Funding the Future

The Bank of England creates unemployment

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The Bank of England says that raising interest rates is necessary to control inflation. What it rarely admits is that its policy is also intended to reduce demand, weaken the economy and, as importantly, increase unemployment.

That is not an accidental side effect. It is how monetary policy is supposed to work.

In this video, I explain what monetary policy is, how the Bank of England uses interest rates, and why its decisions are never politically neutral. Higher interest rates impose greater costs on mortgage holders, tenants, borrowers and businesses. At the same time, banks, wealthy savers and owners of financial assets can gain.

I also explain why interest rates are an extraordinarily blunt tool for controlling inflation. Much recent UK inflation was caused by external shocks, including disrupted energy, food and manufacturing supplies. A policy that deliberately increases unemployment in the UK could never address those issues.

Worse still, higher interest rates can themselves increase prices by raising business costs, rents and finance charges.

The result is a monetary policy that redistributes income upwards, damages investment and conflicts with the government’s stated aim of creating jobs.

Monetary and fiscal policy must be coordinated. The Treasury should determine economic policy, including on interest rates, while the Bank of England should operate and regulate the banking system.

Monetary policy should serve the public interest. At present, it does not.

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This is the audio version:

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The Debate Ammunition for this video is available here.

This is the transcript:

We recently made a video on fiscal policy, which is one of the two foundations of economic policy that governments use to manage any economy, including that of the UK. Fiscal policy is really important, and it's not very well understood, and that's why we made the video. And now I want to look at the other of those foundations. That is monetary policy, and that's about as much misunderstood as fiscal policy.

Understanding how this works changes everything when it comes to seeing how the economy works. How they work together is even more important, and that will be the subject of another video to come.

Monetary policy shapes the whole economy. Let's be clear about this. In the world that we currently live in, that is the consequence of the way in which the government manages the economy. In the UK, monetary policy controls the money supply, credit, and interest rates. And it is largely controlled by the Bank of England, which devolved responsibility for this issue from the Treasury in 1997. It was, in fact, one of the very first things that Gordon Brown did in that year when he became Chancellor of the Exchequer under Tony Blair.

And now the Bank's policies influence borrowing, saving, investment and demand in the UK economy as well as unemployment, which is a particularly important point I want to make. Therefore, monetary policy impacts your life as much as it impacts mine.

At the same time, the Bank of England also controls two policies called quantitative easing and quantitative tightening. Both of those have too many T's in them for comfort when you're presenting to a screen. And they have had a massive impact upon policy over the last fifteen years since they were first introduced and have totally changed the way we think about government funding and the allocation of resources within our economy. So, monetary policy affects every household and business in the UK, and that's why it's important.

And it’s important to also say that monetary policy is never politically neutral, even though the Bank of England likes to claim it is. It isn’t. Every interest rate decision creates winners and losers. It redistributes income, wealth, and opportunity. Interest rates change investment and employment, and they change inflation and economic growth. Those issues are not neutral when it comes to the economy. So we should always ask, when looking at this issue of monetary policy, whose interests are being served?

That’s the political-economic question we should be looking at here. Who has the power and who uses it to whose advantage? And let’s be clear, and let’s not break any secrets before I go any further. The Bank of England is mainly run by bankers. Bankers benefit from what it’s doing.

Higher interest rates do redistribute income. This is a matter of fact.

We also know that higher interest rates make borrowers pay more on mortgages, on car loans, on credit cards and everything else.

That also impacts businesses. They have less to spend. They have lower profits. They can’t spend as much on training or recruiting new employees.

And governments lose as well because they pay higher rates of interest too. The consequence is that it is claimed there is no money to spend on other things which are essential, like housing, social security, and dealing with climate change.

High interest rates set by the Bank of England do therefore have massive consequences. But there are winners. Banks gain, wealthy savers gain, and financial asset owners gain.

There is a bias in this whole process, therefore, against those who have not got money towards those who have got money; against those who are in need, in favour of those who already have. This redistribution is a political choice made by bankers based in the Bank of England and not by elected politicians, but it affects us all.

And let’s be clear, lower interest rates reverse these effects. If we have lower interest rates, the wealthy savers, the banks, and financial asset owners tend to be worse off. Whilst borrowers, including those with mortgages and also those who pay rents because rents are almost invariably linked to mortgage rates, are better off.

Interest rates always change who benefits in our society. That’s not a politically neutral decision as a consequence.

Higher interest rates also have real impacts upon the level of activity in the economy as well. Higher interest rates are used by the Bank of England for a particular purpose. They claim that higher interest rates reduce demand in the economy, and they claim that if there is less demand in the economy, the risk of inflation is reduced. But let me be unambiguous about this: they know, but don't say, that the consequence of reduced demand in the economy is higher unemployment. That is a deliberately created outcome of Bank of England policy, which they know they are doing.

They increase unemployment to reduce inflation. The two are supposed, in economic theory, to run in opposite directions. Higher inflation, lower employment. Lower inflation, higher employment. That's the claim. And interest rates are supposedly the mechanism that changes the inflation rate. And so interest rates supposedly have an inverse relationship with unemployment as well. These things are not proven, by the way, but the fact is that's what the Bank of England thinks, and they do deliberately create unemployment as a result, and we can see this now.

We in the UK do, at present, have the highest interest rates in the G7 countries, and we also have the highest unemployment rates. It's not by chance that we have 5% of people out of work in this country at the moment and 10% of young people out of work. That's the result of deliberate decisions by the Bank of England. And when the government bleats about its objective of creating jobs, the answer is, tell it to stop the Bank of England creating unemployment then. These outcomes of unemployment and pain for those who have to borrow are the deliberate aims of monetary policy, but that is never said.

Interest rates are, in any case, a blunt instrument. The fact is that if the Bank of England tries to use interest rates to change inflation, the impact takes up to two years to work. It can be even longer than that in an era where we now have many people on fixed-rate mortgages. And excess demand, which is what these interest rates are supposed to control, normally goes away within two years.

We have data on excess demand in the UK since 1210. That's not 10 minutes past noon. That's the year 1210, way back in deepest, darkest history. And what the data shows is that every time we get a spike in inflation, it was, until we got an active central bank, followed by a period of deflation. In other words, everything went back to normal after a short period of time without any interest rate intervention. Since we've had central banks in the last century or so, we haven't seen deflation, but inflation rates have always returned to normal anyway, as they did, for example, in 2023 after the shocks of 2021 and 2022.

And in any case, not only are interest rates a blunt instrument with regard to the time they take to have an impact. They're also a blunt instrument because most of our inflation in the UK is not created by excess demand. The Bank of England assumes that all inflation in the UK economy is created by there being too much money in proportion to the value or volume of goods and services available to buy. And therefore prices are pushed up as a consequence. But that has rarely been true.

Recent UK inflation has had very many different causes, but none of them has anything to do with excess demand in the economy.

We didn't have excess demand during the pandemic.

We didn't have excess demand, which caused supply shocks after the pandemic.

We didn't have excess demand creating the supply shocks that happened after the war started in Ukraine, or again, when the Straits of Hormuz were shut by Donald Trump earlier in 2026.

Those were all external shocks to the UK economy. There wasn't an internal cause of inflation. Higher interest rates could not tackle any of those causes of inflation because higher interest rates do not increase flows of oil. They do not increase flows of cars and fitted kitchens, which was the problem after COVID reopening. They do not create additional supplies of wheat, which was one of the reasons why we had inflation after the war started in Ukraine.

That then creates a secondary issue. Used in the wrong way, high interest rates can actually cause inflation themselves. That's because high interest rates can cause businesses to inflate their costs because they're borrowing more money and paying more interest, and they can then pass that on in higher prices. Landlords charge higher rents. This is a well-known fact. People who are buying cars have to pay more for their car leases, and most cars are leased these days, as are many other products. And all of these things have prices dependent upon interest rates.

Push up the interest rate: push up the price. Inflation can be increased by high interest rates. As a consequence, high interest rates don't necessarily cure inflation. They can create it. Monetary policy can in fact create the problem it's supposed to cure, but our Bank of England doesn't seem to know that, and that is a massive issue.

So, inflation is not always solved by raising interest rates, and we know that because the evidence says it, and that is the third big problem with monetary policy that I've outlined in this video.

The fourth is quite different. That is that, hidden inside this monetary policy is a massive subsidy to our banks because the Bank of England pays interest on the sums which are supposedly deposited with it by our commercial banks in what are called central bank reserve accounts.

Now, there was almost nothing in these accounts before 2008, but since 2008, monetary policy put into place by quantitative easing, has massively inflated the balances on these central bank reserve accounts. They reached nearly £900 billion in 2021. They've been reduced to about £500 billion now, which has created its own problems for the UK economy because that has forced up interest rates yet again.

But the fact is, this was money that was effectively given to our commercial banks by the Bank of England, but it insists on paying interest on these balances. Right now, we’re paying around £20 billion a year to our commercial banks for them to supposedly deposit money which they must leave with the Bank of England - they have no choice about it - and which we do not need to pay interest on.

That is £20 billion that could be used somewhere else, but which is being used to boost bank profits, used to boost bankers’ bonuses, used to not further the public interest. There is no need for us to subsidise the City of London and banks in this way, but as a result of monetary policy, that’s exactly what we do.

And that’s not the end of the problems that we face either. There is a fifth major problem with the way in which we manage monetary policy at present. We have the government running fiscal policy. We have the Bank of England running monetary policy, and sometimes the two just crash against each other. We can see that. The government says it wants more employment. The Bank of England, by keeping interest rates high, is creating unemployment.

That is precisely the problem that I’m talking about. It isn’t the only one, but in practical terms right now, it is the problem that we can see. And we need to have this reconciled, and you can’t reconcile it if you say that monetary policy has to be managed independently of the government. You must bring monetary policy back under the control of the Treasury to achieve that goal. We need coherent economic policy, and we’re not getting it because monetary policy is managed not only badly, but against the public interest. This is the crisis we’re facing.

So, who should control monetary policy? Well, very clearly it has to be used in coordination with fiscal policy, which should be the more powerful tool that we have in the economy to create jobs, investment, and public services. And monetary policy should not be used to support financial wealth and our elites above all else, so we need to bring policy back under the control of the Treasury.

I’m not saying the Bank of England has no role. It should have a role. It should run our national bank and our banking services and regulate all our banks, but it should not be running our economic policy. The Treasury must be in charge. I know the world doesn’t agree, but if we want to make this country a better place to live, that’s what we have to do.

Only when we get joined-up thinking, which links together interest rate policy, monetary policy, quantitative tightening, and quantitative easing policy, and fiscal policy all at once, can we begin to tackle the problems that we have in this country.

And at the same time, we must also truly understand inflation and what causes it. And most of the time, that is not excess demand. So, interest rate policy has no role in controlling it, and we need to look at ways in which we can manage the problems created by external shocks much better, so that we can deal with those problems in better ways, like building the resilience of the UK economy so we are not so dependent upon external supplies to keep us going.

We need to have policy that matches remedies to causes. We need better analysis, and that requires a single organisation to be in charge. This is why monetary policy has to be integrated into economics as a whole. Interest rates have to stop being used as a blunt tool of monetary policy, which only serves to redistribute income and increase inequality.

We must be able to judge outcomes by benefits, and that isn't possible with monetary policy at present. Monetary policy should, and this is the key point, ultimately serve the public interest, and that is why democracy needs to be in charge of it. We haven't got that now. We need it.

Well, that's what I think anyway. What do you think? There's a poll down below. Let us have your opinions. Please share and like this video if you do that. Please subscribe to the channel and ring that bell because that guarantees you get notifications of what we are up to. And if you'd like to buy Tom and me a coffee, that would be great.

Poll

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