by the Bank of England in the next year or so when I confidently expect there will be another £125 billion or so of QE purchases - are going to remain in the ownership of the Bank of England. And what that means is that at least one third, and over the next year in all likelihood rather more, of the government's debt is going to be owned by the Bank of England which is in turn wholly owned by the government (don't believe those who say otherwise). It's a bit like, therefore, a loan being taken by a husband only for his wife to buy his debt back,

with them only having a joint bank account. Of course he could now repay her the debt he owes, but the net effect is no cash would move because in reality the debt has, of course, been cancelled in practice, even if not legally.

So, my third point is to ask what is the practical consequence of this absolutely unambiguous reality that QE has now cancelled about a third of our government's debt leaving it at March 2012 at just under £700 billion instead of in excess of £1 trillion, as the government's scare-mongers would have us believe?

Well, I suggest it's this. First of all, all those tales of leaving a debt burden for generations can be ignored: it's not going to happen. Most of the debt has already been repurchased by the government and has effectively been cancelled. All the stories about burdening your children with it are just fairy tales.

Second, since it is very obvious that whilst the government refuses to boost demand the deficit (that's the annual borrowing which will be about £120 billion this year, and not the total debt which is either £700 billion net of QE or just over £1 trillion gross of it in my table above) is going to continue and in that case so will QE. That's necessary because the market probably doesn't want to buy that much UK debt (although it will certainly readily absorb some) but more importantly, it's essential to make sure the debt is not left around for future generations.

Third, since it's now clear that so long as demand is as low as it now is in the economy this QE and the associated money printing can go on without risk of inflation (and as importantly, it stops the risk of deflation that might otherwise occur as the money supply would shrink without QE) then the right question is not whether we do more QE, because we obviously will, but just what we should do with it?

That question has to be asked because the problem with QE to date is that it has been designed to put money in the hands of bankers. Why anyone thought that a good idea after 2008 is hard to imagine, but let's not reflect on who is to blame for too long, just say it's Mervyn King (as it is), and then suggest what the alternatives are so that we can stop too much of this cash being used to pay bankers' bonuses in the next few years (which it has been used for to date).

The alternatives are all designed to cut out the banks as "middle men" to get the cash into the economy. The aim is to boost economic activity so that people get back to work, and life returns to something like normal. All of them are intended to make sure that the maximum benefit of the cash spent is retained in the UK. They're also designed to be sustainable i.e. green and also sustainable in that they generate income to ensure that if interest does ever have to be paid then the resources to do so are available.

So, first, QE should be used to buy debt issued by a new Green Investment Bank which is given newly printed cash in exchange. It would then use this to deliver

some "shovel ready" projects that will get people to work and reduce carbon emissions, save fuel and so protect us from fuel imports in the future and in the process protect the value of the pound. That means putting tens of thousands of people to work double glazing, insulating and loft cladding. The payback on this is very high. And then after this they could then move on to making every building a power station - with solar power.

Second, in much the same way QE could be used to provide the capital of a new state investment bank to get business going again. It's been estimated that at least £40 billion is needed for this purpose by IPPR and I tend to agree with them. With QE that is no problem.

Third, and this is a new one: all student loans could be cancelled. The student loan book is now £40 billion, almost all owed to the government. So, just buy it back. Suddenly there would be extra money for people to spend in the economy. People would not become debt slaves for their working lives for trying to get a decent education. And people could be educated again without fear. What better way to boost short term consumption and liberate new enterprise, thinking and creativity?

And what else? Well, let's build the new homes this country needs, now. QE could provide the capital to build the social housing that will give people who currently can't buy the security of the long term tenancy they need to have a stable family life, a secure place to bring up children and the chance to settle into a community which is impossible in most private rented accommodation.

But what about the cuts I hear you say? Well, if all the above happen using QE then people will get back to work, taxes will be paid, government revenues will be restored and we won't need cuts because we'll have the cash to ensure that we can afford our public services, to pay the those who really can't work, to provide for the sick and to ensure all who are old can live in security. So QE does not need to be used to stop the cuts directly: if used wisely it does that indirectly. Right now it's not used wisely so the cuts continue.

I am of course well aware that many economists will say this is wrong. But let me assure you, 99% of the people said they could see the Emperor's clothes. It only took one person to say otherwise to change people's minds.

And let me also assure you, all this can be done: it just needs us to open our eyes to what is actually happening. Right now, instead, politicians relying on economists who face blackboards rather than the real world are saying other things should be happening and we must behave as if the economy is working in accordance with neoliberal theory rather than in accordance with the reality we can observe. I've described what's happening, and how it can be turned to benefit. All we need is the courage to do it.

