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It is a strange moment when an idea that you have promoted suddenly moves towards the political centre stage, even if Nigel Farage is the person who is doing the pushing.

This happened yesterday when the Reform Party presented its idea to eliminate payments of interest to the UK's commercial banks and other financial services organisations that enjoy the privilege of having a central bank reserve account balance with the Bank of England. As I have noted here many times, the payment of bank base rate on these accounts at one time cost in excess of £40 billion a year, and still costs in excess of £35 billion per annum now.

From 2009 until 2021 the payment of interest at bank base rate on these reserves was a matter of inconsequence because the base rate in question was 0.1%, and the cost was, as a result, immaterial.

Prior to 2009, the cost was immaterial because the balances on central bank reserve accounts were tiny, totalling only about £20 billion in all.

Before 2006, interest was not paid on these balances.

Andy it is important to note that these balances are not, in any significant sense, sums deposited by the banks in question with the Bank of England on a voluntary basis . The balances in question were instead created as a result of deliberate deficit funding of the economy by the government using newly created money that was spent

to manage the consequences of the fallout from the global financial crisis between 2009 and 2016, and to cover the cost of the Covid crisis from 2020 to the end of 2021.

Ignore anything to do with quantitive easing, which was simply a disguise for the fact that the government had created money via the Bank to inject the economy during these periods: these central bank reserve account balances represent the total amount of money that the government did inject during these period to cover the cost of fulfilling its policies.

In total more than £900 billion was injected into the economy in this way, and these balances were recorded by the creation of what were, supposedly, deposits by the commercial bank with the Bank of England.

However, since the banks that benefited did not actually deposit any funds, but instead had these deposit balances created on their behalf by the Bank of England acting on behalf of the government, they represented a windfall to the banks in question.

That windfall turned out to be equivalent of the proverbial golden egg when the Bank of England then began to, quote unnecessarily, increased interest rates to supposedly tackle inflation from late 2021
onwards.

From that time onwards, the good times began to roll for all of the banks as a result of these interest payments, enormously increasing their profits with no action on their part. I noted some of this impact here.

Let me also stress that these balances cannot be used by the banks, except to facilitate payments to each other or to the government. That is their sole purpose. This is what is called base money, and it does not circulate in the rest of the economy. It is, instead, the liquidity that has been provided by the government to ensure that the banking system can function properly by guaranteeing every bank should have sufficient funds to pay each other, come what may. This is, in effect, a practical reaction to the Northern Rock affair. This increase in bank liquidity might have been a side-effect of a necessary government policy to keep the economy going, but it has undoubtedly been beneficial in bailing out under-capitalised banks.

The downside has been it has been enormously costly to the government, and has promoted austerity economics because it has been necessary, over the last three years, to make payment of interest at inflated rates on these balances.

The Bank of England and others now argue that such payments are absolutely essential as a mechanism for the delivery of Bank of England monetary policy because, they claim, the Bank could not influence the rate of interest in the economy unless it had to pay bank base rate interest on these balances. There are numerous reasons for rejecting this argument.

The first of these is that since significant payment on these balances has only been happening for less than three years this claim is completely unsubstantiated. We do not know that this is true in the context of the British economy.

The second is that other central banks, including the European Central Bank and the Bank of Japan, do not make payment on all such balances. They pay interest on a tiered basis, making full payment on part of the balances, but by no means on all of them.

Third , there is the argument that this is a windfall profit if this interest rate needs to be paid, and that in practice it should be subject to a substantial excess profits tax to recover most of that sum paid so that the banks are not unduly enriched.

Fourth, the stench of avarice underpinning the arguments that the banks should be paid cannot be avoided.

As a consequence I have made it clear that I think that the current policy is inappropriate and should be reformed, and nothing has yet changed my mind about this.

That said, I recognise that there may be (and I stress the may) some merit to the argument that interest should be paid on a part of these balances to communicate Bank of England interest rate policy and have therefore accepted some cost might still be involved.

Alternatively, I would be quite happy with a windfall tax to cancel most or all of this gain.

Best of all, I would like a substantial cut in bank base rate, certainly to nothing more than 2% now, which would also significantly ease this problem .

But what I am not convinced by is Nigel Farage’s claim that the entire sum of £35 billion being paid at present can be recovered to fund other spending. That is largely because if this is pure profit to the banks, as it would seem to be, then they do already pay tax on it and so at least £9 billion is already returned to the government, undermining his logic.

Is it, however, true that his logic is fundamentally correct and that these payments are not necessary in total? On this, I have to agree with him. It is unfortunate that he is the person to raise this issue because of his other politics, but the reality is that commercial banks have been enriched in a way that is unjustified, and is unjustifiable, and the time for reform of this policy to radically reduce this cost has arrived. A policy of tiered rates and, most likely, an excess profits tax to recover much of the remaining sum paid would make a lot of sense. Commercial banks should not be enriched by central government money creation, which statement is the beginning and end of this argument.