Why 2% inflation?

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Catherine Mann of the Bank of England says inflation will stay above 2%. But what if the problem isn’t inflation but is the target itself?

The 2% rule was invented in the 1990s to please markets, not to help people.

In this video, I explain why our obsession with hitting that number is crushing wages, stalling investment, and protecting the rich at the expense of everyone else.

It's time for an inflation policy that serves people, jobs, and the planet, and not financial markets.

https://www.youtube.com/watch?v=971ZezThexQ?si=TBxdZ48X4US8jLFB

This is the audio version:

https://www.podbean.com/player-v2/?i=jy366-199e4ef-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=f6f6f6&font-color=auto&logo_link=episode_page&btn-skin=c73a3a

This is the transcript:

Catherine Mann, who is one of the members of the Bank of England's Monetary Policy Committee that sets the Bank of England's base rate in this country, with the aim of controlling inflation, has said recently that inflation will stay above 2% for some time to come.

Now, I don't agree with everything that Catherine Mann says on a great many issues, but I have a suspicion that she's right on this one. Where she's wrong is with her answer. She says that means that we have to keep monetary policy tight, which is code for keeping interest rates high. But what if the problem isn't the fact that the economy is simply running with an inflation rate of around 4% at present, but that the problem is instead with having a target of 2%? Suppose we're just trying to crush the economy to achieve something that is itself pointless. That's what I want to talk about in this video.

The 2% inflation target is not scientifically determined. It was based on politics. It was invented in the 1990s by the Central Bank of New Zealand, and nobody knows why it picked that number. It was simply plucked out of thin air in the height of the hype of the neoliberal era, to reassure markets that central bankers were in control of the destinies of the fortunes of the wealthy by keeping inflation low.

They were given power. That is, central bankers were given power by elected governments to achieve that goal of keeping inflation low. In most countries in the world where we have independent central banks, there is no other goal that is set for them. Everything is supposedly decided within our economies for the single purpose of keeping inflation low, and nothing else matters.

But the truth is, there is absolutely no empirical evidence to show that a 2% inflation rate optimises either growth or jobs. It's just become a ritual target which central bankers want to prove they can hit, and they try to prove it more for the sake of, well, trying to suggest their own virility is intact than anything else, as far as I can see. You could say it's about trying to prove the credibility of finance, but whatever it is, that credibility has come at a massive social cost.

We've faced pandemics, wars, climate shocks, and supply fragility since that 2% target was set. The world has, in other words, changed phenomenally since the mid-1990s, and yet the inflation target remains the same.

And that ignores the fact that, in many senses, inflation is the price of adaptation to deal with the shocks that I've just described. More than that, it's a measure of the resilience in the system. Low inflation does imply we have reached a point of relative stability, but controlled and moderate inflation is simply an indication that we are going through a process of change and nothing more or less than that. So long as the inflation doesn't go out of control, and there's no reason why it should if we stand back and understand the reasons why the inflation is created, which is normally precisely because we have pandemics, wars, climate shocks, and supply fragility, none of which are influenced by the rate of interest in any particular country, then we will adapt to the situation that is developing and go back to the mean, which is a very low inflation rate.

More than 500 years of history in the UK, or rather, I should say in England, because the

UK hasn't got that long a history, has proved that this is the case. Whenever there's been a shock of the sort I've described, usually a war in the case of England, but the others as well now, then there might be an inflation hike, but very soon after, there's a fall, and the trend is always to return to normal without ever having had central bank's involvement in the process of achieving that outcome by changing interest rates. Change in the value of money is not, then, an indication of a policy failure; it's simply the reality of adaptation inside the economy.

So is it the case that we're using the wrong tool, the wrong weapon to try to tackle inflation? Are interest rates just a blunt and aggressive instrument for this purpose, which achieves no real outcome?

After all, upping interest rates hurts mortgage holders and renters, but rewards banks.

It discourages productive investment.

It discourages the activity that is necessary to manage climate change.

And there is absolutely no indication at all that it solves inflation caused by external shocks like COVID.

So what is really going on? Is Catherine Mann actually simply saying that she doesn't like the higher wage demands that are the current result of higher inflation expectations? Is what we are really seeing: a war on labour? Are we really seeing the bank's paranoia about labour power being revealed? And is monetary discipline really something no more than social control hidden behind the disguise of inflation control?

After all, the bank has admitted that we do have modest growth and a softening labour market. In fact, that's inevitable because if you increase interest rates above the rate of inflation, and they have now managed to do that for a period of time, then the consequence is going to be that there will be a tightening within the economy. High rates of interest, after all, crush spending and stall investment, and that's exactly what the Bank of England has done. The fact that we have an economy that is not functioning well is the consequence of an economy crushed by the Bank of England's policy to take inflation out of it, which is actually exacerbating inflation expectations.

They're choosing stagnation, and that's the problem. A 2% inflation target might keep markets happy and workers disciplined, but in practice, all it is doing is protecting financial assets from mild devaluation when we all know that stock markets are overvalued, houses are almost certainly overvalued, and esoteric supposed savings vehicles like Bitcoin are off the scale with regard to the price being paid for them. And whilst those asset prices are being protected, jobs are being sacrificed, innovation is being lost, and fair outcomes within society are being foregone.

So what if we changed the question?

What if we didn't ask how to force inflation to be 2%, but instead said, " What level of inflation supports full employment and a green transition, and what level of inflation protects those on low incomes from real hardship?" We would then get targets that would fit the world we live in, and not the one that no longer exists. Wouldn't that be a better choice?

We would get fiscal policy in that case that encouraged investment and infrastructure development, and fair taxation as a means to control real inflation through, for example, changing the rate of VAT, rather than getting inflation management through interest rate changes, which appear to have no beneficial impact at all, either on inflation or anything else. We would end up with a situation where we would actually get proactive management of the economy for the greater good.

But instead, by choosing just one economic goal, instead of many, we end up with economic policy that is balanced against price stability, full employment, and our biosphere and climate.

A single number can never define success. If inflation stays above 2%, it doesn't mean the economy is broken. That's my core message.

It simply means that the inflation target is no longer working, and that is my second core message.

Inflation targets should serve people. That's my third core message and not the other way round.

We need other targets, in other words, and that's my fourth core message.

We do need to care about people, employment, investment and our planet, and they're much more important than protecting the value of financial assets. That's what we need as economic policy, and we're not getting it.

Catherine Mann does not understand the job that she's been given by the Bank of England, and nor does anybody else on that committee either come to that at this point in time. And as a consequence, we are in deep trouble. But we don't need, and this is fundamentally important, we don't need an inflation target of 2%, which drives all economic policy, because that is incredibly harmful.

Taking further action

If you want to write a letter to your MP on the issues raised in this blog post, there is a ChatGPT prompt to assist you in doing so, with full instructions, **here.**

One word of warning, though: please ensure you have the correct MP. ChatGPT can get it wrong.

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