Abstract

The monetary policy today has literally become interest rate policy. The central banks decide the short term interest rate to achieve their objectives. The monetary policy is conducted without considering any socioeconomic and ethical implication of its use. However, in reality, the monetary policy has several socioeconomic, moral and ethical implications. For example, the conduct of monetary policy is based on the assumption of demand channel of monetary transmission mechanism. This channel assumes that by increasing the interest rate, the aggregate demand in the economy could be reduced which will put downward pressure on the aggregate price level. Suppose the demand channel works and the aggregate demand could be reduced by increasing interest rate, it is quite clear that such a reduction in demand can occur mainly due to luxuries, and therefore, the price of luxuries shall reduce. The consumption of necessities could not be reduced reasonably by the change in interest rate, therefore the prices of necessities are also unlikely to reduce and the monetary intervention would increase real income of consumer of luxuries compare to those having necessities in their consumption basket, leading to a redistribution of real income which favors privileged class of society. There are many other ways in which the monetary policy can affect the socioeconomic variables. This paper summarizes number of logical flaws and socioeconomic consequences of the monetary policy which show that interest based monetary policy is always harmful for the society.