Funding the Future

The missing X

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I was interviewed by Henry Bonsu on Times Radio after ten last night. He wanted to talk about this week’s Twitter threads from me and why I thought that the government and Bank of England had got so much wrong when it came to inflation.

I explained that after thirteen times doing the same thing and not getting the result that was desired you should imagine any sensible person standing back and asking “what are we missing here?” My suggestion to Henry was that the fact that this is not happening at the Bank of England is in some ways one of the most worrying aspects of this whole fiasco.

He was curious as to why it is that is not happening. I did, in effect, quote Upton Sinclair when answering that question. Sinclair said “It is difficult to get a man to understand something, when his salary depends on his not understanding it.”

But it is worse than that. The Bank of England has had to admit before now that almost everything it thought about banking, how banking worked and how money is created within the banking system, was wrong. They did this in 2014 when they were forced to admit that bank lending creates new money, and so deposits, and it is not bank deposits that fund loans. Doing so they had to quite explicitly admit that everything text books had said about banking was wrong and needed to be rewritten.

I think that is also true on the causes of inflation now. Most of what the Bank thinks it knows about inflation - that it is created by excess demand caused by wage settlements that are too high - is simply wrong and does not fit with the evidence of the current experience of inflation.

However, as I explained, the Bank is not paid to think, let alone to admit that it has got things wrong. The Bank is paid to do. And what the already painful experience of the Covid Inquiry is revealing is that those in charge are those who ‘do’, unquestioningly. I am sure that is the case at the Bank.

Henry then asked what I had done. I said I had simply thought about the issue. I sat back, keyboard in front of me, and thought that there had to be a ‘missing X’ in the inflation equation that might explain why continual increases in interest rates were not bringing the UK inflation rate down. All I really did was ask “what is the missing X?”

The answer then stared me in the face. The missing X is the fact that because of the current structure of the UK economy interest rate rises not only could not bring inflation down as the Bank wants, but could in all likelihood be forcing inflation upwards. We have now reached the point where increasing the price of money is in itself inflationary.

I have, I suspect, been close to this position for some time. I just happened to put it in Twitter threads this week, and they have been widely read, not least by journalists.

Am I right? Theoretically I think I am: the case I have made is logical and fits the facts. It’s a good theory.

Can I prove it? Not yet, is the honest answer. We’d need some rate cutting from the Bank to do that.

Is that rate cutting likely right now when those in power have all their credibility invested in status quo thinking, meaning that they are dedicated to interest rate rises? I think that makes those cuts unlikely, as yet. I fear that we will have the disaster that they are promising us first of all.

But I think my argument holds that if what you are doing is not working, and it clearly is not, and what you are doing as a result is to deliberately stoke fear of ruin for millions and recession for all in the UK then there must be a better option than the one that the Bank is using right now.

So, in the first instance I suggest that the Bank do nothing. They should take the option of doing no more harm, in other words.

And then they should begin to reduce fear. In other words, they should choose to do good by cutting rates.

When doing harm hasn’t worked, why not try doing good instead? I think that’s a pretty good question to ask. And I have laid my reasoning out for all to see. I just wish it would happen.