“Who is in charge of economic policy?”

We are indebted to Sir John Redwood MP for his thoughts on the role and function of an independent Bank of England within a democratic framework which he provides in an exclusive interview with CIBUK.

There has been a worrying tendency for the political class to offload responsibility for mistakes in monetary policy onto the Bank of England. But as Sir John points out the Bank is wholly owned by the State. Ultimate responsibility for its remit lies with Parliament. Any confusion which may have arisen needs urgently to be addressed if future mistakes in monetary policy are to be avoided.

We are delighted to share Sir John’s thoughts on the matter in his interview with us which we provide in full below.

INDEPENDENCE WITHIN A DEMOCRACY

By the Rt. Hon Sir John Redwood MP

I have two major frustrations listening to so many MPs and establishment figures about inflation. They tell me the Bank of England is independent when the Bank says it is not in many crucial respects. They refuse to engage in any conversation that might criticise the Bank for inflation soaring to more than five times its target for price rises though they think the Bank is responsible for delivering the 2% target.

The Bank of England is 100% owned by the state. Its Governor is chosen by the government, and he answers to both the Chancellor in private and to Parliament in public for his conduct and policy. George Osborne as Chancellor chose a

Governor who backed his economic and political strategy.

The Bank became strongly Remain when the country was deciding whether to be Remain or Leave, backing the partisan position of the Chancellor and some other Ministers. The Governor took the Bank into advocacy of green policies without a change of the Bank's statutes, again reflecting the wishes of the government.

Gordon Brown as Chancellor gave the Bank the sole power to set the Bank rate and called this making the Bank independent. At the same time, he took away crucial powers to regulate commercial banks and to influence government debt issuance. Arguably the Bank was less independent overall after his changes.

In 2009 the great banking crash led the Bank to want to conduct money policy by creating more money and buying government debt to drive down longer-term interest rates, as well as just cutting the Bank rate. The Bank decided it did not want to be independent when doing this and agreed that all such activities needed the express written consent of the Chancellor. The Bank also insisted on a government guarantee against any losses on owning and selling the bonds and said that it acted as the agent of the Treasury when dealing with the bond portfolio.

As money creation and bond buying became the main tool of money policy it is simply wrong to say the Bank followed an independent money policy after 2009. The Treasury/Bank agreed policy added £895bn of assets to the Bank's balance sheet and set taxpayers up for possible large losses as soon as interest rates rise. When rates rise bond prices fall.

Of course, government and Parliament needed to be the ultimate arbiters of £895bn of bond buying, as these sums dwarfed the extra amounts Chancellors spent at annual budgets. The Bank of England is sitting on unrealised losses that far exceed its stated capital but it is happy to do so knowing taxpayers will repay it as the losses come in. All this makes it more perplexing why there is such a deafening silence between the political parties over the estimated £100 bn plus of losses for the next five years, and over how the Bank came to allow double figure inflation.

The Bank, the government and most politicians say the Bank is solely responsible for inflation because it alone has the power to settle Bank rate. It can use that to create a boom or a recession, higher inflation or lower inflation. It is lurching from an asset boom and high inflation to recession in a desperate bid to get the inflation down.

Those of us who warned that the last £150bn of money creation in 2021 was likely to prove inflationary have never been given a proper answer as to why the Bank thought we were wrong. The Bank largely blames the Ukraine invasion and energy market disruption for the inflation, ignoring the fact that inflation in China, Japan and Switzerland stayed much lower despite their need to import plenty of dear energy. It also needs to explain why UK inflation hit 5.5%, 175% above target, before the invasion.

The UK should have an honest debate of how inflation took off. More need to be open to the idea that money policy allowed too much money to chase far too few assets, first creating a bubble in bonds and properties, only to be followed by a more general inflation as more money washed out of asset markets. I am not proposing taking away powers from the Bank of England, but do want some wider understanding of just how the Bank fits into Treasury policies so we can try to avoid the boom/bust mistakes in the future.

For now my advice to both is they have done enough to bring inflation down and do not need further rate rises. The Bank should reduce its bond holdings as they are repaid, but should not accelerate the process by selling into the market. The

Treasury does not need a swelling bill to pay losses from market sales that do not need to be undertaken. The largest financial commitment the new government has put through Parliament is to pay £11 bn to the Bank for losses by March! They should agree to stop this drain on taxpayers.

Meanwhile the government does need a budget for growth. The UK lacks capacity of many kinds from water to energy, from food to steel. Controlling long term inflation will be greatly assisted if we have a budget for growth which helps put in all the extra capacity we need. As the world scrambles towards protectionism and home production, the UK needs to offer the tax incentives and the sensible regulation to attract and retain major investment in making and growing things we need.

By the Rt. Hon. Sir John Redwood MP, 6 Feb 2023

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CIBUK thanks Sir John Redwood for his permission to republish this article.

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