

Why the Bank of England is taking us to hell in a hand...

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I posted this thread on Twitter this morning:

I keep reading that we are going to suffer stagflation in the UK. That's possible, I agree. I also think it's unlikely. It's just as likely that we might face deflation. But what we definitely need is a change of economic policy. A thread....

Stagflation assumes a continuing situation where wage growth exceeds growth in available goods and services on which income can be spent, pulling prices up.

There are some in the UK for whom this wage growth is happening. Let's call them the wealthy. They can pay all the prices now being demanded for goods that are in short supply and subject to big price increases, from second-hand cars to heating for the swimming pool.

Others are managing price rises by dipping into their savings, which is going to happen a lot over the coming months, and even years. But for many, these savings will run out. This means of maintaining a lifestyle in the face of inflation is only available to some, and is finite.

For a majority of households, with average incomes (or less) and few savings, the current inflation means reduced standards of living. The amount consumed will fall, as is already becoming apparent in GDP figures, and this crisis has hardly begun as yet.

My point is that excepting the case of the well off (who are the only people most economists and politicians know) there is no wage surplus indicating people have the excess income required to support sustained rising prices in the UK. And in that case we can't have stagflation.

That's especially true when the other condition for stagflation, which is that a workforce able to secure above-average pay increases, doesn't exist, except in a few professions.

So, again, the claims are wrong. Because accountants are doing well right now does not prove all are.

The inflation we have is something quite different. It's not driven by excess money or wages in the economy. We have inflation caused by Covid supply chain disruption, and workforce disruption as older people refuse to work in unsafe conditions on unsafe terms.

We also have inflation caused by the disruption and chaos of Brexit, which we alone are suffering. In addition we are suffering the fallout from war. Energy and food prices are high for reasons entirely beyond our control. We could also suffer inflation because of climate change.

The things causing inflation are entirely unrelated to excessive wages then, which do not, in any case, exist for most people. Instead they are caused by failed policy in the UK (Brexit and Covid management) and issues beyond it (war and climate change, creating supply shortages).

The combination is unprecedented. There is nothing in the textbooks to address this. It's inflation of a type not previously known. It's not demand-pull (except for the rich) or cost-push, because in truth costs have not risen.

The last point is important. Shortages don't increase costs and so push up prices. Shortages provide the opportunity for exploitation by profiteering, which pushes up prices. So what we have is profit-driven inflation - a new phenomenon.

Two questions follow in that case. The first is, how long can this last? The second is, what do we do about it? The first is easy to answer. This situation will last until the cause of this inflation is understood and addressed.

Unfortunately, this is not happening as yet. The Bank of England and almost all economic commentators are treating the inflation as 'demand-pull' i.e. they are assuming people have excess money to spend when the exact opposite is the case.

As a result the Bank is deliberately making a bad situation much worse by increasing interest rates to crush people's incomes and increase unemployment when that is already happening and people are actually already short of income. Enormous harm will arise as a result.

There is, however, another dimension to this question of how long this might last. As a matter of fact, most inflation is caused by a shock. War is the most common. Fuel shortages are the next big issue. Put them together and it's worse. That happened in the 70s and again now.

This time we have just added in some more shocks, including Covid itself, plus reopening without adequate planning from Covid and failing to maintain Covid

precautions, plus all the problems of Brexit plus the potential for international food shortages.

There are three dimensions to those shocks as they impact inflation. The first is that the shocks they create are initially one off. For example, fuel prices go up dramatically, but then settle at the new price.

If this happens then in the year the shock happens the impact on inflation is big - as we are seeing. But if in the second year the price does not go up again then there is no more inflation that year.

Since inflation is a measure of change and in the second year prices will not have changed this must be the case. Of course, prices are higher than they once were, and people may be worse off, but the inflation stops.

Quite a lot of the inflation we are now looking at may be of this type. Fuel can't keep going up in price, for example. The market will become orderly. That's also true of food. We will eventually sort out Covid. And as for Brexit, one can live in hope.

I stress, I am not saying the damage to people's incomes and well-being goes away if this happens. What I am saying is that the inflation does. Simple maths say that is likely.

Then there is the second situation, which is that prices actually go into reverse. No one but Danny Blanchflower and I seem to think this likely, but actually I think it probably is, at least in some cases

That is because there is panic buying going on in many cases. Take second-hand cars as an example. People have been paying more than the equivalent price for a new car in some cases because shortages of chips has reduced new car supply.

The price for second-hand cars right now - especially when many are technically outmoded - is crazy. A lifetime's experience says they will fall. Cars have never appreciated in value when they become second hand before, and normality will return.

We have all seen this panic buying, whether of toilet rolls or other products. My suggestion is that both fuel and food are likely to be in that situation now, worldwide. There is a very real chance their price will fall. As a result we might have deflation in a year or two.

There is, incidentally, already evidence that this is happening. Wholesale gas prices in the UK are already falling, although because of forward buying for the consumer market this will not reduce inflationary pressures as yet, but give it time and it might well do so.

Then there is the third scenario, which is that we get persistent inflation. This cannot be

ruled out. It is also the most unlikely of these three scenarios. This is for a number of reasons.

First, this assumes that the impact of all those shocks will continue and prices will keep going up. For that to happen we need another war, another Brexit, another Covid, or something equivalent we have not even thought of yet of similar scale.

I stress, anything is possible. We live in an uncertain world, with climate change happening faster than we expect being easily the most likely disaster we have not properly anticipated. But I doubt that in the next year or so.

Importantly, without further shocks prices can only keep rising if people can afford to keep paying them. As a matter of fact, there is no mechanism that is likely at present to ensure wage earners will see their earnings rise fast enough for that to happen.

In the 70s, which is the last time when stagflation happened, strong trade unions ensured wage earners were protected from the impact of inflation. But then Thatcher deliberately broke the unions, with the intention of leaving wage earners vulnerable to markets.

Thatcher succeeded. The vulnerability she created persists. People do not have the negotiating power to push up wages now, except maybe by moving jobs.

There is evidence people are moving jobs to get pay rises and that people aged 50 and over are also quitting work. Some of them may be dead from Covid, but many more will just not accept the risk employers are demanding they take when going to work and are quitting instead.

Brexit may have also caused some labour shortages, but there is little sign of this in lower age groups where EU workers were more commonplace. On this occasion any loss in employee numbers is not likely to be its fault then.

But even with a more mobile and reduced workforce there's no sign employees are going to get 10% pay rises to compensate them for rising inflation. The required likelihood that wages will keep dragging inflation upward, which is the condition for it persisting, does not exist.

In that case the chance that inflation rates will fall because market pressure for them to continue will disappear is very high, especially if, as I expect, the shocks that created them dissipate.

Put these facts together and whilst I am not denying we have a real inflation problem now it is nothing like the one that the government, central bankers and most economists, who are looking for past behaviour to explain current trends, are suggesting we have.

We have a new type of inflation, driven by speculative profit-taking in reaction to shocks that have induced panic buying in reaction to shortages which cannot be matched by wage rises because the labour-power to demand that wages rise does not exist.

So the phenomenon is temporary because a) the shocks will stop b) the panic will be over c) wage rises will not be big enough to compensate for the price rises and d) to keep selling their products the prices of many items will have to fall in due course.

This is all just basic logic, economics, common sense and observable fact. But what it says is that to increase interest rates to tackle a type of inflation caused by a shortage of relative buying power in the face of over-powerful market operators in a period of chaos is crazy.

In fact, it just makes matters worse by reducing the capacity to pay for overpriced basic necessities when many cannot already afford them, literally imperilling many, whilst also actually fuelling excess profit-making by increasing the price of money.

I cannot stress this point enough. When the crisis we are really facing is that business is claiming a bigger proportion of national income for itself by making excess profits at cost to working people, the Bank of England wants to make that worse by inflating the profit of banks.

You literally could not make up a policy response by the Bank of England quite as foolish as this.

So, what to do instead? First, protect the most vulnerable. Restore universal credit cuts. Upgrade all benefits for inflation now, because the vulnerable need to be kept in touch with the rest of society anyway.

Then do windfall taxes, including on the banks now as they are not passing on interest rate increases and so are going to profit massively at present.

After that take the heat out of price inflation itself by cutting taxes on fuel so that the overall government tax take from fuel does not increase as the raw material cost of it rises, which it will otherwise do. The government does not need to profiteer from this.

This policy will literally take the heat out of some current inflation, so reducing the need for wage and benefits rises. And since if prices fall, as I suspect will happen, any tax cuts could then be restored meaning the policy is only temporary, which addresses green concerns.

We should definitely also increase taxes on the wealthy, whose income and savings are still capable of fuelling this inflation. These tax increases should help stop them pricing more vulnerable people out of their ability to buy basic essentials.

And if we're really wise we'd realign UK trade rules with the EU to eliminate most of the vast and inflationary costs of Brexit. We'd also reintroduce Covid protection for more vulnerable people in society to encourage them back into the workplace.

Do all these things and we actually have an inflation policy that has a chance of working. Right now we have nothing like that.

Then we wait and see before taking further measures. Why? Because as I have noted, there is a better chance that this inflation will stop or even go into reverse than there is that it will continue in the long term.

But, if we do continue with the current policy we will instead get several things. First, people will die of cold, hunger, or both. Second, we will have austerity as the government crushes public services, using inflation as an excuse. Third, corporate profits will skyrocket.

Fourth, the wealthy will initially get much wealthier as profits increase and so too do their investment returns rise as interest rates rise. Fifth, many homeowners will lose their homes as they cannot pay their mortgages. Sixth, tenants will be evicted for non-payment of rents.

Seventh, we will have a banking crisis, full-scale recession, mass unemployment and risk of civil unrest. Eighth, recovery will be delayed for a very long time. And all because Bank of England economists wrongly assume all inflation requires interest rate rises.

I actually may be understating how bad the current policies from the government and Bank could make matters, which is why suggesting alternatives based on a calm appraisal of the facts in a long thread like this is so important.

It's also why thinking differently, as the current situation demands, is so vital. But that alternative thinking is not happening enough. In fact almost no one, excepting Danny Blanchflower and me, is arguing for the approach in this thread.

That, though, does not make it wrong. It just shows the mountain we have to climb to overcome the economic fallacies currently embedded in political and economic thinking that put us all at risk.

I just hope the message gets through. We all need it to. We need to survive this and some won't unless things change. That's why this matters.