# DR WILL BATEMAN – WRITTEN EVIDENCE (QEI0017)

# QUANTITATIVE EASING INQUIRY

This short submission addresses Questions 2, 4, 5, 6 and 9.

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

Transparency could be improved in two key areas: (i) QE's legal basis and impact on public finances; and (ii) transaction-level data regarding QE operations.

Publish the Deed of Indemnity

The legality of the UK's QE program is (in part) founded on the "Deed of Indemnity" executed by HM Treasury (**HMT**) and the Bank in 2009. That contractual document provides the legal framework for the indemnification of QE with fiscal receipts and the transmission to the UK's Consolidated Fund of the accumulated profits of the special purpose corporate vehicle which executes asset purchases under the QE program:[1] the "Bank of England Asset Purchase Facility Fund Ltd" (**QE Subsidiary**). Additionally, it appears that the requirement for the Bank to seek the Chancellor of the Exchequer's consent before any expansion of QE stems from the Deed of Indemnity.[2] Thus, the Deed of Indemnity is the legal instrument which directly exposes the UK's public finances to the financial risks of QE and appears to permit the deployment of central bank money in QE programs.

The Deed of Indemnity is not a public document, despite being referenced (in vague terms) in various public documents.[3] That secrecy is an extraordinary feature of the UK's QE program. The Deed of Indemnity is a contractual document between two governmental institutions which commits the UK's taxpayers to potentially enormous liability and appears to authorise QE in the UK. It should be published.

Publish transaction level data

The Bank publishes less transparent data regarding the financial market operations of QE than comparable central banks.

For example, the Federal Reserve Bank of New York (**FRBNY**) publishes extensive details of its asset purchase transactions, including:[4] trade dates, settlement dates, security identifiers and, critically, the identity of asset purchase counterparties. By publishing the identity of counterparties, provides critical transparency and

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[1] See the letters between the Governors and Chancellors at: https://www.bankofengland.co.uk/-/media/boe/Files/letter/2012/governor-letter-091112 (regarding remittance of coupon payments) and https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/932940/governor-apf-letter-november-2020.pdf (regarding the indemnification of QE out of fiscal receipts).
[2] See the initial authorisation of the asset purchase program in January 2009 (Letter from Darling to King (last page) https://www.bankofengland.co.uk/-/media/boe/files/letter/2009/chancellor-letter-290109) and all subsequent expansions of the program (eg Letter from Bailey to Sunak (last page) https://www.bankofengland.co.uk/-/media/boe/files/letter/2020/governor-letter-apf-march-2020.pdf?la=en&hash=0C633B497A48C6D859300DAD7B2FB94BF0B9A263).
[3] In addition to the letters above, see Bank of England Asset Purchase Facility Fund Limited Annual Report 2020, page 4: https://www.bankofengland.co.uk/-/media/boe/files/asset-purchase-facility/2020/annual-report-2020.pdf.
[4] See, https://www.newyorkfed.org/markets/omo_transaction_data.

accountability by identifying the financial flows between the monetary institution of the US and private sector financial organisation. The FRBNY releases that data with a 2-year lag to avoid disclosing price-sensitive information.

The Bank's operational results of asset purchases do not identify counterparties.[5] Without that critical information, it cannot be determined whether one or more financial institutions has:

- a dominant position in asset purchases;
- identified a unique arbitrage opportunity in asset purchase operations; and
- collects a commercial windfall from QE.

The Bank is a public sector agency and the central bank money deployed in QE is a public resource. The precise circumstances under which that public resource is distributed to private sector entities should be disclosed. Such disclosure would provide a critical accountability mechanism, building the Bank's credibility and legitimacy.

## Question 4. How should Quantitative Easing be defined?

QE should be defined as an economic rescue measure with fiscal and monetary policy effects.

Economic rescue was clearly the overriding goal of QE, although the underlying economic dysfunction shifted over time: a sudden withdrawal of commercial bank credit (2009); general economic stagnation in the aftermath of the financial crisis (2010-2019); and the sudden stop of economic activity caused by the COVID-19 pandemic (2020-21). Each of those economic dysfunctions had heavy implications for monetary and fiscal institutions, most notably among the latter is the UK's treasury which inherited an increased expenditure load (funding support for businesses and welfare payments, "automatic stabilisers", to individuals) and reduced taxation (from reduced economic activity) in each case. The monetary policy effects of QE are well documented and require no further analysis here.[6]

The fiscal policy effects of QE have been less extensively documented, but they are a critical part of QE.

The main fiscal policy effect of QE is to maintain the UK's government access to debt finance in large volumes and low cost in the face of sustained budget deficits. That objective was achieved by providing direct and indirect funding support for the UK's treasury, HMT. The Bank of England currently owns ~45% of UK sovereign bonds (**gilts**) on issue:[7] being the largest single creditor of the future tax revenues of HMT. Because the Bank's QE Subsidiary transfers most of the interest payments (**coupons**) on gilts to HMT, QE is a direct form of debt relief for the UK via a **coupon round robin**: HMT -> Bank of England -> HMT. QE also reduces the cost of debt financing for HMT via boosted demand for gilts in primary markets by creating scarcity in secondary markets which sterilises the UK's default risk interest rate premium.[8] Finally, QE

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[5] See the 'Gilt Purchase Operational Results' sheets at https://www.bankofengland.co.uk/markets/bank-of-england-market-operations-guide/results-and-usage-data.

[6] Most prominently, stimulating real economic activity by supressing the interest rate of private sector credit and re-balancing investment away from fixed income markets to equities and real estate.

[7] At 30/03/21. Gilt data from UK Debt Management Office, 'Gilts in Issue': <https://www.dmo.gov.uk/data/pdfdatareport?reportCode=D1A>.

[8] Which follows from its sustained fiscal deficits: helpful charts at

creates demand for gilts by providing a mechanism for select banks and securities dealers (the **Gilt-Edged Market Makers**) to liquidate gilt holdings irrespective of private market demand.[9] All of those fiscal effects of QE provide the UK's public finances with critical support during economic emergencies when fiscal receipts fall significantly behind public expenditure. They also explain why the intuitive connection between (large) fiscal deficits and (high) sovereign debt interest rates has been absent since the financial crisis.

All QE programs provide the same type of funding support for national treasuries.[10] The Bank appears to accept, in a qualified manner, that QE provides monetary support to HMT.[11] That position conforms to mainstream public financial literature,[12] and is entirely consistent with applicable legal rules regarding "monetary finance".[13] Therefore, it should be readily accepted that fiscal policy effects are part of the definition of QE.

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

The authoritative public statement of the original objectives of QE is contained in the exchange of letters between Governor King and Chancellor Darling in early 2009 which initially authorised the Bank's asset purchase program:[14]

> *purchases of assets would be financed through central bank money…to boost the supply of broad money and credit and increase the liquidity of private sector portfolios, thereby raising nominal spending.*

Public explanations of QE have largely conformed to that statement despite variations in emphasis over the past 11 years.[15]

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https://commonslibrary.parliament.uk/research-briefings/sn06167/.

[9] HMT will only borrow directly, and the Bank of England will only purchase gilts under the QE program, from Gilt-Edged Market Makers: see 'Asset Purchases' in https://www.bankofengland.co.uk/markets/bank-of-england-market-operations-guide/our-tools; https://www.dmo.gov.uk/media/15073/guidebook180507.pdf, page 6.

[10] Some central banks provide much larger monetary support to their treasuries: see, eg the Bank of Japan's underwriting of Japanese government bonds: BoJ Time Series Data Search, 'Monetary Base and the Bank of Japan's Transactions', Stock Table item 2(h) and Flow Table item 2(h), https://www.stat-search.boj.or.jp/index_en.html.

[11] Gertjan Vlieghe (Monetary Policy Committee Member), 'Monetary policy and the Bank of England's Balance Sheet' (23 April 2020) https://www.bankofengland.co.uk/speech/2020/gertjan-vlieghe-speech-monetary-policy-and-the-boes-balance-sheet; Andrew Bailey (Governor of the Bank of England), 'Bank of England is Not Doing 'Monetary Financing', Financial Times (6 April 2020).

[12] Richard Hemming, 'The Macroeconomic Framework for Managing Public Finances' in Richard Allen, Richard Hemming and Barry Potter (eds), *The International Handbook of Public Financial Management* (Palgrave Macmillan, 2013) 17, 21.

[13] For a brief institutional history of HMT and Bank relations, see Will Bateman, *Public Finance and Parliamentary Constitutionalism* (2020, Cambridge University Press) Chapters 2 and 5. For the legal rules governing central bank support to treasuries in the US, EU and UK see, Will Bateman, 'The Law of Monetary Finance under Unconventional Monetary Policy' (2021) *Oxford Journal of Legal Studies* (forthcoming).

[14] Letter from King to Darling (17/02/09).

[15] Some later explanations include Charlie Bean (Deputy Governor Monetary Policy), 'Pension funds and quantitative easing', https://www.bankofengland.co.uk/-/media/boe/files/speech/2012/pension-funds-and-quantitative-easing.pdf; Ben Broadbent (Deputy Governor Monetary Policy), 'The history and future of QE', https://www.bis.org/review/r180724c.pdf

Absent from the public explanations of QE is an acceptance that fiscal accommodation (via debt monetisation) was an objective of QE. Indeed, Governor King sought an assurance from Chancellor Darling that HMT "should not alter its issuance strategy as a result of the transactions that are undertaken through the Asset Purchase Facility for monetary policy purposes." Chancellor Darling gave that assurance, but reiterated that HMT's "annual decisions about gilt issuance will continue to be informed by a number of factors include: the size of the annual financing requirement; supply-side considerations including the Government's risk preferences; investors' demand for gilts; the shape of the yield curve; and other financing market conditions."[16]

The initial assurance, that QE had no fiscal policy objectives, appears less credible over time. It was given in 2009, when the QE program authorised £100b of gilt purchases. As the QE Subsidiary now holds £875b of gilts, it is impossible to understand how HMT's gilt issuance strategy could not be affected by the Bank's asset purchase program, for the following set of (simplified) reasons:

- Gilt issuances occur via auctions conducted by the non-statutory agency of HMT, the Debt Management Office (**DMO**);
- Pricing and demand at DMO auctions will be heavily influenced by secondary market demand for gilts;
- Demand in secondary gilt markets is materially impacted by the QE subsidiary's asset purchases;
- The Gilt Edged Market Makers are the exclusive counterparties in primary treasury markets and QE operations; thus
- QE will be a major factor in the pricing and allocation of gilts in DMO auctions.

Accordingly, it should be accepted that a core objective of QE is (or has become) monetary support for the UK's sovereign debt portfolio.

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

Again, the success of QE should be measured according to monetary and fiscal policy effects.

The monetary effects of QE are well understood and include: increased commercial lending, via the liquidity channel; inflation of asset prices (most visibly listed equities and real estate) via the portfolio rebalancing channel; reduction of yields in fixed income markets, again via the portfolio rebalancing channel; and preventing deflation. There is ample evidence to suggest that each of those effects has occurred and debate continues regarding their merits.

The fiscal effects of QE are less prominently examined, but include: direct monetary stimulus to HMT, via the coupon round robin of payments from HMT -> the QE subsidiary -> HMT; and reduced funding costs for sovereign debt, via scarcity and liquidity effects in primary and secondary gilt markets. Again, there is strong evidence that each of those fiscal impacts has occurred and QE should be judged as successful in achieving substantial support for the UK's sovereign debt portfolio during a sustained period of economic instability.

[16] Letter from Darling to King (03/03/09).

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

The core of the Bank's QE program is very similar to QE programs undertaken by other globally-significant central banks. As in the US, EU and Japan, the UK's program involves purchasing very large volumes of (mainly) sovereign debt securities from a small set of commercial bank/security dealer counterparties with the monetary and fiscal effects recognised above: increased credit provision to the real economy and portfolio re-balancing; and monetary support for treasury funding.

For brevity, I emphasise the following major differences between QE in the UK and comparable advanced economies.

**1. Cooperation with the national treasury**: the UK's QE program operates with an unusually-high level of cooperation between the UK's central bank and national treasury. Legally, QE came into existence in 2009 with an agreement between the UK's elected treasurer and the Bank of England's governor, which appears to require the Chancellor's "consent" before any deployment of central bank money in asset purchases.[17] That treasury consent has been sought under each subsequent expansion of the QE program. Additionally, the transmission of the profits of QE from the Bank's QE Subsidiary to HMT occurred via a written agreement between the treasury and central bank (following a treasury request) rather than the independent operation of legislative profit transfer rules.[18] The high-degree of cooperation between the Bank and HMT continues a long (and successful) tradition in the UK, but is markedly different to comparable jurisdictions, particularly the US and EU.[19] It also presents a rather interesting case study for central bank independence.[20]

**2. Impacts on public finance**: compared to US and European QE programs, the UK's program was strongly skewed towards the national treasury. In particular, the Bank:

- owns (via the QE Subsidiary) a higher proportion of sovereign debt instruments (~46%)[21] than the Federal Reserve (~14%)[22] or ECB (~25%)[23];
- remits a larger proportion of gilt coupon payments to the UK's treasury than in the US or EU; and thus,

[17] See Letter from Darling to King (29/01/09, last page) https://www.bankofengland.co.uk/-/media/boe/files/letter/2009/chancellor-letter-290109.

[18] See Letter from King to Darling (09/11/12): https://www.bankofengland.co.uk/-/media/boe/Files/letter/2012/governor-letter-091112.

[19] Both of which have legislative profit transfer rules and execute their QE programs without requirements to seek the consent of their national treasuries: eg, *Federal Reserve Act, ss 7 and 12A*; *ECB Statute*, Arts 7, 29-33 and Decision (EU) 2016/2248 of the European Central Bank of 3 November 2016 on the allocation of monetary income of the national central banks of Member States whose currency is the euro (ECB/2016/36) [2016] OJ L 347.

[20] See the leading accounts of central bank independence in Rosa M Lastra, *International Financial and Monetary Law* (Oxford University Press, 2015); Peter Conti-Brown, 'The Institutions of Federal Reserve Independence' (2015) 32(2) *Yale Journal of Regulation* 257; Forrest Capie, Charles Goodhart and Norbert Schnadt 'The Development of Central Banking' in Stanley Fischer, Charles Goodhart and Norbert Schnadt (eds), *The Future of Central Banking: The Tercentenary Symposium of the Bank of England (Cambridge University Press*, 1994).

[21] See, footnote 6 above.

[22] Data from https://fred.stlouisfed.org/series/TREAST; https://www.treasurydirect.gov/govt/reports/pd/pd_debttothepenny.htm.

[23] Data from https://www.ecb.europa.eu/mopo/implement/app/html/index.en.html#pspp and https://ec.europa.eu/eurostat/documents/portlet_file_entry/2995521/2-21012021-AP-EN.pdf/a3748b22-e96e-7f62-ba05-11c7192e32f3.

- provides greater monetary support to the UK government's debt portfolio than comparable North Atlantic monetary authorities.

Again, HMT and the Bank have a long-standing close financial relationship which differs from the stronger separation of fiscal and monetary institutions in the US and major European jurisdictions (such as Germany).[24] Despite anxieties about "monetary finance", the financial flows between the QE Subsidiary and HMT, and the funding support provided to HMT's debt portfolio via scarcity and liquidity effects, are not institutionally improper, but they do raise complex questions regarding the constitutional legitimacy of the UK's fiscal and monetary institutions.[25]

**3. Transparency**: the legal basis of the UK's QE program, and the exposure of UK taxpayers to the potential losses of QE, is less transparent than the comparator programs in the US and EU. Chiefly, this lack of transparency stems from the secrecy surrounding the Deed of Indemnity and the failure to publish transaction level data concerning QE trades, particularly the identity of counterparties (both discussed above). In other important respects, however, the UK's QE program is more transparent than the ECB's QE program, particularly in terms of the clear and detailed operational guides published by the Bank.[26]

**4. Institutional complexity**: The UK's QE program is both more complex than some comparators (ie, the US) and less complex than others (ie, the EU). QE in the UK operates by reference to three separate entities: (1) the Bank of England, which creates and loans the central bank money (reserves) which funds QE asset purchases and sets QE policy; (2) the QE Subsidiary, which executes QE trades and remits QE profits to HMT; and (3) HMT which indemnifies the QE Subsidiary and provides consent to the Bank to initiate and expand the QE program. That structure creates rather high levels of policy, financial, accounting and legal complexity which are absent in jurisdictions which execute QE via a single legal entity, such as the FRBNY. That complexity increases the difficulty of public understanding of QE. The UK's QE program is, however, far less complex than the ECB program, which is spread across 20 separate legal entities (ECB+19 NCBs), each with their own operational framework and member-state law.

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[24] See sources in footnote 13 above.
[25] See, eg Will Bateman, 'Quantitative Easing, Quasi-Fiscal Power and Constitutionalism', *JustMoney Roundtable Essay*, https://justmoney.org/will-bateman-quantitative-easing-quasi-fiscal-power-and-constitutionalism/.
[26] See, https://www.bankofengland.co.uk/markets/bank-of-england-market-operations-guide/our-tools.