Interim Policy: amendment to Monetary Policy
Background Paper

This is an amendment to our monetary policy. The current wording was considered to be implicit, but it has left our policy open to criticism because the precise meaning was unclear. Notably, we had been publicly criticised by a leading left-wing commentator – Richard Murphy – who is usually quite supportive of our policies.

EC664 currently reads:

'EC664 A Green Government will therefore develop and implement a programme of banking reform based on the following principles:
a) All national currency (both in cash and electronic form) will be created, free of any associated debt, by a National Monetary Authority (NMA) that is accountable to Parliament;
b) The 1844 Bank Charter Act will be updated to prohibit banks from creating national currency in the form of electronic credit. To finance their lending, investment or proprietary trading activities, banks will have to borrow or raise the necessary national currency from savers and investors;
c) The NMA will be mandated by law to manage the stock of national currency so that it is sufficient to support full employment, while avoiding general inflation in prices, and taking into account the development of local currencies (Ref. paragraph EC678);
d) Any new money created by the NMA will be credited to the account of the Government as additional revenue, to be spent into circulation in the economy in accordance with the budget approved by Parliament;
e) The members of the NMA will be appointed – for fixed terms – by a Select Committee of Parliament;
f) The independence and integrity of the NMA will be assured by law requiring NMA members and staff to be free of any conflict of interest; mandating full transparency of NMA decisions; and prohibiting lobbying or undue influence of NMA members or staff by government, financial institutions, corporations or any other private interest.'

The combined impact of clauses EC664 b) and d) above is likely to lead to significantly reduced bank credit in the economy, compared with what happens in practice now.

EC664 b) prohibits banks from creating money through their lending – currently, the majority of money circulating in the economy is created through private bank lending, so our policy, as stated, would be a major change that we did not intend to make. The clause then limits banks to financing their loans from savers and investors or through borrowing. However, it doesn't specify who they may borrow from.

EC664 d) then limits government money creation to government spending, making no provision for banks to access newly created money to finance their lending. Since the NMA will be the sole creator of all UK currency (see EC664 a)), this will likely lead to a significant restriction on bank credit as banks will need to rely on savers and investors and borrowing from other sources to finance their lending. This could lead to an economic crash as businesses and others are likely to be denied the credit they need. It will also restrict the establishment and growth of sustainable Small and Medium Enterprises (SMEs), our ability to localise manufacturing and the creation of vibrant local economies, all of which will require credit.

To avoid these issues, we propose to amend the existing policy to make it clear that banks will be able to borrow from the NMA to finance their lending. But, in keeping with existing policy, where all new money created should be used for purposes approved by parliament, we propose to limit, through credit regulation, banks to lending money borrowed from the NMA to purposes approved by parliament.

In this way, banks will operate as intermediaries between the NMA and businesses and other organisations needing credit—the bank's customers spend money created by the NMA into the economy for purposes that are approved by parliament.

The amendment to EC664 b) enables banks to borrow money created by the NMA to finance their lending should the currency raised from savers and investors be insufficient. It also expands the clause's applicability to include community banks, a key part of our banking policy.

Since under existing policy, retail and investment banks will be separated, an additional sentence has been added to confirm that investment banks will not have access to credit from the NMA.

The amendment to EC664 d) defines how the government may spend newly created money into circulation. The amendment expands this to include the NMA lending to banks, but restricts this, through credit regulation, to bank lending for desirable purposes as defined by parliament. As with EC664 b), investment banks will not be able to obtain credit from the NMA, in line with existing policy.

Consultations
The following people were consulted about this proposed amendment”

GPEW
Molly Scott Cato
Peter Sims
Sheridan Kates
Zaid Alasad

External: Professor Richard Murphy – at a meeting also attended by Caroline Lucas, Molly Scott Cato, Peter Sims, Rupert George