

Funding the Future

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This is the weekend when there is endless speculation about what might happen in the budget.

The discussion is of tax cuts, incentives to be given and the political calculus that both entail. However, given where most people currently think the economy to be everything that most commentators are putting into the arena for debate is peripheral in its overall impact.

It is being suggested that Jeremy Hunt has £13 billion of wriggle room. That is around 1.1% of total anticipated government spending in the next year. I am not saying the sum is insignificant. Nor am I suggesting that big politics cannot be played with small sums because the debate on cutting inheritance tax shows how wrong it is possible to get decisions on relatively small changes to the overall government income and expenditure cycle. Instead what I am saying is that there is a poverty of imagination in thinking we are stuck with the system as it is.

What the commentary on 'limited fiscal headroom' suggests is that there is a government income and expenditure cycle and we must just muddle along with it. I do not accept the assumption.

There are at least four things we could do to change how we see this cycle.

First, we could deal with some decent data. That produced by the ONS on which government decision-making is based is total nonsense. It is based on single-entry accounting. It makes up national income that does not exist. Ten per cent (I stress, 10%, just to make clear that this is not a typo) of our national income is made up, according to the ONS, of rent owner-occupiers of houses pay themselves for the privilege of living in their own homes. But no one does pay that, ever. It is just a make-believe number. And yet politicians obsess about growing GDP. When that figure is itself nonsense they might as well set targets for the number of fairies spotted at the bottom of the Downing Street garden.

Then there is the fact that these accounts do not recognise the existence of a balance sheet. If they did it would quite emphatically not balance. For example, the national

debt does, according to the ONS, include a figure of around £300 billion that they call 'the Bank of England contribution to the national debt'. There is, however, no such equivalent figure in the Bank of England's accounts, which have no net liabilities. The number is total fiction.

So too is the ONS figure for government borrowing. It states the gilts in issue gross, i.e., it ignores the fact that about £800 billion worth of debt owing by the Treasury is owned by a Bank of England subsidiary that is, in accounting reality, a pure nominee for the Treasury itself, with the latter having the benefit of the whole beneficial ownership of those bonds. This means they are for all accounting purposes cancelled, as the properly prepared Whole of Government Accounts shows.

Meanwhile, the ONS utterly ignores the central bank reserve accounts supposedly owed by the Bank of England to the UK's commercial banks on which more than £40 billion of interest is paid a year.

The ONS also fails to make clear the break-down in debt between short and long-term liabilities. Nor does it discount the long-term ones.

This is terrible accounting. It is no basis for decision-making. If a Chancellor was serious about trying to manage the economy, they would be changing this now.

Second, they would, as a result, very clearly split spending into that on assets for long-term benefit and that spending that is for current consumption. They would also be offering interpretations of this spending to indicate its effectiveness by estimating multiplier effects. Not all spending is equal. Some, like healthcare or most asset expenditures (defence apart), create big long-term paybacks. Some do not. That's also true for cuts. Inheritance tax has almost no economic stimulus effect. Cutting tax on the lowest paid has a big stimulus effect. But none of this is talked about, so economic decision-making takes place in an uninformed void.

Third, the structure of government debt matters. So, index-linked bonds have proved to be a terrible idea. They have apparently increased the cost of government debt by many tens of billions a year. But no one mentions that, on average, this debt won't be repaid for more than fifteen years, which is when the average index-linked bond is redeemed, which is the only time when this liability can fall due. Instead, it is portrayed as a current cost. That, though, is not true. The real question is not the cost, but how funds are to be set aside between now and the redemption date to fund the cash cost at that time. Properly understood in this way, we have no index-linked bond funding crisis at all. There is a long period to accumulate a redemption fund, and the right question to ask is how the funds in question should be used now to produce the return required fifteen years hence. But with totally crap accounting data, that point is totally missed. It is scandalous that it is.

Finally, because we do not use a national balance sheet we do not talk about what

should be on it. Let me go back to those so-called central bank reserve accounts that the UK's banks supposedly hold with the Bank of England. The vast majority of these balances were created during the QE era when the reality is that the government spent more into the economy than it taxed back, which fact it tried to disguise by creating bonds that it then bought.

When you look at what really happened during these periods, the government used the power only it has to create new nationally created currency to inject it into the economy to keep it (and the nation's banks) going at a time when there would otherwise have been insufficient liquidity in the economy for it to function.

That was a capital injection, and should have been shown as capital on its balance sheet.

However, because we do not question the national balance sheet, because most people do not even realise that we have one, this injection of cash is bizarrely treated as if the credit on the Bank of England (and so national) balance sheet is in the form of deposit accounts held by our commercial banks with it. This, though, is absurd. Deposit accounts are places where organisations save excess funds. These balances were not created by those commercial banks with their excess funds: they were created by the state injecting money it made into those banks and so on into the economy at the precise moment when they faced a shortage of funds.

The money injected in that way did not take the form of deposit account balances apparently gifted to banks on which interest needed to be paid: they represented national capital injected by the government into the economy at a time when banks and the economy as a whole were at risk of falling over.

Right now, however, we apparently have to pay the banks for the privilege of having saved them at a cost of £40 billion a year. My suggestion is that there should be no such payment, or if one was required for the transmission of monetary policy, it should be on the balances that it could be shown that the banks had themselves created - which may well be less than £100 billion. The savings might be £35 billion a year. That would be the return to the national capital that could be made by properly understanding the national balance sheet.

But will any Chancellor say such things? No, of course not. Why not? Because the Treasury and the Bank of England would not let them, and in this context, remember that Rachel Reeves is a loyal former employee of the Bank.

So, we carry on with totally rubbish accounting, an absence of critical thinking, let alone understanding, and a massive slush fund payment to the banks that is utterly unjustified by any known economic fact, whilst the population is left entirely in the dark about the true nature of the nation's accounting and what it is possible that we might do.

Transforming this situation is what I would like to hear about in the Budget this week, but I know I have no chance of doing so.