We all believe in an independent Central Bank

The independence of the Bank of England is widely asserted and almost universally applauded. Let me begin before I am condemned for views I do not hold, by saying I do support the Bank of England continuing to have the important independent power to fix and change short term interest rates by setting an official influential Base rate. The wider problem is money policy (anti inflation policy) is about much more than just fixing the short term official rate. In most of the other areas that matter the Bank is not independent.

The obvious point which no-one else ever seems to make in the debate concerns the main thrust of money policy since 2008. The decisions to create a lot of money to buy up government bonds have always been joint between Chancellor and Bank. This was set up by the Labour government and continued under the Coalition and Conservative governments. The Treasury not only agrees and signs off the policy but also offers a full guarantee to the Bank against losses on the bonds bought. Presumably Chancellors as well as Governors have therefore taken this task seriously, as the Treasury runs the risks. When interest rates are around zero money policy is driven by decisions on how much to print and how many bonds to buy. Why did the Bank do so much for so long last year? Why didn't they have target interest rate levels for longer term borrowings to guide their interventions? Why didn't they monitor and comment on the explosion of money growth their bond buying generated?

These decisions have had a big impact in setting longer term interest rates at artificially low levels, which in turn leads to lower borrowing costs for property, business and other users. This has fuelled asset price inflation for more than a decade until this year when the underlying bond buying stopped. The Bank did not worry about asset inflation.

It is also the case that Gordon Brown when he wrongly said he was making the Bank of England independent took away crucial powers it used to have to regulate the commercial banks. The main UK clearing banks determine many of the details of how much credit is advanced, to whom. They decide how many loans to make. Regulation of these activities including warning them about running too much individual balance sheet risk rests with a different Regulator. Pre Gordon Brown the Bank directly and daily influenced clearing bank balance sheets and lending positions.

In practice the independent Central Bank, 100% owned by the state, answers directly to Parliament. The Treasury Committee makes the Governor attend and defend his actions on a regular basis. Parliament changed the legislative controls and requirements on the Bank when Labour took over and when the Coalition took over. Labour changed the inflation target when in office. I think it is right that the Bank should be held accountable for its actions through Parliamentary scrutiny and through media questioning of policy and results. There needs to be more consideration of why inflation is so far above target, and more analyses of past recessions when Bank tightness was part of the problem.

It remains a mystery how the Monetary Policy Committee thinks it can control inflation without monitoring and commenting on the amount of money in circulation or the speed at which it is used from bank accounts. Real money supply is now contracting. Money policy has lurched from far too loose to tight. I agree with the Bank who now forecast inflation will tumble next year. There is no need for them to be selling bonds at big losses to make things worse.