

Six ways to fund Labour's "black hole"

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According to Rachel Reeves, she and Kier Starmer need to find £22 billion to fund the levels of government spending that Rishi Sunak and Jeremy Hunt planned for the economy from March 2024 onwards.

The first thing to say about this claim, which very clearly originates in the UK Treasury, is that delivering the plan that Sunak and Hunt created in March 2024 would be wholly inappropriate. That plan was for austerity. Everything but health, defence, and maybe some parts of education would have seen real-term cuts in funding if that plan was to be delivered, with enormous consequences for all services supplied by local authorities, and for social care, benefits and much else. Therefore, as a matter of fact, finding £22 billion is an insufficient goal for this government.

It also has to be said straightaway that no government needs to find money before it spends. Neither tax receipts nor government borrowing funds what the government spends. Instead, the Bank of England always funds government spending in the first instance.

Taxes are then charged to cancel the inflationary impact of that process of money creation that the Bank of England undertakes daily on behalf of the government, whilst what is called government borrowing is nothing of the sort: instead, those who end up holding the money that the government has created if it runs a deficit are offered the chance to place those funds on deposit with the government because it provides the most secure place for any institution to save. The sums the government creates to fund spending do, as a result, return to it, either by tax or as sums deposited, but they never fund the spending that it undertakes. This is why "black holes" are not technically possible: money the government spends into the economy never disappears, so "black holes" can never be created.

It is also vital to note that there is absolutely no need for a government to "balance its books", as it is commonly suggested. Historically, governments never have. Since 2010 the consequence of the government not balancing its books has been that approximately £1,700 billion has been injected by the government into the economy by

way of money creation, and without it having done so we would be in the almightyest mess. Why Reeves and Starmer want to do something no wise government has ever done is very hard to fathom.

But what this also means is that the claim that we have a “black hole” is completely false. There are never black holes in government funding. There are simply deficits, and they are entirely normal and appropriate within a growing economy that needs new government-created money to facilitate trade, which, in fact, makes them desirable.

All this being said, what could the government do if it wanted to fill this fictional “black hole” it claims exists? There are numerous options available to it.

Borrow from the Bank of England

The Bank of England, if it so wished, could make a £22 billion overdraft facility available to the government to fund this so-called “black hole”.

It offered a £20 billion facility to the government in March 2020, using what has historically been called the Ways and Means account, and there is absolutely no reason at all why it could not do the same now.

As in 2020, we now face a government funding crisis. Services that are needed cannot be delivered. Investment that must take place if essential infrastructure is to be renewed is not happening. Spending that is essential if climate change is to be tackled is not planned. And all of these are at least as big an issue as Covid was.

There is no reason at all why, in that case, the Bank of England could not lend this money on overdraft to the government.

What is more, since the government owns the Bank of England, there would be no reason to pay interest on the loan because the government would, in effect, be paying itself.

Quantitative easing

If the government did not want to borrow from the Bank of England, even though it can, it could instead issue a bond at any time now for at least £22 billion. I would suggest that the bond in question should last for at least 25 years.

At the time of issue of this bond, the government should make clear that it fully intended to re-purchase this bond from the financial markets within a week of its initial sale. In other words, it should always be made clear that it would use quantitative easing to re-acquire this gilt.

The effective consequence would be that the Bank of England would have advanced a loan to the government, albeit through the slightly more internationally acceptable

structure of QE, rather than by way of simply offering an overdraft facility. The net outcome would be the same, either way (although quantitative easing is more expensive): the supposed “black hole” would have been filled.

Borrowing

Alternatively, the government could just issue the bond that I refer to above and beyond a shadow of a doubt, the City of London would acquire it. The “black hole” would be filled in a moment.

Cancelling quantitative tightening

To make sure that the City had the capacity to buy the above bond and any further bonds that needed to be issued to ensure that the government could fulfil its mandate to the people of this country, the government could also instruct the Bank of England that it bring to a close its quantitative tightening programme. As a result of this programme, the Bank is selling back to financial markets approximately £100 billion worth per annum of the bonds acquired under the QE programmes that existed from 2009 to 2021. So far, approximately £200 billion of bonds have been sold in this way, **with £33 billion being sold between April and June this year**. As a result, it is **obvious that there is capacity in the City to sell a new £22 billion bond, but that this could be guaranteed if quantitative tightening was cancelled.**

Cutting interest rates

The only reason that the Bank of England is undertaking this programme is to keep interest rates high. The last thing that our economy now needs is high interest rates. That is also true for the government: it could greatly benefit from a cut in its borrowing costs. If the government were to tell the Bank of England to cut its base rates by at least two per cent, the likely saving to the government would more than exceed the £22 billion required to fill the so-called “black hole”. That supposed “hole” would simply disappear.

Raising taxes

The Taxing Wealth Report 2024 shows how Labour could raise more tax from those with wealth. I suggest these options:

- * Equalise capital gains tax and income tax rates, **raising £12 billion a year**.
- * **Charging VAT on financial services that are only consumed by the wealthy would raise £8.7 billion a year**.
- * **Removing higher rate income tax relief on pension contributions would raise £14.5 billion a year**.
- * **An investment income surcharge, equivalent to national insurance on**

investment income, might raise £18 billion a year.

There are many more options available.

Summary

In conclusion, Labour is not facing a £22 billion funding crisis. There is no crisis in government funding of any sort right now, and nor is there any in prospect.

There is, as a result, nothing within the current economy that requires Labour to deliver austerity.

Nor is there any reason at all for Labour to suggest there needs to be more pain in our economy. Funding the £22 billion (and more) Labour needs would be easy.

So, what is Labour doing, and why? I am genuinely clueless as to why Labour is talking itself into a situation that is wholly unnecessary and which can only be bad for it.

Reeves and Starmer have to answer that question, but I seriously doubt that they could provide a rational answer to it. Nothing I can see suggests that there is one available to them.