People's Quantitative Easing
A Jeremy Corbyn Proposal

T SABRI ÖNCÜ

The Labour Party of the United Kingdom (UK) was defeated in the 2015 general elections on 7 May. The next day, the leader of the party, Ed Miliband, resigned from his post and triggered the 2015 Labour Party leadership election. The election concluded on 10 September and the result was announced on 12 September.

The winner was Jeremy Corbyn, a self-described democratic socialist whose admiration for Karl Marx became public knowledge after he was nominated on 15 June. Despite being with the party for many decades and a Member of Parliament since 1983, Corbyn had been virtually unknown prior to his nomination. Even running for the leadership was not his idea. He was persuaded to run by a small group of leftists who felt that the other three candidates did not represent the political views and wishes of the grass roots of the party. Initially considered an underdog who barely made the nomination deadline of 15 June, he won 59.5% of the vote in the first round of an election that had an unusually high turnout of 76%. A landslide victory. Corbyn is now the leader of the main opposition in the UK.

What is important about Corbyn's win is that it represents a reversal of the right-turn of the Labour Party that started in 1980 and was finalised in 1994 with the election of the "Third Way" politician Tony Blair as leader. From Blair until Corbyn, the Labour Party (or "New Labour" as Blair used to call it) had been an advocate—and from 1997 until 2010 an agent—of free markets, austerity, central bank independence, and other "conventional wisdom" that any right-wing party would have supported without questioning.

A vegetarian and peace activist, Corbyn promises to reduce military spending, facilitate nuclear disarmament, increase taxes on businesses and the wealthy, renationalise natural monopolies such as railways, and other such things that go against current "conventional wisdom." In addition, as if to add insult to injury, Corbyn has appointed John McDonnell as his shadow chancellor, who is also a Marx-admiring socialist. McDonnell in 2012 proposed ending the central bank's control over interest rates—that is, ending central bank independence.

Corbyn's landslide victory in conjunction with his anti-war, anti-austerity stands have created much controversy. For example, on 12 September, Prime Minister David Cameron tweeted: "The Labour Party is now a threat to our national security, our economic security and your family's security." And a few days later, when concerns about Corbyn downgrading the military and pulling the UK out of the North Atlantic Treaty Organization spread, an unnamed senior army general reportedly told the *Sunday Times*: "There would be mass resignations at all levels and you would face the very real prospect of an event which would effectively be a mutiny" (Mortimer 2015). Of course, the Ministry of Defence moved almost immediately to condemn this general for his warning that Corbyn could face "a mutiny" from the military if he became Prime Minister.

People's Quantitative Easing

When the dust settled, what took centre stage was Corbyn's People's Quantitative Easing (PQE) proposal. The PQE and central bank independence are, of course, interconnected because when there is one, the other cannot happen, as I will elaborate later.

There is much confusion about what exactly central bank independence is, but many would consider a central bank independent if it can conduct its monetary policy independently from the fiscal policy conducted by its government. As is well-known, while monetary policy is about central banks' attempts to manage the money supply in some fashion (by setting interest rates or, more precisely these days, setting the cost of money creation to the banks), fiscal policy is about governments' attempts to manage their spending. Therefore, central bank independence is essentially about separation of the management of money supply (monetary policy) and the management of government spending (fiscal policy).

The Bank of England is the central bank in the UK. The Bank of England was founded as a privately-owned institution in 1694 and had remained so until 1946, when it became government owned. Its nationalisation gave the government the power to issue "directions" to the bank—central bank independence in the UK became questionable in 1946. Although the Bank of England has remained government owned from 1946 to this day, this questionable-independence situation ended in 1997.

In 1997, under the leadership of Tony Blair, the Labour Party won its first election since 1979 and started implementing its "Third Way" policies. Included in these policies was granting the Bank of England its independence. On 6 May 1997, the then Chancellor Gordon Brown sent a letter to the Bank of England to express the government's commitment to "ensure that decision-making on monetary policy is more effective, open, accountable and free from short-term political manipulation" and give the bank operational responsibility for setting interest rates. In the bank's own words, "[t]he Bank thus rejoined the ranks of the world's 'independent' central banks," the next day.

Since then, a nine-member Monetary Policy Committee (MPC)—consisting of the governor, the two deputy governors, two managers appointed by the governor and four external members appointed by the chancellor—has been meeting on a monthly basis and setting interest rates in the UK. It was this that McDonnell objected to as being undemocratic and said in 2012 that he would "in the first week of a Labour government … [end] the Bank's control over interest rates."

Quantitative Easing

After becoming the shadow chancellor, possibly to avoid further outbursts, McDonnell now says the Bank of England should remain independent. However, the Labour Party's interest in reforming the Bank of England to make it focus on growth, jobs and wages as well as inflation remains intact. "We will launch a debate on expanding that mandate to include new objectives for its monetary policy including growth, employment and earnings," McDonnell told the Labour conference in Brighton on 27 September (Parker 2015).

As for Corbyn's PQE proposal, it is essentially about the government instructing the Bank of England to purchase bonds issued by a yet-to-be established National Investment Bank (NIB) to fund infrastructure projects. Since this violates the separation of monetary policy and fiscal policy, central bank independence goes out of the window.

Central Banking

In my previous H T Parekh Finance Column (EPW, 13 June 2015), I gave a detailed technical description of how several central banks—including the Bank of England—conducted their quantitative easing (QE) programmes. To distinguish between these programmes and Corbyn's yet-to-be (if at all) implemented PQE programme, I will refer to them as "Vanilla Quantitative Easing" (VQE) programmes.

So we are talking about two types of QE programmes: VQE and PQE.

Recall that in the absence of QE or other similar mechanisms, apart from printing banknotes and minting coins, that is, creating cash, central banks cannot create any other money.

Central banks can, however, create reserves, but reserves are not money. They are just some numbers central banks create to settle accounts between banks for which they act as banks as well as clearing houses. These reserves are kept in the accounts of the banks at the central bank and cannot go elsewhere. Banks create additional money and increase the money supply. They do this through extending credit by simultaneously creating the corresponding deposits of the borrower, with the caveat that they have to find some reserves to back these deposits. How much reserves they have to find depends on the deposit-to-reserve ratio their central bank determines.

In the presence of a QE programme, on the other hand, central banks can create money and increase the money supply directly as below.

If the QE is a VQE, the process starts with some bonds—mostly government bonds—that are included in the programme. Suppose that these bonds are already purchased by some non-banking financial company (NBFC) either from the issuer or in the secondary market.

First, some bank purchases these bonds from the NBFC by creating an equal amount of deposits in the account of the NBFC.

This is the new money created by the bank.

Then, the bank gives the bonds to the central bank, gets from the central bank an equal amount of reserves the central bank created, and the VQE process ends.

What happened here is that the central bank effectively bought the bonds from the NBFC by paying reserves.

Now, the NBFC can do whatever it fancies with that new money in its bank account and, as it happens, almost nobody views this as a problem.

In the case of Corbyn's proposed PQE, it is evident that the process is almost identical to the VQE process, except there is no NBFC involved and the bank in question is the NIB. Indeed, if you replace the NBFC of the VQE process with the government (that is, if the bank involved in the VQE process purchases the bonds directly from the government), then the VQE and PQE processes are identical.

Now, the government can do whatever it fancies with that new money in its NIB account and, as it happens, almost everybody views this as a problem because they think that PQE removes "fiscal discipline."

Maybe so.

But given that the QE programmes are heavily dependent on government bond purchases in all countries they were implemented in, does not the VQE remove "fiscal discipline" too?

Fiscal Discipline

In the UK, the QE programme that started in March 2009 was implemented by the MPC of the Bank of England. When it ended in July 2012, the total amount was £375 billion (bn) and most of the purchased assets were UK government debt or "Gilts." What is more important is that while in 2008 the total amount of outstanding Gilts was £479 bn, this amount jumped to £713 bn in 2009 and at the end of 2012, the outstanding amount was £1,164 bn. So, during the QE period the UK government debt grew by about 143%. Currently the total amount of outstanding Gilts is £1,428 bn, corresponding to only about 23% debt growth after the QE.

Now, can there be a relationship between the implemented VQE programme and "fiscal discipline" in the UK also? Could it be possible that even the VQE removed the "fiscal discipline" there?

Although we do not know the answers to these questions, one thing is for sure. Debates on central bank independence and the PQE will continue in the UK. My suggestion to policymakers in developing countries such as India, and my home country Turkey, is that they should pay attention to these debates.

T Sabri Öncü (*sabri.oncu@gmail.com*) is an economist based in Istanbul, Turkey.

REFERENCES

Cameron, David (2015): "The Labour Party Is Now a Threat to Our National Security, Our Economic Security and Your Family's Security," Twitter, 13 September, https://twitter.com/david_cameron/status/642984909980725248?lang=en

Mortimer, Caroline (2015): "British Army 'Could Stage Mutiny under Corbyn', Says Senior Serving General," *Independent*, 20 September, http://www.independent.co.uk/news/uk/politics/british-army-could-stage-mutiny-under-corbyn-says-senior-serving-general-10509742.html

Parker, George (2015): "John McDonnell Sets Sights on Reform of Bank of England and Treasury," *Financial Times*, 28 September, http://www.ft.com/intl/cms/s/0/6c543e46-65dc-11e5-a57f-21b88f7d973f.html#axzz3ngdoMVum