

Economic impact of coronavirus inquiry: Positive Money submission

Positive Money welcomes the opportunity to respond to the Treasury Committee's economic impact of coronavirus inquiry.

We are a not-for-profit research and campaigning organisation, working towards reform of the money and banking system to support a fair, democratic and sustainable economy. We are funded by trusts, foundations and small donations.

Our submission makes the following points:

- The government's borrowing schemes have a number of significant shortcomings.
 - The Covid Corporate Financing Facility (CCFF) gives larger corporations privileged access to funding directly from the central bank at considerably more generous terms than those offered to smaller businesses. Despite such favourable terms, the scheme lacks transparency and does not impose any social or environmental conditions on participants, making it inconsistent with the government and Bank of England's pledges to 'build back better'.
 - Other state-backed commercial lending schemes have three key problems: (i) they rely too heavily on commercial banks lending to sectors of the economy that they do not usually lend to; (ii) they are overburdening SMEs in unsustainable debt; and (iii) they are setting the stage for an implicit bank bailout as borrowers inevitably begin to default on their loans.
- There is scope for the government to lower the interest rates small businesses are paying on state-backed loans. In order to decrease the size of any implicit bank bailout, the government should also make greater use of grants rather than loans and focus on reducing business expenditures.
- The government should take advantage of RBS' low share price to buy the remainder of shares in the bank and transform it into a network of stakeholder banks, to ensure that Britain's economic recovery is not held back by a collapse of lending to productive SMEs, as occurred after the 2008 crisis.
- The impact of covid-19 on public finances will be made more manageable by the Treasury and Bank of England utilising monetary financing. The government should take full advantage of the conditions for direct monetary financing to reduce Britain's debt burden.
- Attempting to 'pay back' monetised debt through austerity would be unnecessary and counterproductive, and could have severe consequences for Britain's economic recovery.

Support to businesses and Financial services

How effective is the Coronavirus Corporate Finance Facility, Coronavirus Business Interruption Loan Scheme, and the Coronavirus Larger Business Interruption Loan Scheme? In particular, are these measures succeeding in preventing viable businesses from potentially going under during the Coronavirus lockdown?

- 1. The government's borrowing schemes currently appear to favour large corporates while failing to meet the needs of SMEs. Policymakers must address significant shortcomings with the Covid Corporate Financing Facility (CCFF), and consider changes to the support offered to smaller businesses to prevent debt burdens hindering economic recovery.**

The Covid Corporate Financing Facility (CCFF)

1.1 The Covid Corporate Financing Facility (CCFF) has a number of significant shortcomings. It offers Britain's biggest corporations privileged access to funding directly from the central bank at considerably more generous terms than those offered to smaller businesses. Despite such favourable terms, the scheme lacks transparency and does not impose any social or environmental conditions on participants, making it inconsistent with the government and Bank of England's pledges to 'build back better'.

1.2 Investment grade companies (in practice around 300 of the UK's biggest firms) are able to access up to £1bn of public money at extremely low interest rates, estimated at around 0.3-0.7%. Meanwhile, the rest of the country's businesses, including SMEs, are faced with interest rates between approximately 2 to 8% higher under the government's other emergency lending schemes administered by commercial banks.¹

1.3 As of 24 June 2020, 63 companies have £18.596bn outstanding in commercial paper via the CCFF. Due to a lack of conditions attached to these loans, beneficiaries have gone ahead with dividend payouts and worker layoffs. For example, BASF went through with a €3 billion dividend payout to shareholders after

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<https://www.telegraph.co.uk/money/consumer-affairs/small-businesses-spend-twice-much-much-using-wrong-government/>

having received £1 billion from the CCFF. Further, 39% of CCFF companies have announced large-scale redundancies, totaling approximately 34,000 UK jobs.

1.4 The CCFF also lacks environmental conditions while providing support to high-carbon sectors, including airlines, car manufacturers, and oil and gas companies. Analysis from ESG consultancy AG suggests that more than 6.9 billion trees would need to be planted to sequester all of the carbon emitted by CCFF companies in the 2018/19 reporting year - a feat which would require covering an area three times the size of the UK with trees capable of carbon storage.² Further, only 19% of companies using the CCFF have disclosed accurate statistics for carbon emissions, energy, water and waste.

1.5 Lastly, despite the CCFF's use of public money, it is lacking in transparency, insulating the scheme from public scrutiny. For example, neither the Bank nor the Treasury have published a comprehensive record of total amounts borrowed by each company since the start of the scheme, nor have they provided the public with information on how loan amounts are being agreed upon. This lack of transparency is deepening issues of democratic accountability and legitimacy at the Bank of England.

1.6 For more information on the issues with the CCFF, and recommendations on how to address them, please refer to a draft version of Positive Money's upcoming report on the scheme:

<https://positivemoney.org/wp-content/uploads/2020/06/The-Covid-Corporate-Financing-Facility.pdf>

Coronavirus Business Interruption Loan Scheme (CBILS), Coronavirus Larger Business Interruption Scheme (CLBILS) and the Bounce Back Loan Scheme (BBLs)

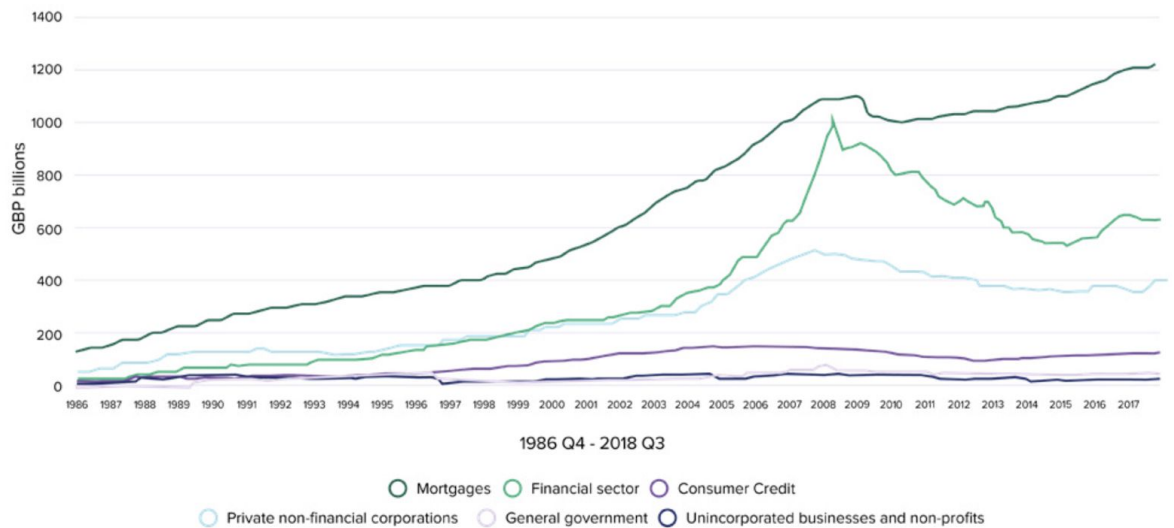
1.7 The government's other emergency lending schemes - the Coronavirus Business Interruption Loan Scheme (CBILS), Coronavirus Larger Business Interruption Scheme (CLBILS) and the Bounce Back Loan Scheme (BBLs) - have another set of shortcomings. We outline three key problems: (i) they rely on commercial banks lending to sectors of the economy that they do not usually lend to; (ii) they are overburdening SMEs in unsustainable debt; and (iii) they are setting the stage for an implicit bank bailout as borrowers inevitably begin to default on their loans.

1.8 First, by excessively relying on commercial banks to administer emergency lending to businesses, the government's schemes were doomed to failure from the beginning. Figure 1 shows that over the past three decades, banks have increasingly favoured lending into property and financial markets rather than businesses. Before the pandemic, approximately three quarters of outstanding loans from UK banks were in real estate and the financial sector. Given banks' aversion to business lending in normal times, it is hardly surprising that they approved only a small

² <https://agsvs.uk/ccff>

proportion of emergency loan applications and sought excessively high interest rates and personal guarantees.³ Therefore, over-reliance on commercial banks was the first key flaw of the government's lending programmes.

Figure 1: UK monetary financial institutions' loans outstanding by sector/activity⁴



1.9 Second, in focusing on loans, the government's schemes are overburdening businesses with debt at a time when their revenues are taking an enormous hit.⁵ As a result, many borrowers may prove unable to repay these loans. For example, banks have estimated that 40 to 50% of borrowers from the Bounce Back Loan Scheme may have to default on their emergency loans.⁶ A City taskforce has estimated that overall £36bn of emergency loans could go unpaid by borrowers.⁷ To ease the debt burden that businesses are facing as they emerge from the current crisis, the government should at the very least consider lower interest rate caps on emergency loans. For example, in Switzerland small business loans are interest-free, with interest on loans above 500,000 Swiss Francs (£420,000) capped at 0.5%.⁸ In the UK, only the biggest corporations are currently benefiting from such low interest rates (see paragraph 1.2), while interest rates on loans to the smallest businesses are capped at 2.5% under the BBLs. However 2.5% is higher than many of the rates banks are charging for mortgages, and therefore an unreasonably high rate for 100% guaranteed loans that carry zero risk for the lender. Further, under CBILs, interest

³ <https://www.bbc.co.uk/news/business-52043896>

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<http://positivemoney.org/wp-content/uploads/2020/05/Positive-Money-Tragedy-of-Growth-Digital-Single-Pages.pdf>

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<https://www.scotsman.com/business/coronavirus-businesses-forecast-substantial-revenue-hit-three-ten-consider-job-cuts-2505412>

⁶ <https://www.ft.com/content/8a551c37-2de8-446b-a8b8-d4a61d33ef73>

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<https://www.theguardian.com/business/2020/jun/07/36bn-of-government-backed-loans-will-be-toxic-taskforce-warns>

⁸ <https://www.admin.ch/gov/en/start/documentation/media-releases.msg-id-78572.html>

rates remain as high as 8.9%.⁹ Going further, the government should consider a heavier focus on grants,¹⁰ as well as policies to reduce small business expenditures, including freezes and write-downs on rent and debt payments.¹¹

1.10 Third, loans issued under these schemes are either 80% or 100% guaranteed by HMT. This means that if businesses default, the government will bail out their creditors with public money. HMT has offered £330bn in government-backed loans, which if 80% of the value is guaranteed, would mean it is offering to pay up to £264bn to banks if loans fail. As of 21 June 2020, banks have so far lent £10.53bn through CBILS, which means that the Treasury is currently liable for up to £8.424bn.¹² If banks are correct in estimating that up to half of BBLs borrowers could default, this would leave the Treasury with a £14bn tab due to the banks just to cover losses from this single scheme so far. This further strengthens the case for an entirely different approach - relying less on commercial bank lending - to supporting businesses in times of crisis.

1.11 The question of how we get money to businesses does not only apply to the current emergency phase of the crisis, but also to the recovery phase. Britain's long-term economic recovery from the coronavirus pandemic may be held back by banks' unwillingness and inability to lend to small businesses producing goods and services. After the 2008 crisis, bank lending to non-financial companies collapsed in the UK (see figure 1), whereas countries with strong stakeholder banking networks, such as Germany and Switzerland, saw their local banks step-up lending.¹³ The fact that Britain's banking system is particularly poor at providing funds to productive enterprises is a significant factor in explaining why the British economy has fared so poorly in comparison to other countries' in the years since 2008.

1.12 Buying the remainder of RBS could provide a long-term solution to the difficulty of getting money to businesses. Under full public ownership, the government could use RBS as a vehicle to establish a network of stakeholder banks which are able to build relationships with small businesses and would be well-placed to support local economies.¹⁴ Doing so at the historically low share price (currently around 120p per share, less than a quarter of the 502p per share the government paid in 2008) would cost less than £5bn, representing strong value for money.

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<https://www.telegraph.co.uk/money/consumer-affairs/small-businesses-spend-twice-much-much-using-wrong-government/>

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<https://positivemoney.org/2020/03/more-private-debt-isnt-the-solution-this-crisis-calls-for-bold-measures/>

¹¹ https://www.ippr.org/files/2020-05/1589291707_who-wins-and-who-pays-may20.pdf

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<https://www.gov.uk/government/collections/hm-treasury-coronavirus-covid-19-business-loan-scheme-statistics>

¹³ https://neweconomics.org/uploads/files/141039750996d1298f_5km6y1sip.pdf

¹⁴ https://neweconomics.org/uploads/files/CONTROL-OF-RBS_BULLETIN_E.pdf

Economy, public finances and monetary policy

What will be the impact on the public finances?

- **What are the potential future implications for tax and spending?**
- **What are the implications for the Government's "levelling up" agenda announced in the Budget/infrastructure strategy?**

What will be the impact of high levels of Government debt on market interest rates, private investment, capital formation and future productivity?

- 2. The impact of covid-19 on public finances will be made more manageable by the Treasury and Bank of England utilising monetary financing. During the coronavirus crisis quantitative easing (QE) has served as an indirect form of monetary financing, and the Bank of England has offered to undertake direct monetary financing through the government's Ways and Means 'overdraft' facility at the central bank. The government should take full advantage of the conditions for monetary financing to reduce Britain's debt burden. Especially with the right institutional checks, there is little reason to fear excessive inflation or other adverse effects. Attempting to 'pay back' monetised debt through austerity would be unnecessary and counterproductive.**

2.1 'Monetary financing' refers to various arrangements where the central bank's power to create new money is used to support public spending. Typically it involves the central bank 'monetising' government debt by exchanging it for newly created money and holding the debt permanently on its balance sheet. Policymakers have used monetary financing as an effective tool to manage extraordinary spending commitments throughout history, such as those incurred by wars and public investment programmes. In the UK the existence of monetary financing has actually been the norm rather than the exception. In the 20th century, forms of monetary financing were used extensively to fund spending in both World Wars, and the Bank of England continued to absorb a large proportion of public debt (at times more than a quarter) throughout the post-war period until the 1990s (with a notable exception of 1974-1988, a period of high inflation).¹⁵

2.2 QE is an indirect form of monetary financing, which involves the central bank buying up government debt from the secondary market with newly created money. The Bank of England bought up £435bn of government bonds (gilts), in addition to £10bn of corporate bonds, through QE between 2009-2016. Since the covid-19 outbreak the BoE has announced a further £300bn of QE purchases - of which £290bn will be gilts and £10bn corporate bonds. As a publicly owned central bank,

¹⁵ <https://www.ucl.ac.uk/bartlett/public-purpose/sites/public-purpose/files/iipp-wp-2018-08.pdf>

the bonds bought by the Bank of England sit on the public sector's consolidated balance sheet - meaning the government effectively owes the debt bought up by the BoE 'to itself', rather than private creditors.

2.3 The BoE has typically justified QE as a means of pushing down interest rates to stimulate the economy by encouraging lending and spending.¹⁶ But by lowering interest rates primarily on government debt, QE also makes it cheaper for the government to borrow. This is something the government had refrained from taking advantage of before the coronavirus crisis, instead trying to reduce public borrowing through austerity. Nevertheless the Office for Budget Responsibility suggests that the first £435bn of QE has reduced the debt burden by £18.2bn on aggregate.¹⁷

2.4 £200bn of QE was announced the day before the Treasury announced plans to pay 80% of private sector wages, indicating that it was coordinated to help keep borrowing conditions easy for such a huge fiscal expansion. Indeed, the chief executive of the Debt Management Office has suggested the government would have struggled to pay for its lockdown rescue package without the BoE's expansion of QE.¹⁸ The £190bn of new BoE gilt purchases neatly covered the £180bn the government seeks to borrow between May and July.¹⁹

2.5 Previous rounds of QE have been distanced from monetary financing by the BoE's insistence that they are purely monetary policy operations attempting to push down real interest rates in the private sector. However in its March announcement, the Bank for the first time added deteriorating conditions in the UK gilt market among its reasons for expanding QE, suggesting that the purpose of asset purchases is to support the government's ability to borrow.²⁰ The BoE maintains that QE is not monetary financing because it is temporary and will be reversed, in that the government debt will be sold back to the market.²¹ However governor Andrew Bailey has since acknowledged that QE is being used to help the government finance public spending.²² Moreover, the fact not a single pound of QE has yet been reversed, means that for all intents and purposes, the Bank of England has effectively monetised a large proportion of government debt.

¹⁶ <https://www.bankofengland.co.uk/monetary-policy/quantitative-easing>

¹⁷ https://obr.uk/docs/dlm_uploads/Direct_fiscal_consequences_of_unconventional_monetary_policy.pdf

¹⁸ <https://www.thetimes.co.uk/article/bank-of-england-rode-to-government-s-rescue-as-gilt-markets-froze-w8dkqvvg>

¹⁹ <https://www.gov.uk/government/news/hm-treasury-announces-revision-to-the-uk-debt-management-offices-financing-remit-2020-21>

²⁰ <https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2020/monetary-policy-summary-for-the-special-monetary-policy-committee-meeting-on-19-march-2020>

²¹ <https://www.ft.com/content/3a33c7fe-75a6-11ea-95fe-fcd274e920ca>

²² <https://www.ft.com/content/ad63e45c-ad55-41a2-ae2e-8d550ff0ac92>

2.6 QE represents an 'indirect' form of monetary financing, as the Bank of England is buying gilts from the secondary market, rather than from the government itself. The BoE buying gilts at market price from bondholders means a significant subsidy to the financial sector - the so-called 'auction concession'²³ - with the OBR suggesting the market value of the first £435bn of QE purchases was £62.8bn greater than the nominal value bondholders originally paid for them.²⁴ This means a £62bn opportunity cost to the public purse from monetary financing being carried out indirectly rather than directly. The Resolution Foundation also suggests that there will be a £30bn cost to the additional £200bn of QE announced in March, based on this same difference between the market and nominal value of bonds purchased.²⁵ This could mean a cost of around £105bn to the Bank of England going through the secondary market for its total £725bn stock of gilts, a figure which would only increase with further rounds of QE.

2.7 The costs associated with quantitative easing could be avoided by more direct forms of monetary financing. The two main mechanisms through which this could be done are gilt purchases from the primary market or use of the government Ways and Means facility at the Bank of England. In going through the primary market, the BoE would use QE to buy gilts directly from the Treasury's Debt Management Office, which would mean newly created money going straight to the government's account, as opposed to via financial intermediaries on the secondary market. The need for such primary market operations has however been forestalled by the Bank of England extending its 'Ways and Means' advance to the government in response to the developing coronavirus crisis, offering an even more direct means of monetary financing which cuts out unnecessary intermediaries.²⁶

2.8 The Ways and Means, which dates back to the central bank's founding in 1694, is the government's 'overdraft' with the BoE, in which the Bank credits the government's account directly with newly created money. As figure 1 shows, the government regularly took advantage of the Ways and Means up until the turn of the millennium, at which its balance was frozen at £13.4bn until the 2008 crisis, when £20bn was created for the bailout of Bradford & Bingley. The Ways and Means was extended to an effectively unlimited amount in April 2020, but the government has not yet taken advantage of this, with the size of its outstanding balance remaining flat at £370m since 2009.²⁷

²³ <https://www.bis.org/publ/work571.pdf>

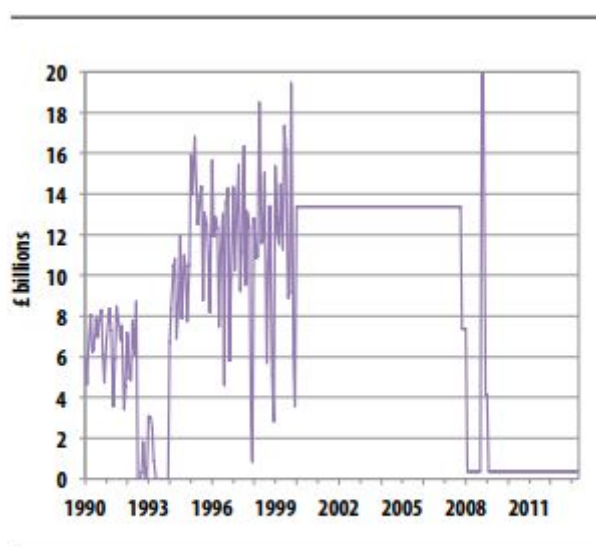
²⁴ https://obr.uk/docs/dlm_uploads/Direct_fiscal_consequences_of_unconventional_monetary_policy.pdf

²⁵ <https://www.resolutionfoundation.org/app/uploads/2020/04/Doing-more-of-what-it-takes.pdf>

²⁶ <https://www.bankofengland.co.uk/news/2020/april/hmt-and-boe-announce-temporary-extension-to-ways-and-means-facility>

²⁷ <https://www.bankofengland.co.uk/boeapps/database/fromshowcolumns.asp?Travel=NixAZxSUx&FromSeries=1&ToSeries=50&DAT=RNG&FD=1&FM=Jan&FY=2009&TD=31&TM=Dec&TY=2025&FNY=Y&CSVF=TT&html.x=66&html.y=26&SeriesCodes=RPWB72A&UsingCodes=Y&Filter=N&title=RPWB72A&VPD=Y>

Figure 1 - Ways and Means Advance to HM Government (£ billions) ²⁸



Source: ONS

2.9 A common criticism of monetary financing is that it would be inflationary. However, such concerns are inconsistent with empirical evidence and are usually based on flawed understandings of the monetary system. The link between money creation and inflation is not as tight as is commonly believed. Inflationary pressures depend on a variety of factors, including the spending patterns of households, changes in the economy's output, and distributional conflicts between employers and workers. Empirical evidence shows that inflation is rarely caused by increases in the money supply,²⁹ and in advanced economies like the UK, there is no causal relationship between monetary financing and inflation.³⁰ Despite the Bank of England's QE programme following the 2008 financial crisis, inflation has remained low, often even below the 2% target. As explained by a member of the Monetary Policy Committee, the Bank's recent decision to expand its QE programme by £200bn was deemed necessary to avoid falling even further below the inflation target.

2.10 In the current crisis, all of the signs so far (such as recent CPI figures and plunging oil prices) suggest that deflation rather than inflation is the bigger danger presented by the coronavirus crisis. The Bank of England's own projections indicate

²⁸ <https://positivemoney.org/wp-content/uploads/2013/11/Sovereign-Money-Final-Web.pdf>

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<https://www.ineteconomics.org/perspectives/blog/rapid-money-supply-growth-does-not-cause-inflation>

³⁰ <https://www.ucl.ac.uk/bartlett/public-purpose/sites/public-purpose/files/iipp-wp-2018-08.pdf>

below-target inflation for the next two years.³¹ Further monetary financing may therefore be necessary for the Bank to reach its 2% inflation target.

2.11 Like any form of spending, monetary financing may be inflationary if it does not generate productive output or reduce debt burdens. The phenomenon of ‘too much money chasing too few goods’ will not appear if the newly-created money is facilitating the production of new goods and services, or reducing debt burdens as monetary financing would particularly help do during the coronavirus recovery phase. Especially with the right institutional checks in place, namely making sure that the BoE’s Monetary Policy Committee ultimately retains authority over the method and amount of monetary financing, there is no reason to fear excessive inflation.

2.12 Like any form of financing, monetary financing is not without costs. By keeping interest rates well below inflation, monetary financing suppresses real yields on financial assets, and effectively acts as a ‘tax’ on asset wealth and speculative rentierism. In doing so monetary financing allows the costs of increased public spending to be borne primarily by the wealthiest in society, which is more equitable than forcing workers on lower incomes and more productive sectors of the economy bear the costs through higher taxes.

2.13 Monetary financing is often deemed unnecessary on the basis that government debt is debt we ‘owe to ourselves’. Indeed around a quarter of government debt is held on the public sector balance sheet precisely because the Bank of England has been absorbing it through QE, a form of indirect monetary financing. It is also true that many households will be invested in government debt through their pensions, with around a third of gilts held by insurance companies and pension funds.³² But like with any asset ownership, the distribution of pension wealth is highly unequal, with nearly half of private pension wealth being held by the top 10% of households.³³ The other major owners of government debt are overseas investors, meaning that a large chunk of debt repayments are going to wealthy bondholders outside of the UK. As public sector debt is predominantly owned by the wealthiest in society, it is therefore more useful to think of this not as debt we ‘owe to ourselves’ but debt owed by the general public to wealthy households. To avoid a transfer of wealth through interest payments from the public purse to private bondholders, the Bank of England should buy a larger proportion of public debt. If the government does not take advantage of monetary financing to minimise debt costs and instead pursues austerity, wealthier households which gain from interest payments will benefit, while poorer households,

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<https://www.bankofengland.co.uk/-/media/boe/files/monetary-policy-report/2020/may/monetary-policy-report-may-2020.pdf>

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https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/785550/debt_management_report_2019-20_final_web.pdf

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<https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/bulletins/pensionwealthingreatbritain/april2016tomarch2018>

who own little or no savings but pay a higher proportion of their incomes in tax, will see net losses.³⁴

2.14 The government has currently pledged to repay any drawings from the Ways and Means “as soon as possible before the end of the year.”³⁵ Doing so is not only unnecessary, with historical experience showing that states are able to keep debts monetised for long periods of time, but could also be counterproductive to any recovery, especially if achieved through austerity. Attempting to ‘pay back’ the Bank of England through austerity would be extremely ill-advised at a time when the private sector’s balance sheet is also contracting as private debts are repaid and aggregate demand has collapsed, and could lead to a debt deflationary spiral into a severe depression.

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<https://leftfootforward.org/2018/11/debt-disaster-how-the-budget-will-stuff-more-money-into-the-pockets-of-the-financial-sector/>

³⁵<https://www.gov.uk/government/news/hm-treasury-and-bank-of-england-announce-temporary-extension-of-the-ways-and-means-facility>