

Is Rachel Reeves constrained by the City?

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Is the City really stopping Rachel Reeves from doing what Labour wants, or is she just using it as a convenient excuse for her neoliberal austerity?

https://www.youtube.com/watch?v=EUxXGmZOmEc&si=NKV5KjlqPr4Q_VYj

This is the audio version:

https://www.podbean.com/player-v2/?i=tym2-186000a-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=f6f6f6&font-color=&logo_link=episode_page&btn-skin=c73a3a

This is the transcript:

Is Rachel Reeves constrained by the City of London?

The question is, of course, important because she is going to make her Spring Statement and she has trailed that her room for manoeuvre is massively constrained by what the City of London will tolerate with regard to government borrowing.

She would have it that this is the major constraint upon the choices that are available to her.

The media would agree with her.

Both of them would say that look what happened to Liz Truss. When Kwasi Kwarteng stood up and made a budget presentation in September 2022, which was recklessly irresponsible with regard to the tax cuts it proposed, there was a supposed financial crisis that weekend as a consequence.

Let me assure you, there was a financial crisis that weekend. Let me also assure you that it had nothing to do with anything that Liz Truss or Kwasi Kwarteng had had to say.

The reality was that Kwarteng spoke on a Friday. On the Thursday, Andrew Bailey, as Governor of the Bank of England had announced that the Bank of England was going to start a positive programme of quantitative tightening, by which he meant that the Bank was going to start selling the bonds that it had bought during the Covid crisis back into the financial markets.

He said that £80 billion worth of bonds were going to be sold over a matter of months. And it was that sale that caused the financial crisis in many of the UK's pension funds because they had not anticipated this happening and as a consequence, they had structured their finances in a way that meant the government's bond sales would deliver a cashflow crisis for them meaning that they may not have been able to pay pensioners, and that was what caused the meltdown in finances that weekend.

So the suggestion that Rachel Reeves is making that anything she might do on Wednesday with regards to her spring statement might produce an outcome similar to that which Liz Truss and Kwasi Kwarteng generated is, like so much that she says, complete nonsense because Andrew Bailey has not made any such similar announcement this Tuesday, and as a result, he isn't going to crash financial markets for her.

So let's stand back instead and look at the reality of this relationship between the Chancellor as the person who manages the government's finances and the City of London. And let's ignore for a moment the role of the Governor of the Bank of England, who caused the Kwasi Kwarteng crash.

As Chancellor Rachel Reeves is not constrained by the City of London.

There is one very simple and obvious explanation for that.

Every single pound that the UK government spends is created by the Bank of England for it.

There is no tax or borrowing constraint on what the government may spend. The only actual constraint on what the UK government may spend is the power of Parliament. If Parliament decides that the government may not spend because it refuses to pass a budget, then the government cannot create the money to fulfill its programs, and of course, it then has to resign. But so long as Parliament approves a budget that the

government sets before it, then the power to create the money that is required to fulfill that budget is automatically put into existence.

And whenever a government minister then goes to the Bank of England and says, I need to spend money, whether it be on pensions, or teacher salaries, or the NHS, or defence or whatever else it might be, so long as the amount that they plan to spend is covered by the budget the Bank of England has no choice but make the payment that the minister has instructed them to do.

That is the beginning and end of how the government funds itself. It creates money on overdraft with the Bank of England.

Now, of course, what we do know is that there is a limit to the capacity of any government to do this before inflation follows, and so the government does two things as a consequence.

One, it taxes us. It brings back into the Treasury the money that it has already spent by taxing us so that the value of the currency is maintained, which we would all agree is a pretty important objective. But that is the role of tax in the economy above all else. It has other roles, which I've explored in other videos, but let's be clear, tax does not fund government spending.

It can't, because if the government hadn't spent first of all to put the money into existence and in circulation, that then is available to pay the tax then that tax could not be paid. It's as simple and straightforward as that.

And then there's the second dimension to this, which is that most of the time, most sensible governments run deficits, and that's by plan.

They need to run deficits for two reasons. One is that most countries are growing.

They're growing physically in terms of the number of people in them. This is not because of migration. This is because of changing patterns in population over time. Migration is one part in that, but so is the birth rate and so is the death rate, and so is the economic activity rate. And so long as the economy is growing, it needs more money in circulation. And the best source of that new money in circulation is the government and therefore the government runs a deficit.

The second reason for running a deficit is that, by general agreement amongst almost every economist, some inflation is a good idea because it tends to encourage people to invest, whereas deflation tends to encourage people to not invest and to save. And as a consequence, by and large, inflation is good for continuing to encourage innovation and growth.

So, you will have inflation in an economy, but if you have inflation, you need more money in circulation. Again, it's a simple, straightforward statement of fact that I have

just made.

So, the government needs to provide more money to keep the economy going because it's growing and because there's inflation and the only sensible way in which it can supply that money, unless it is to be created by private debt from commercial banks, which is a very, very fraught basis for providing new money supply, is for the government to run a deficit. So, that's what the government does.

But when the government runs a deficit, there is more money in circulation, and some people will save some or all of what they eventually end up with as a consequence. Not everybody, because most people actually spend all of their income after tax, but some people don't. They're called the wealthy. And the wealthy will put money aside - more of it in the form of pensions than anything else, because over 80% of all savings in the UK are in tax-incentivised arrangements of some sort - but some will also be in stocks and shares and other things like government bonds.

And the reality is that pension funds, life insurance funds and private investors all want to buy government bonds because they are the safest place available to anyone to deposit very large sums of money - the sorts of sums of money in excess of £85,000 that most people dream of when it comes to saving, but which are otherwise not guaranteed by the government in the event that a bank fails.

The guarantee does apply, though, if you save it with the government in the form of bonds or with National Savings and Investments. So, the government is the place where those who are cautious but do have a lot of wealth want to save their money.

The government provides this savings facility to wealthy people as a favour. They don't have to take that money back. They don't need to take that money back. It doesn't fund any form of spending because the spending has already taken place. The money that is being saved exists because the government has spent it into existence through the Bank of England, so it can't possibly be a source of funding for that spending. It is the consequence of that spending, which is a fact acknowledged by all central bankers, the world over now, and therefore the government is not dependent upon those funds that the City might want to deposit with it in the form of gilts or other types of security to make its operations work.

Again, what I've just said to you is a simple, straightforward statement of fact. You can't dispute it because it's true. That's how the system works.

But as a consequence, Rachel Reeves is not constrained by whatever the City of London decides to do with regard to the amount of money it wishes to deposit with the government.

So if Rachel Reeves did decide to tell the Bank of England to cut its base rate, that would have an implication for the cost of government borrowing because there's a

massive and obvious correlation between the base rates that have been set by the Bank of England in particular since 2008, and the cost of government borrowing. The cost of government borrowing was low or almost non-existent between 2009 and 2021. And during that period, the Bank of England set base rates which were, near enough, zero.

Since 2021, the Bank of England has increased base rates to over 5%, and during that period, unsurprisingly, the cost of government borrowing went up.

And now as the Bank of England is reducing its base rate again from 5.25% to now 4.5%, the cost of government borrowing has gone down.

This is not by chance; the Bank of England does have a massive influence on the cost of government borrowing.

So, first of all, Rachel Reeves could, of course, cut the cost of government borrowing by telling the Bank of England to cut the base rate. She is not dependent upon the Bank of England to follow market trends. The Bank of England creates market trends, and this is a statement of fact, again.

But also, if the City decided it doesn't want to place money with the government, she doesn't have a crisis. There is no problem. She can simply leave the balance that the government has created, which is not being recovered by way of new deposits placed by the City, with the Bank of England on what is called the government's Ways and Means account, which is otherwise called the government overdraft with the Bank of England.

Now, this account was very active and had significant balances on it before 2006 when the arrangements were changed, but there is no reason why it could not do this again. In fact, in April, 2020 as the Covid crisis emerged, the Bank of England did offer the UK government, a £20 billion overdraft facility on the Ways and Means account, which was incredibly generous of it, given that it's owned by the government anyway, but the point is this facility exists and it could be used at any time if the City tries to play up.

Rachel Reeves is not, therefore, in hock to the City.

She isn't constrained by them.

They cannot dictate terms to her because she makes the money that they are using.

They do not provide privately created money to her to use, and of course, they can't do that. There would be no money without the government. That's another simple, straightforward statement of fact.

So why does Rachel Reeves say she's constrained by the City of London when she isn't in any way at all constrained in that way? There's only one obvious answer, and that is

that she wants us to believe that she is constrained in that way. Or she's stupid, and I'm not going to presume she's stupid. So, I'm going to believe the former of those two explanations - that she wants us to believe that she's constrained.

And why would she want us to believe that? Because she is a true neoliberal politician.

What that means is that she thinks that government should be limited in its scope of activity because the private sector is always going to meet our needs and the government won't.

She is therefore pursuing a policy that is aimed quite deliberately at making us poorer by refusing to provide us with the services that we need as the bedrock for our economy so that we can flourish.

We haven't got the education we need.

We haven't got the healthcare that we need.

We haven't got the judicial system that we need.

We haven't got the defence system that we now need either.

I could keep going on. Social care is another obvious thing to add to that list.

Those things are leaving us in stress and worry, and that is particularly true with regard to benefits payments, of course.

None of that is necessary. She could meet all those needs.

She could reorganise the economy to do this.

The City of London can't stop her doing so, but she doesn't want to do them, and the City of London provides her with a wonderful excuse for not doing the things she doesn't want to do anyway.

So, what is Rachel Reeves up to? She's deceiving you.

It's simple.

It's straightforward.

She's in denial of the facts as to how the city operates.

She's in denial of the facts as to how the government operates.

And all of that is because she doesn't want the government to do what you need it to do, and as a result, she's a failed politician.