Funding the Future

Infrastructure quantitative easing can provide the SNP ...

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Paul Johnson of the Institute for Fiscal Studies has argued that in his opinion the SNP might, on the basis of its current plans, run what he would appear to consider an unacceptable deficit in Scotland if it were to be granted full fiscal autonomy from London based on a blog written by David Phillips of the IFS.

I have to say I think Paul is wrong when forming his opinion.

First, Paul very clearly thinks that removing a funding deficit should be the highest priority of any government. With the very greatest of respect to him, that reveals a poverty of aspiration on his part. Only an economist specialising in tax could think that there are politicians in Scotland who aspire to secure full fiscal autonomy for the country with the sole aim of becoming a nation of paranoid bookkeepers.

Second, the IFS commentary ignores the fact that running a fiscal deficit can be a wholly proper and appropriate goal of any government. When an economy is in need of economic recovery, or reorganisation in a way that market forces cannot ever deliver, then government has a duty to intervene to create the environment in which private sector prosperity can be created. So long as the government has the goal of stimulating long-term economic growth as the reason for running a deficit then such a policy is not only necessary but has a virtuous intent.

Third, as I read the SNP manifesto this is exactly what they're talking about when they say:

We will continue to maximise investment in our nation's infrastructure, using both capital spending, new borrowing powers ***and a range of innovative finance mechanisms***.

I have added the emphasis because those highlighted words are, I think, the ones that Paul Johnson, and most other people, will have ignored. In that case it is worth explaining what I think the SNP is referring to when it mentions 'innovative finance mechanisms'.

It is my belief that they are referring to ***green infrastructure quantitative easing*****, which was the subject of *****a speech I made at the Convention of Scottish Local Authorities conference in March*** ***. In that speech I made clear that if the SNP wanted to do a service to Scotland, and to the rest of the UK, it would use its bargaining power after May 7 to demand that the UK government create a new form of quantitative easing that would be quite deliberately intended to provide the funding for new investment in infrastructure, housing, new energy systems, transport and the other essential underpinnings of growth in Scotland and throughout the UK.***

This form of quantitative easing is entirely possible. As an example, the proposed Scottish Development Bank could, using this form of quantitative easing, issue bonds to the finance markets (because that is what EU law requires) that could then be repurchased by the Bank of England using funds specifically created by for this purpose.

There is nothing new about this money creation arrangement by the Bank of England to repurchase government related debt. Between 2009 and 2012 £375 billion was electronically printed by the bank of England to buy back UK government bonds in a process which has, in effect, reduced UK national debt by an almost exactly equivalent sum that has meant that interest is no longer paid on the debt in question. This effectively means that the debt in question has effectively been cancelled even if politicians, wishing to hold us in fear of the debt ogre that drives the austerity agenda, have refused to publicly acknowledge that fact.

Let me also be clear: e-printing money in this way is also not unusual. As the Bank of England admitted in 2014 this is, contrary to almost all public and political opinion, exactly how banks also create the funds that they lend whenever anyone asks for a loan from them. The big difference in the case of quantitative easing is, however, that because the Bank of England is a government owned body that prints funds to buy back the debt of other government owned bodies the government then does, in effect, own its own debt. And since you can't owe yourself money charging interest on such loans becomes pointless: it's like shifting money from your left pocket to your right one.

What this then means is that so long as e-printing money to pay for investment is kept at sensible levels to prevent the risk of serious inflation

this process of green quantitative easing could be used to fund the investment Scotland wants and badly needs without risk. I believe that's what the SNP is saying in its manifesto.

And let's be clear: we printed £375 billion to pay for quantitative easing to bail out the financial markets in the three years from 2009 to 2012 and the outcome is that we now have zero per cent inflation, which is less than anyone thinks economically desirable. So we do in fact need new quantitative easing now to create the new money the economy badly needs to create the moderate inflation that keeps the economy on an even keel.

And before anyone says that the Bank of England could not do this to fund infrastructure investment, that's not true. In March 2014 Bank of England Governor Mark Carney confirmed in a letter to Green MP Caroline Lucas that "It is possible that if the Monetary Policy Committee did vote to increase its asset purchases in future, it could expand the range of assets it purchased. Such a decision, however, would need to be agreed with the government." In other words. Green infrastructure quantitative easing, about which she was asking, is possible.

What that means is that the SNP does have it within its power to demand this type of quantitative easing to pay for investment in Scotland. That's important precisely because quantitative easing debt is effectively cancelled almost immediately after it is issued because it is effectively the issuing of new money, and not debt. And what that means is that in reality this new type of quantitative easing could be used to pay for the investment programme the SNP wants to build Scotland's future without the debt going on the books of the Scottish government. Or to put it another way, Paul Johnson's assumption that Scotland cannot afford to fund its growth is just not true if this innovative finance mechanism is used: it can.

There's one final point to make. Paul obviously thinks there is no reason why Scotland could grow faster than the rest of the UK. I beg to differ. I might be an economist, but I'm also a chartered accountant who has run, bought and sold companies in my time and my sense is that right now Scotland feels like a company where a management buy out is overdue to release the latent energy and talent within its economy that is simply screaming for the opportunity to put its economic ideas into practice. That's why Scotland could deliver exceptional growth.

But to make it happen the SNP needs to embrace the innovative financing mechanism that green infrastructure quantitative easing represents. There's a more detailed note on how it might work here, but the key issue is a simple one and is that Scotland must now demand that the finance system must be used to benefit its people and not just its bankers. If that is done it's not true

that almost anything is possible, but what is undoubtedly true is that investment in the Scottish economy of well over £5 billion a year could be funded without any risk of inflation at all.

If the SNP’s MPs put an economic demand high on their agenda on May 8th I urge them to make it green infrastructure quantitative easing. The rest of the UK will be in their debt if they do, but only metaphorically, because the miracle of quantitative easing is that at the end of the day there is no debt at all. And it’s time that this possibility was harnessed for the benefit of us all, and not just bankers.