

Not all pounds are born equal, and it is time that we a...

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Something strange is happening in discussion about money, debt, interest and monetary policy. I would almost say that there are signs that the debate is growing up, based on my reading of a number of articles this week.

Gillan Tett in the FT frames this. [As she notes](#), in August we will mark the 50th anniversary of the USA coming off the gold standard. It's an event that had seismic consequences, and it is still remarkably little understood. Fundamentally, it changed the view of the state. Instead of the state relying on a third party - gold - to give the money it issued value it said that its promise alone was good enough to achieve that goal. It simultaneously claimed that it was capable of being trusted to manage the resulting responsibility to manage the money supply, the value of money, and its availability in the interests of all. Those were big claims. Although Tett thinks they might change again in the next fifty years - and she clearly sees crypto as the source of that threat - I cannot agree. I do not see the state retreating from this monetary claim for sovereignty, which now underlines a great deal of its basis for the claim that it has the ability to govern.

But in that case, as [Brendan Greeley argued in the FT](#), the state really does have a duty to understand money better than it does. His argument is relatively straightforward. First, he says that there is a great deal of money in the world, much of which has little apparent use as it is simply conglomerating in massive cash piles. This is a [point the IMF also made recently](#) when they noted the adverse consequences of this for monetary policy. Second, he acknowledges that much of this money is bank made (albeit under licence from the state), saying:

The Federal Reserve doesn't manufacture all the dollars in the economy. Anyone who makes a new loan makes new dollars. When you borrow — to buy a house or a car — the lender creates brand-new dollars, then hands them to you in return for a promise to get them all back with interest. When there are more loans, there are more dollars. When borrowers pay down their loans, there are fewer dollars.

That, of course, is a modern money understanding of the way banking works. It's also now indisputable.

Third, and critically, he then notes that Fed-created money is different. In particular, he is referring to the central reserves created by the quantitative easing (QE) process. The central bank reserve accounts that are created as a result of this are held by the clearing banks with the Fed (in the UK with the Bank of England, in an identical process). But what he, correctly, notes is that this Fed-created money - and there are now trillions of dollars of it and in the UK in excess of £800 billion of it - might be denominated in dollars (or sterling) but they are simply not the same thing as bank-created money. That's not least because there is literally nothing that the banks can do with this money except pass it between themselves as a means of payment which ensures bank solvency in the event of another crisis. They can't redeem this cash, offload it, or destroy it unlike other money, so to call it money like all other balances makes no sense.

Simon Wren-Lewis has made the same point, but does so in the context of interest rate policy, where he argues that there is absolutely no reason why the Bank of England, Fed or any other central bank need pay base rate on these central bank reserve accounts that central banks have themselves created and given to clearing banks. His argument is one that I have used a number of times here before now, which is that in practice whatever happens to base rates interest rates on these central bank reserve accounts can stay fixed at 0.1% or even be 0% if the Bank wanted, and there is nothing the clearing banks can do about it.

Simon links to an article by Irish economist [Karl Whelan](#) when doing so. Karl makes the point that:

I've always been uncomfortable with the labelling of central bank reserves as liabilities. Yes, in recent years, central banks have chosen to pay interest on them but they get to choose that interest rate and it can be zero if they want it to be. These are not debts that look like a normal person's debts.

That is correct, and it needs to be appreciated by government and central banks (in fairness, the Bank of Japan and ECB do seem to get this point: it is the UK and USA that do not). These reserves are simply not debt.

What this means for interest rate policy is an issue I will look at in another blog. The IMF already think world cash balances basically destroy the effectiveness of that policy. I agree with Simon Wren-Lewis and Karl Whelan that central bank reserves are neither debt nor money as such. And I agree with Brendan Greeley that there is a cash mountain floating around the world unproductively that the corporate sector, that is in possession of a large part of it, has literally no idea what to do with.

What does this all mean? It means that we are living in a world where not all pounds,

dollars, euros, yen or whatever are equal. How they came into being makes a big difference to what they are and what interest rate should be used on them, and whether they should be considered as debt, or not. This is a theme of a paper I will be issuing very soon. But what that also means is that if this power to create and manage money is to be properly used - and it is essential that it is - then this has to be understood and I do not think that is the case. I know that because the world's central banks still think they can change a single interest rate and that this will result in a transmission effect flowing through the economy to change the way in which people think and behave. But that is not true.

The IMF have noted that the world's largest companies are exempt from this because they have their own cash hoards.

Dan Davies in [the Guardian](#) has noted that the transmission mechanism with regard to housing is creating considerable distortions in society that may not be sustainable.

[Gertjan Vlieghe in his retirement speech from the Bank of England](#) monetary policy committee has noted that there are so many feedback loops from the financial economy around demographics, debt and income distribution now that raising interest rates may be nigh on impossible and poses a fascinating range of questions as a consequence.

Govenments have reserved for themselves the right to make money. Now they really have done just that. But in the process they have, it seems, lost control over the ability of cash to be destructive, and they have lost control of interest rates in the way that they at least once thought they had.

It is welcome that this need for deeper understanding to regain control is being appreciated now. It is to be hoped that central banks get the message.