TRADES UNION CONGRESS – WRITTEN EVIDENCE (QEI0016)

QUANTITATIVE EASING INQUIRY

The TUC exists to make the working world a better place for everyone. We bring together more than 5.5 million working people who make up our 48 member unions. TUC takes a view on QE, and macroeconomic policy more generally, because economic outcomes – above all recession – affect jobs, pay and working conditions. We want to see economic policy that provides work for all who want it, with inflation contained and a fair distribution of incomes.

It is important to recognise the exceptional context in which QE has been so extensively used: first through the most severe global financial crisis since the great depression, second alongside government pursuit of contractionary policy, third alongside financial instability caused by the referendum result, and finally the pandemic. The approach follows longer-standing convention that monetary policy is the main tool for stabilising economies (so-called 'monetary dominance'). This has had broader impacts, not least the consequence on public services and household incomes of cutting government spending, as well as the distributional impacts of QE. There are concerns too that the arrangement has fostered renewed financial excess long pre-dating the pandemic. TUC call for a wider inquiry into these outcomes and the relation with monetary and fiscal policies.[1]

1. Has the expansion of the Bank of England's Quantitative Easing programme undermined the independence of the Bank, or the perception of its independence? What are the implications of this?

Given monetary dominance, QE followed logically after central bank rates were cut to near zero. But in parallel there has been a growing interplay between monetary and fiscal policy, as government borrowing (and hence debt issuance) surged in the wake of the global financial crisis. Over the pandemic the interplay has been even more obvious, with the *Financial Times* showing "the BoE's asset purchases in 2020 have perfectly tracked central government's borrowing needs".[2] While MPC member Gertjan Vlieghe pushed back against this characterisation,[3] in 2017 Mark Carney compared G4 countries' issuance of government debt with central bank asset purchases, and observed that over the "past four years [2014-2017] … all net issuance within the G4 was effectively absorbed".[4]

The impression overall is of policymakers downplaying the relation between government borrowing and QE. The same *Financial Times* article reported "investors" effectively suspicious of a "thinly veiled attempt" to "finance the government's deficit to keep its borrowing costs down" (leaving aside whether or not this might be desirable).

---

[1] In TUC (2019), 'Lessons from a decade of failed austerity', we called for a review of how policymakers judge the impact of government expenditure on the economy. https://www.tuc.org.uk/research-analysis/reports/lessons-decade-failed-austerity

[2] https://www.ft.com/content/f92b6c67-15ef-460f-8655-e458f2fe2487

[3] 'Assessing the Health of the Economy', 20 October 2020.

[4] 'De-globalisation and inflation', 18 Sep. 2017; his figures showed over 2014-2017 asset purchases of $5.7tn against bond issuance of $5.4tn.

But this does not mean that the independence of the Bank is undermined. The political view is that a balanced budget is the right end of policy, and this has translated to a perceived need to restrain spending. In economic policy terms, this is related to the output gap which suggests that stimulus cannot go beyond a certain rate without causing inflation. Estimates of this gap – by the Bank of England and others – often also suggest there is little room for government spending.

2. How well has the Bank of England communicated its decisions on Quantitative Easing? Is the programme transparent enough?

No. There is a need for more clarity on the interplay between government borrowing and QE.

3. Should the Bank of England's mandate be altered?

Yes. In his Budget speech the Chancellor reported "an updated monetary policy remit for the Bank of England. It reaffirms their 2% target. But now, it will also reflect the importance of environmental sustainability and the transition to net zero". We consider the questions on QE raised in this inquiry lead to the need for a wider review, including how to secure fuller, greener and better employment.

4. How should Quantitative Easing be defined?

QE is understood as central bank purchases of financial assets (mainly government debt) in secondary markets using deposits (or reserves) created on the central bank balance sheet. This makes it distinct from 'ways and means' loans directly to finance government spending. Given the relation between QE and government borrowing (and the practice of returning interest payments to government), it is not obvious that the process should operate via secondary markets.

5. What were the original objectives of Quantitative Easing and have they changed?

The objective has throughout been to support spending in the economy. The suggestion at first was that this spending should come from the private sector, with some uncertainty over whether this was through the consequent lower interest rates or directly as the quantity of money in the economy was increased. In a speech last year Andrew Bailey emphasised both monetary policy and financial stability objectives. He did not mention fiscal policy.[5]

The relation between QE and the rate of interest is a key question. While QE was intended to reduce the rate of interest, other factors are at play – not least since the dot.com crash an increased demand for advanced economies' government bonds as a safe asset. However alongside these monetary factors, central banks promote a natural rate theory of the rate of interest, accordingly to which low rates of interest are governed by low productivity outcomes.[6] But low productivity is likely at least in part a consequence of wider fiscal policies, and therefore there are circularities here.[7] Not least given some are making essential

[5] 'The central bank balance sheet as a policy tool: past, present and future', 28 August 2020.

[6] For example Ben Broadbent's speech 'monetary policy, asset prices and distribution', 23 October 2014.

[7] In a June 2019 discussion with Professor David Blanchflower, MPC member Gertjan Vlieghe observed: "I thought he would perhaps argue that, if only there was more demand stimulus, higher productivity growth might return, i.e. that some part of the lost productivity is cyclical and reflects lower intensity of factor utilisation, not structural developments. I would have some sympathy with that idea." https://www.niesr.ac.uk/events/not-working-where-

fiscal expansion contingent on low interest rates, there is a need for some clarity here.

6. Has Quantitative Easing been successful and how should success be measured?

It is important to assess QE in the wider context of monetary dominance, or more fully the dual approach of monetary ease and fiscal restraint. Certainly policy (along with other more explicit and large-scale subsidies to the financial sector) halted the financial breakdown in 2008-09 and contained the implosion of the real economy. But the approach of fiscal restraint and monetary ease led to the slowest recovery in a decade in the UK, with now a widespread consensus that fiscal policy have played and should now be playing a more active role. Bad growth outcomes meant also the worst performance over a recovery decade on the public debt ratio.[8] Paradoxically the dual approach has caused increased reliance on QE because of the consequent increased issuance of government debt. In broad terms QE has compensated for the failure of fiscal policies to secure recovery, but policy overall has still been a failure. For these reasons the TUC called in autumn 2019 for a review of how policymakers judge the impact of government expenditure on the economy (footnote 1).

7. What trade-offs does the Bank of England's Quantitative Easing programme entail? What effect might it have on inflation?

Central bankers have seen QE as necessary to protect economies and markets at a time of low growth and wider fragility. At the same time, government policy makers have relied on monetary rather than fiscal policies to promote growth – reinforcing this reliance.

QE was originally characterised in relatively mainstream circles as inevitably inflationary, presumably following crude monetarist arithmetic.[9] But with ongoing and likely chronically deficient aggregate demand, QE has not led to price inflation. Instead prices (retail and wages) have been subject to persistent disinflationary pressures. Inflationary factors have instead been focused in asset markets, with in particular the price of corporate and government bonds relentlessly rising. These are then a factor in the distributional considerations that are the subject of the next question.

8. What have been its distributional effects?

For several decades policy has advantaged wealth and disadvantaged labour. The post-global financial crisis policy setting simply intensifies this approach: wealth is subsidised at the expense of labour (across pay, conditions, public services and social security). Workers have endured the most severe reduction in real wages for two centuries.[10] In the meantime the ONS wealth and assets survey shows the financial wealth of the top 10% more than doubling to £1.4tn from £600bn over the latest decade for which figures are available; the bottom decile has negative financial wealth of -£12bn, little changed over the decade.[11] The relation between asset prices and QE is discussed below (#11).

---

have-all-good-jobs-gone-david-blanchflower-conversation-about-his-latest

[8] Figures for GDP growth and public debt can be found in https://www.tuc.org.uk/news/tuc-issues-call-avoid-despair-mass-unemployment-plan-work-our-way-out-recession

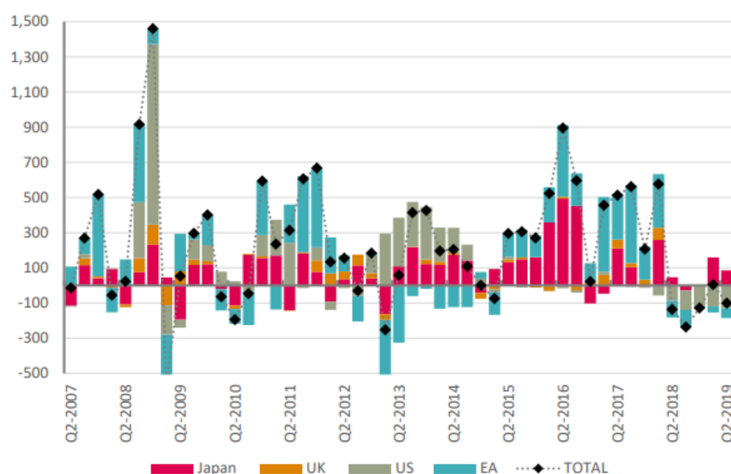
[9] 'Why didn't quantitative easing lead to hyperinflation?', Adam Hayes, Dec 10, 2020. https://www.investopedia.com/articles/investing/022615/why-didnt-quantitative-easing-lead-hyperinflation.asp

[10] https://www.tuc.org.uk/blogs/17-year-wage-squeeze-worst-two-hundred-years

9. How does the Bank of England's Quantitative Easing programme compare to other programmes internationally?

Most if not all central banks have deployed QE policies. The chart below reproduced from TUC (2019) shows how QE across a G4 of the euro area, US, UK and Japan has been sustained almost continuously since the start of the global financial crisis in August 2007. Monetary policy debate in the UK (and more widely) over the same period has been punctuated by occasional appeals to inflationary dangers and consideration of withdrawal of stimulus. But such episodes have been short lived: for example in August 2014 MPC members Weale and McCafferty called for policy tightening, but retreated in January 2015 as global deflationary threats loomed. The chart was constructed at the end of 2019 in the wake of a tentative tightening of policy in the UK and US (in February 2018 UK Bank rate was increased to 0.75%, above 0.5% for the first time since the financial crisis) and parallel disturbances in financial markets (FTSE fell more than 10% over the year). Already an expansionary stance was expected to be renewed: MPC member Saunders voted alone for a cut from November 2019, and US policy had been eased to 1.75% from 2.5% over the second half of the year. But events were overtaken by Covid-19.

Figure 3: Quantitative easing, $billion



Source: national central banks and TUC calculations

Future of QE

10. Could the expansion of Quantitative Easing in the UK create the possibility of economic stability being undermined in the future? If so, how?

A decade after the global financial crisis, financial and economic stability is unresolved. The events discussed above suggest financial markets have become wholly reliant on QE. While resumed recession has so far been prevented, economic outcomes have been very poor.

Beyond this is the greater concern that financial instability is not only unresolved but intensified. Even before the pandemic, the Systemic Risk Council (comprised of ex-central bankers and academics) were warning: "Covid-19 strikes the world at a time when too many corporations around the world are over-indebted, and after a period during which persistently favourable market conditions caused

[11]https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/datasets/totalwealthwealthingreatbritain; figures issued in December 2019.

traders to take aggressive positions, exposing them and the system to spikes in volatility, let alone a collapse in asset values".[12]

QE has been integral to the associated risks. As described above, central banks create new deposits as they purchase government debt; financial institutions then use these deposits to buy riskier assets issued by the UK private sector and/or in the private and public sectors of other countries. The Bank of England illustrates a process where QE expands pension fund deposits, and describes the likely next step in the process: "for example by [pension funds] using the new deposits to buy higher-yielding assets such as bonds and shares issued by companies".[13] In their 2016 assessment, 'QE: the story so far', Bank of England chief economist Andy Haldane and others observed a "powerful international portfolio rebalancing channel".[14] The key risk is borrowers being unable to repay these high returns. The Turkey experience is indicative, with in 2018 large scale capital inflows reversing in the wake of a corporate debt crisis.[15] The situation is all the more dangerous if financial institutions are intermediating so that the consequent risk is with households through pension funds and other investments. The sum of the parts may be the paradoxical situation where QE is keeping the system afloat only by increasing risk.

In his inaugural address (4 March 1933) Franklin Delano Roosevelt observed: "Faced by failure of credit, they have proposed only the lending of more money". His solution was greatly extended government spending, the Wagner Act reforms for trade unions and a greatly more managed domestic and global monetary environment. These policies led to the decisive recovery from the great depression.

11. What evidence is there for any upper limits to the Bank of England's Quantitative Easing programme?

It is not known if there is an upper limit to this process. But the overall approach to economic policy appears dangerous and unfair.

12. Will Quantitative Easing be unwound in full, and if so how? Is it likely that the Bank of England's balance sheet will be permanently, and structurally, larger going forwards?

Unwinding QE seems a distant prospect, when the evidence of the past decade is of increased not reduced reliance on QE. Instead the need is to devise a different model. In the wake of the pandemic there is much talk about 'building back better' and the changes achieved under the Attlee government. These changes were rooted in the lessons of the great depression.

In our 2019 report we deployed the theories of over-production/under-consumption that were integral to the Attlee approach, as set out in the 1945 manifesto: "Over-production is not the cause of depression and unemployment; it is under-consumption that is responsible. It is doubtful whether we have ever, except in war, used the whole of our productive capacity". In the context of the

---

[12] https://www.systemicriskcouncil.org/2020/03/src-statement-on-financial-system-actions-for-covid-19/

[13] Figure 3 in McLeay, Michael, Amar Radia and Ryland Thomas (2014) 'Money creation in the modern Economy', *Bank of England Quarterly Bulletin*, 2014 Q1, 14-27.

[14] 'QE: the story so far' Andrew G Haldane, Matt Roberts-Sklar, Tomasz Wieladek and Chris Young, Staff Working Paper No. 624, October 2016

[15] https://www.bloomberg.com/news/articles/2019-04-08/turkish-banks-sweat-under-rising-pile-of-debt-restructurings

need to reach net zero emissions, the aim should be to better use spare and existing capacity. Rather than the conventional interpretation of excessive demand relative to supply ahead of the global financial crisis, inter-war thinking was that supply was excessive relative to deficient demand (i.e. production was excessive relative to purchasing power). High levels of debt follow as firms are unable to sell production, and households are unable to afford a basic standard of living.

The system is operating beyond the means of the public not the other way around. Since the global financial crisis, there has been a continued need for more not less spending. We now know that Attlee's analysis was vindicated: building back better was the correct approach and moreover set the public debt ratio on a positive trajectory for thirty years.

8 March 2020