Funding the Future

We cannot afford to not give inflation matching pay ris...

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Inflation is in the news again.

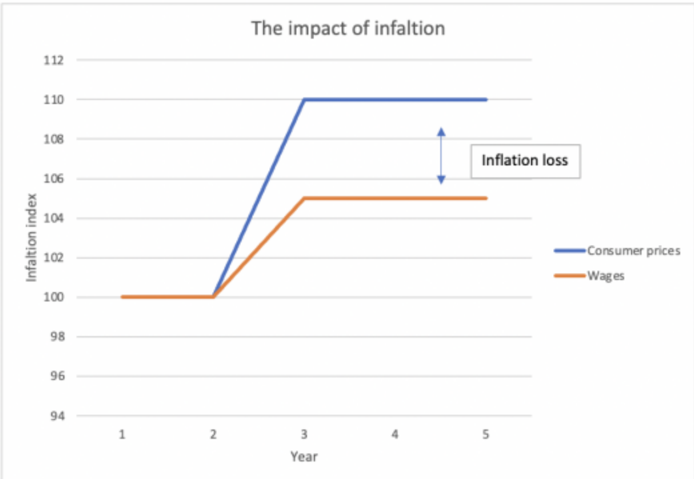
The government says pay rises cannot be afforded because they are inflationary.

Unsurprisingly, people want pay rises to compensate for inflation.

And as a matter of fact, the economy needs people to have pay rises if a recession is to be avoided. Latest data [from consumer markets] reports that consumer spending, unadjusted for inflation, was up 4.2% in November, but consumer prices were up 11.1%, meaning there is already a significant recession on the High Street.

And yet ministers are out yet again saying that people must not be allowed inflation-matching pay rises, whilst Labourt sits, silent as ever, on the issue.

It would seem as if very large numbers of people do not understand this really rather simple chart:



The data is for five years. In the first two there is no inflation. Wages and prices do not change.

In year three there is a big external shock. Prices increase by 10% in reaction. Wage rises are held down to 5% increases.

In years 4 and 5 there is no inflation and so wage rises are resisted: they stay at 105% of those before the shock.

The result is a continuing loss of well-being by those who were not allowed inflation-matching wage rises. They only have about 95.5% of the spending power they had before the external shock arose. The impact is to permanently reduce spending power in the economy in a way that is deflationary.

This is, of course, the government's intention. It wants to reduce inflation. But, the inflation was not caused by wage price increases. It was caused by an external shock that can do one of two things. The first is to permanently shift economic power out of the country, which requires a shift in the exchange rate or to permanently shift economic benefit from those on wages to those charging the new higher prices within the economy. Both are happening, but the latter is almost certainly significantly more marked than the former.

The result of the policy now being pursued by the government is threefold. By reducing spending power it reduces growth and virtually guarantees recession. Within that recessionary environment, it reinforces and increases inequality. Third, it provides no incentive to invest as markets are not there to encourage anyone to do so. Far from helping the economy, denying a pay rise harms it in that case.

And yet all our politicians are saying there is no chance that we can afford inflation-matching pay rises.

The truth is we cannot afford to not give inflation matching pay rises. It really is that simple, unless, of course, we want to trash the economy and increase inequality.

And will those inflation-matching pay rises then force prices up? The answer is no, because the increased profit margins out of which they can be paid already exist so long as recession is not allowed to bite first, reducing firms' profits for a quite different reason. And that is precisely why we need the pay rises now.