

Funding the Future

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Quantitative easing, or QE as it is usually called, was, and always will be, a sham to disguise the fact that a central bank is lending money to the government that owns it. In this video, I explain the ins and outs and costs of this ridiculous denial of the truth.

https://www.youtube.com/watch?v=jFHGeUZzSzE&si=Er_FG2jXSuh60J9g

The audio version is here:

https://www.podbean.com/player-v2/?i=nvwqv-16d1cce-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=c73a3a&font-color=&logo_link=episode_page&btn-skin=ff6d00

This is the transcript:

To understand modern macroeconomics, you have to understand quantitative easing.

Quantitative easing was started in the UK and other countries after the 2008 financial crisis. The objective which Alistair Darling had when he was the last Labour Chancellor of the Exchequer in the 1997 to 2010 government was to require the Bank of England to go into financial markets to buy both government bonds and corporate bonds with the aim of reducing the rate of return available on them by increasing their price (which is what happens when the government creates demand for them), and as a consequence to force people into investing, as he saw it, in shares and other risky assets instead, as a consequence boosting, he thought, the overall rate of investment in the real economy, which would, he believed, reduce the risk of there being a recession at that time.

You will notice that I caveated a lot of the statements I just made very heavily. I did so

for very good reason.

The truth was that actually, in 2009, what Alistair Darling and the Bank of England really wanted to do was to boost the amount of money that was being made available by the Bank of England to the UK's commercial banks to ensure that they had sufficient solvency that they could settle the debts arising between them on a day-to-day basis without having too much recourse to the Bank for borrowing facilities. That required that their central bank reserve accounts - the accounts that the commercial banks hold with the Bank of England - be boosted.

And the way to do that was to effectively allow the Bank of England to create money that would be used to fund government spending which would, in turn, inflate the central bank reserve account balances because that money would not be reclaimed from the economy. by way of either taxation or bond sales.

The trouble was that the European Union, which, of course, we were a member of at the time, did not approve of central banks providing that sort of finance to their governments by boosting government expenditure without requiring either bond sales or taxation. And, therefore, they had to come up with a ruse to cover the fact that this was exactly what they were doing.

Quantitative easing is the ruse that covers up the fact that from 2009 until 2021, the UK government was in large part funded by the Bank of England and the capacity that it has to create new money to fund government expenditure. Over that period, in total, £895bn of new money was created by the Bank of England for this purpose, but it was disguised using quantitative easing.

So let me explain what quantitative easing really did. What happened was, the government had to spend. It needed to because the economy was in crisis. In 2009, tax revenues were collapsing. In 2020, tax revenues were also collapsing because of massive downturns in economic activity. Therefore, it had a shortfall in revenue, but it had to spend all the same. The consequence was that it had to get money from somewhere.

It had three choices. It could have increased tax rates, but that would have been no good because tax revenues were already falling.

It could have tried to borrow from financial markets, but that would have caused a financial crisis.

Or it could have called on its central bank to create the money in question, which is what it did.

But to disguise the fact that it was calling on its central bank to raise the money, it appeared to sell a bond equivalent to the amount of the shortfall that it was getting in

tax receipts. So, if in a month the government was short of £10 billion in tax receipts because the economy was in crisis, it appeared to sell a bond for £10 billion pounds as well. But within a week of that bond being issued, what happened was that the government went into the financial markets and via the Bank of England it repurchased £10bn worth of government bonds. They weren't necessarily the ones that had been issued by the Treasury the week before. They could have been.

But what happened was that whatever value was being issued was, broadly speaking, being almost immediately repurchased by the Bank of England.

Why did they bother to add this stage to the process? The spending was easy to understand.

The Bank of England extended an overdraft to the government, and the government spent.

The government then issued a bond, and so it claimed back from the financial markets the amount that it had just spent.

But, almost immediately, the Bank of England returned that money to the financial markets by repurchasing bonds to equivalent amount to the value of the bonds just issued.

If you're confused, I think that's deliberate. The government did this to be confusing. They were pretending, by issuing these bonds, that they were not being funded by the Bank of England, when indirectly they were, because the consequence was that if the bonds were issued and then repurchased, they clearly weren't available to the financial markets.

They weren't really in issue at all, in my opinion. But the Bank of England was instead, in effect, making the provision of a loan to the government disguised behind the fact that the government had issued bonds which had been bought by the Bank of England.

That's what quantitative easing did. It was a ruse to cover up the fact that the government was, in fact, running up an overdraft with the Bank of England.

But it was a ruse with an enormous cost in it. Firstly, that cost was because of the financial dealing costs of issuing and then repurchasing bonds, which gave an immediate bung in terms of profits to the banks who handled these deals, knowing full well that they would make the return because they knew full well that whatever bonds were being issued by the government from 2009, to a certain value, until 2021, again to a certain value, were going to be repurchased because announcements were made in advance as to how much was to be bought at any point in time.

Secondly, there was a cost because if the Bank of England owned bonds issued by the government, then the government had to pay the Bank of England interest. Now, this

became ludicrous by 2013. It became apparent that there was an enormous sum of money being paid by the Treasury to the Bank of England, which was apparently profiting the Bank, when the Bank obviously was owned by the Treasury and therefore there was no real profit in this system at all. And that money was then returned on George Osborne's instruction to the Treasury. The net effect of the Bank of England owning these bonds was cancelled as a consequence.

But, that problem still remained, and it remained sufficiently present, so that people could argue that it was necessary for the government to get rid of this burden and send it back into the financial markets by selling the bonds back eventually, and that was stated to always be the plan.

It was this part of the ruse which has proved to be so costly. There are two costs to it. One is the fact that now the government is selling back some of the bonds that it supposedly bought. And I know the Bank of England says that it's making its own independent decision, but if you believe that you also believe there are fairies at the bottom of your garden.

So those bonds that the Bank of England bought are being resold into the financial markets, and that is increasing the government's real financial cost, because it is now paying interest to financial markets when previously it was paying the Bank of England.

And also it is selling those bonds at a loss because they were bought at a time when the government was trying to hype the price by increasing demand for government bonds, and now it's trying to sell too many bonds into the market, and when you try to sell too many bonds, you lower the price, and the consequence has been a cost of well over a hundred billion pounds so far to the government in terms of supposed financial losses on supposedly reissuing bonds, which would, frankly, and should frankly, have been cancelled at the time that they were repurchased.

So, this ruse to pretend that the government was not borrowing on overdraft from the Bank of England has cost a significant amount of money, all to pretend that macroeconomics does not allow the government to borrow from its central bank when in reality, it does.

Does that sound totally confusing? I'm really sorry if it does. I tried to make it as simple as possible. But the fact is that this was meant to sound confusing. It was meant to sound very clever. It was meant to sound very complicated, and it need not have been any of those things. There could have been a simple straightforward statement by the government that it was going to borrow from the central bank and that was it, the circumstances required it, and there was no complication, no financial market involvement, no bung to banks, and no losses as a consequence.

All of that could have happened.

QE was entirely unnecessary.

We could simply have let the government run an overdraft.

The price of pretending that economics is something other than it is has been enormous, and we should never let that happen again.