What are we to think of Jeremy Corbyn's 'people’s QE'?

It's one of the oldest tricks in the book - rulers have always sought to reduce the coinage’s precious metal value

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The new Labour leader, Jeremy Corbyn, has said that a **Labour government would introduce “people’s QE”**, that is to say, increased government spending, perhaps on infrastructure, financed with printed money.

What on earth are we to think about this, and indeed QE generally?

I will endeavour to shed some light. But I should warn you that the vagaries of QE present what Sherlock Holmes would have described as a “three-pipe problem” – and possibly four or five.

Despite some people’s serious fears (not including yours truly), apparently QE hasn’t been inflationary. **The most recent inflation figure is 0.1pc**, and it may turn negative by Christmas.

Yet QE probably has caused inflation to be higher than it would otherwise have been. This effect is not visible because of the profound disinflationary forces at work in the world, and the still damaged banking system, which has not fully responded to the monetary stimulus.

In principle, though, once the system returns to some sort of normality, the expansion of the central bank’s balance sheet by four times should put us – and the authorities – on inflation alert.

In practice, higher inflation need not materialise since QE can be reversed. Central banks simply have to sell bonds back to the markets. There clearly are difficulties in doing this without causing serious instability in financial markets. But it can be done.

Bearing this in mind, it might seem surprising, if not daft, that when UK government bonds (gilts) mature, the Bank of England buys more gilts to replace them.

Yet the size of the Bank’s gilt holdings, and hence the extent of QE, should be determined by what it deems to be the appropriate degree of monetary stimulus, not by the redemption schedule of its gilts.

Some say this whole money-go-round should be ended by the Government cancelling the gilts that the Bank holds. Some people have imagined that this would not just bring sanity to monetary arrangements but could also save money.

This is delusional.

The Bank of England is part of the public sector. When the Government pays interest to the Bank, this is virtually the same as paying interest to itself.

So, in other words, while gilts are held by the Bank, they have been, if not cancelled, then effectively suspended.

Now, of course, when the Bank deems it right to reverse QE and sells bonds into the market, then interest will need to be paid to the private sector and this will bring a cost to the Exchequer. But this would also apply if the gilts had been cancelled.

In the same circumstances, there would be the same need to reverse the monetary expansion and accordingly the Bank would need to sell something to the private sector to absorb the excess cash – and to pay interest on that something.

People's QE sounds very different from all this. It is often alleged that conventional QE involves "giving money to the banks" – who then do nothing with it. But this is wildly misconceived. Under conventional QE, money is not given to anyone, but exchanged for financial assets.

Jeremy Corbyn, the new Labour leader, has proposed a ?People?s Quantitative Easing? scheme Photo: EPA

People's QE sounds very different because, analytically, it amounts to the combination of conventional QE and increased government spending financed by the issue of gilts. In other words, both a fiscal and a monetary expansion.

But if there is a case for higher public spending and borrowing, this does not necessarily need to go hand in hand with more monetary stimulus by the Bank of England. It might even require less.

It may seem as though people's QE offers a painless and cost-free form of finance, whatever the economic conditions. But whether the Government issues special infrastructure bonds to the Bank or requires that the Bank supplies it with money directly, this is an illusion.

True, if the Bank funds increased government spending (in whichever way), then there would be no interest cost to the public sector – at first.

Yet once the economy is at full employment, extra demand will cause inflation.

At that point, if inflation is to be avoided the Bank will need to reduce the degree of monetary stimulus by selling bonds to the private sector, thereby obliging the Government to pay interest to finance whatever it has spent its money on.

Of course, there would be the option of never reversing the monetary stimulus created by people's QE. Indeed, it is suggested that the power of QE can be transformed by announcing that it is permanent.

If it is believed, then such an announcement could indeed make QE more powerful. In fact, whatever is declared, the policy could always be reversed or offset by some other measure.

More importantly, committing to the permanent injection of more liquidity implies acceptance of whatever inflation rate emerges. And all of this would fatally undermine the Bank's independence. Now that would be a big deal. It would open the way to inflationary finance on a major scale.

People's QE would represent the return of one of the oldest financial tricks in the book. From the beginning of monetary history, rulers have sought to gain financial advantage by reducing the precious metal content of the coinage.

Once paper money had been invented, the scope for such chicanery increased dramatically and now electronic money can be created even more quickly.

Yet none of these advances in the technology of monetary debasement alters the fundamental economics. Sometimes a sovereign has no alternative to inflationary finance. But this always has a significant cost. And it is never the place to start – or to want to end up.

So how many pipes did you need?

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