What would be the consequences of ending Bank of Englan…

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I was asked these questions on the blog yesterday:

* What would be the short-term effects of the BoE losing its independence?
* Would the pound drop?
* Would our credit rating change?
* Would that in itself drive inflation or deflation?

As the commentator said:

* Undoubtedly long term it would be better but I’m curious how such a change would affect money markets.

Those are fair questions, and I think the comments from Clive Parry echo the same sentiments, so let me address them.

In my opinion, by far the biggest adverse reactions to our ending Bank of England independence would come from other central banks, and the European Union.

Dealing with the second of these first, it is currently a requirement of EU membership that a country have an independent central bank. As a consequence, ending the Bank of England's control of monetary policy would prevent our return to the EU, and I obviously see some problems in that. However, given that I suspect that once the UK had reversed its policy on this issue, many other countries would either do the same or wish to do so, I think that by the time any potential return to the EU might arise the possibility of not having an independent central bank might be embraced within the EU construct. And, if it hadn’t, we might need to ask whether restoring Bank of England independence was a price worth paying to return to the EU, or whether a compromise around membership of the Customs Union and Single Market might be a better deal in any event. Given that all these things would take many years, if not decades, to work through, I do not place much weight on this objection.

I am quite sure that other central bankers would raise considerable objections to this proposal. However, the fact that the idea of central bank independence, with the very clear implication within it that politicians cannot be trusted to manage an economy, is a central plank of an anti-democratic neoliberal form of thinking to which all central bankers subscribe cannot be ignored. Of course, they would rally in defence of their colleagues, who they would perceive to be under attack in the UK, simply for the reason of defending their own positions, which would then be seen to be market more vulnerable. The likelihood that once one central bank falls back under democratic control, others might do so is, very obviously, quite high. In that case, of course significant objections will be raised. But my point is a simple one. If the dispute is over the right of a democratically elected government to pursue an economic policy of its own choosing to fulfil its mandate, on what can basis central bankers claim their entitlement to object? Are they, in fact, declaring their opposition to democratic government by doing so? How will that go down? And, will our politicians ultimately give in to their unelected appointees? I suspect not, so I think that in the end, this objection would also fall aside.

The short-term money market reactions are, therefore, more interesting, but I doubt that they would be significantly adverse.

This would most especially be true if inflation was low at the time that the change was made, as is very likely to be the case.

This would also be true if the conflict between the government and the central bank was over growth policy when almost all money markets would support growth. That is because, in their opinion, growth supports the value of a currency. For once, they are likely to be right. If growth increases either the value of trade from a jurisdiction or productivity within it, then the value of its currency invariably increases. If support of this policy was seen to be the reason for ending central bank independence, I would be very surprised if money markets acted adversely to any such change. Explanation would, therefore, be required to support such a change and after, at most, a brief period of uncertainty, I think markets would quickly accept the change, in contrast to what happened after Brexit, for example.

Would our credit rating change as a result? Given the wholly irrational nature of those few agencies who issue credit ratings, whose role in any economy should have been terminated following their disastrous performance during the 2008 global financial crisis, I am tempted to ask why this matters. Saying that, I am, of course, aware that some banking regulation is based upon these rankings, but candidly, anybody who thinks that the risk of default on UK debt would be impacted by such a change when the ability of the UK government to make repayment of sums that it owes would not be altered as a consequence clearly does not understand the way in which government finances operate, and they should have no influence on economic policy as a result. In other words, I think that any consequence will, in effect, be inconsequential.

So, would such a change drive inflation or deflation? On this I can be quite confident. The answer is very clearly that it would not. Large as financial flows are, the disruption caused by this event would last a day or two, at most, and have no long-term bearing of any sort. Inflation is now very largely caused by the rigging of prices in international commodities markets and not much else. The price of money would change little, if at all, as a result of this policy suggestion and as a result, I cannot see an inflation impact rising because I think the likelihood that the exchange rate would alter much, if at all, is very low.

I am, of course, speculating when making these comments. Anyone proposing a change has to do so. But what are the serious arguments to the contrary? I will take note of the comments, below