

# Funding the Future

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I took some time off writing over the weekend. That did not stop me musing. One strand of thought was on central banks, or rather the failure of the model of central banking that we now have.

Since the 1990s in the UK, and at various times before and slightly afterwards elsewhere, pressure brought to bear on governments by neoliberal economists of a monetarist persuasion was used to secure the supposed 'independence' of central banks from central government control.

Various arguments used to support this policy initiative. The worst (from my perspective) was that it took interest rate settings out of the political arena and gave control of it to central bankers instead. The idea that that were in any way apolitical is, of course, absurd. They very clearly all have pro-wealth agendas to run, but such policies are apolitical in the neoliberal lexicon, and so did not count in the opinion of those proposing this policy or defending it ever since. Bias towards the wealthy and against those who worked was hardwired into the system as a result.

Then there was the fact that this policy split control of economic policy as a whole. It was claimed that monetary and fiscal policy were different issues and that they could be managed independently of each other. Government could have fiscal policy and the central bank monetary policy and mysteriously, and without explanation as to how, co-ordinated policy initiatives were still meant to happen.

They did not, of course. Instead what happened was that, as neoliberal economists expected, government was put under pressure to never increase a tax rate meaning that fiscal policy was effectively neutered, and monetary policy become predominant. This was another remarkably useful outcome for those with wealth. No policy measure now impacted them: the economy was to be managed via unemployment and the imposition of misery on those who had to borrow.

Perhaps more importantly, central banks like the Bank of England here in the UK were given just one policy objective to fulfil. They were told to control inflation without having to take any other matters, such as full employment, into account. Nothing was better designed to deliver boom and bust.

And then there was the issue that the only policy tool given to central banks was control of the interest rate, which remains the case despite the introduction of QE because that takes place only with the permission of the Treasury in countries like the UK.

Using the interest rate to control inflation might have been a useful tool if there was any evidence that it worked. The slight problem with that is that there is no such evidence.

For a long time that did not matter. By the time the model of central banking we have now had for around 25 years was up and running the risk of inflation had largely disappeared from the economy. That was largely because of the impact of the emergence of China on the world economy that over two decades reduced inflationary pressure to close to zero. That had nothing to do with central banks or central bankers, but they felt omnipotent nonetheless.

Even two major crises in 2008 and 2020 did not rock that confidence. Instead they became masters of the universe, creating money out of thin air as if this was some new trick, when it was not. But it did just increase their sense of importance.

And then came inflation. It was not the sort of inflation they had been taught about and which they thought Paul Volcker had shown how to manage in the early 80s through his brutal imposition of recession on the US economy.

That type of inflation, for which they thought they were prepared, was the result of excess domestic demand chasing too little domestic production.

Instead the inflation we got was because of external shocks, supply chain disruption, commodity market profiteering and corporate profiteering, all taking place against a background where households already stressed by low earnings and debt servicing could take little more financial punishment, but were asked to do so nonetheless.

Nothing in the central banking textbooks allowed for this. And since central bankers have all been taught to think alike none had the ability to imagine what was really going on, let alone work out how to deal with it. Instead they assumed that we must have the only type of inflation that they had been told existed, and so responded as they had been taught to do, and raised interest rates.

Again.

And again.

And again.

The trouble is that this has not worked. Inflation is not falling as their theory said it must. There are three reasons.

First, inflation was not of the sort central bankers imagined. Inflation caused by external factors was never going to respond to domestic policy measures.

Second, the driver of inflation was not wages but interest rate policy was solely designed to impact on wages and net household incomes. The prescription missed the cause of the malaise as a result.

Third, the supposed art of managing interest rate expectations, which justified the continuously rising rates (using the logic “do as we say or the beatings will continue”) does not have any impact on the short term speculations of commodity traders and corporate entities that can use price confusion to increase their profit margins, potentially in the losing term.

Unsurprisingly, if you use the wrong tool and target it on the wrong people, and do both these things to target a type of inflation that you are not suffering from then the policy does not work. That is what is happening in the UK and elsewhere.

So what should be done?

First, rate increases should first stop and then fall. That should be obvious by now. If the policy is not working but is causing harm the policy is obviously wrong and should be reversed.

Second, central banks should be brought back under state control. That should be obvious by now. The democratic deficit implicit in the independent central bank model must be removed.

Third, there must be a clear out of central bankers. The wrong people, with the wrong training and the wrong mindset are doing the wrong job at considerable cost to society.

Central banking is necessary. It should also be very boring, and lack a significant policy component. Policy is a job for government.

Nothing less than a central banking revolution is required now. But at least this revolution has few likely victims and the chance of success is high. That, by itself, is unusual and makes this a good place to start when the required radical transformation of our economy is being considered.