

Banks do create money out of thin air - which is a powe...

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Some heat has been expended in the comments section of this blog concerning the ability of banks to create money out of thin air, which despite the evidence some would seem to claim is not true. So let me offer a reference [to this journal paper by Richard Werner](#), the creator of the quantitative easing concept:

As Richard says in the abstract:

This paper presents the first empirical evidence in the history of banking on the question of whether banks can create money out of nothing. The banking crisis has revived interest in this issue, but it had remained unsettled. Three hypotheses are recognised in the literature. According to the financial intermediation theory of banking, banks are merely intermediaries like other non-bank financial institutions, collecting deposits that are then lent out. According to the fractional reserve theory of banking, individual banks are mere financial intermediaries that cannot create money, but collectively they end up creating money through systemic interaction. A third theory maintains that each individual bank has the power to create money 'out of nothing' and does so when it extends credit (the credit creation theory of banking). The question which of the theories is correct has far-reaching implications for research and policy. Surprisingly, despite the longstanding controversy, until now no empirical study has tested the theories. This is the contribution of the present paper. An empirical test is conducted, whereby money is borrowed from a cooperating bank, while its internal records are being monitored, to establish whether in the process of making the loan available to the borrower, the bank transfers these funds from other accounts within or outside the bank, or whether they are newly created. This study establishes for the first time empirically that banks individually create money out of nothing. The money supply is created as 'fairy dust' produced by the banks individually, "out of thin air".

This, of course, [only confirms what the Bank of England has recently admitted](#). And because, as the Bank of England also admits, it can use the quantitative easing process

to create money - and this process is not restricted solely to the purchase of gilts but could also be used to purchase bonds issued by a Green Investment Bank, local authorities, housing authorities and others to fund a Green New Deal - a process I call Green Quantitative Easing - this ability to create money out of nothing can, when an economy is working at less than full capacity, be used to deliver prosperity costlessly and without obligation for the loans to be repaid.

The costless element comes from the fact that if money can be created out of nothing there is no obligation to pay interest on it: such sums can be advanced as if share capital to those authorities able to use them for public good. And the absence of a need to repay comes from the fact that if the money was created out of nothing then there is no need to repay it because no one provided it.

The question then arises as to why this is not being done? Isn't that obvious? To do this would challenge the commercial banks' ability to make money from lending and their chance to extract what in economic terms is called a rent from doing so which is the foundation of the excess returns that the City of London makes at cost to all the rest of us. Green quantitative easing is a direct challenge to the City's right to extract that worth from all of us to benefit a few when it is possible for that worth to instead be used for social good. And that's precisely why it has not happened to date. And precisely why it must be used in future.