

When Do Markets Break?

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What happens when markets stop working?

That is the question at the core of this video, and it matters because we are entering a period in which shortages of essential goods may become impossible to ignore. Oil supplies are already being disrupted. Gas, fertilisers, industrial chemicals and food supply chains are under pressure. And when essentials become scarce, markets ration by price, not by need.

That means those with the least money lose first.

In this video, I argue that neoliberal economics has no answer to a world of absolute shortages. Markets work in conditions of stability, adequate supply and clear price signals. But when fear, disruption and scarcity dominate, those conditions disappear.

So what happens then?

I explain why governments may be forced to intervene through rationing, price controls and deliberate allocation of resources, just as they did during and after the Second World War. I also explore how systems for rationing fuel, energy, and food could actually work in a modern economy.

This is not an argument against markets in normal times. It is an argument about what happens when markets fail.

And I think that moment may be much closer than most politicians are willing to admit.

<https://www.youtube.com/watch?v=SrhCN4q3Erk?si=b1w4CRBGFljkyUv5>

This is the audio version:

https://www.podbean.com/player-v2/?i=5k6y9-1abcf2-pb&from=pb6admin&share=1&download=1&rtl=0&font=Arial&skin=f6f6f6&font-color=auto&logo_link=episode_page&btn-skin=c73a3a

This is the transcript:

When don't markets work? That is the question that this video addresses, and it does so for a very good reason, and that is because markets are already beginning to fail at this moment, and this crisis will make that an issue that is impossible to ignore.

The question is, how long is it before governments abandon their neoliberal dogma? That dogma insists that governments are powerless in the face of market pressure. But at this moment, market pressure is going to create unacceptable outcomes for society. Absolute shortages make market positions untenable, and at some point, governments will have to act and organise the distribution of resources within our society deliberately through the process of rationing, and that is what I am proposing in this video.

Now, let's be clear. We are not in the situation we were during the course of the Second World War, not least because the UK is not at war at this moment. But there are parallels between what we learned in the Second World War and what is happening now. Victory in 1945 did not end the wartime economy. In fact, rationing in the UK continued until 1954, which was nine years after the six-year-long war came to an end. Supply chains, industry, and employment took years to recover from the wartime situation, and in this situation that we are now in, the disruption from this conflict will similarly outlast the fighting, whenever that might come to an end. Who knows when that might be? The consequences of this current war will persist long after any ceasefire, if ever there is one that holds.

The scale of the supply disruption is already severe, and it's only going to get worse. Let's remind ourselves of that. Around 20% of all world oil supplies have currently been disrupted by this conflict. That is a matter of fact, and even if there were a ceasefire today and oil began to flow again, there would be supply chain disruptions, and there would be an absolute constraint on world oil supplies as well because many of the oil wells in the area around the Gulf have been damaged in ways that will require years to repair. Similar disruptions are applying to gas, fertilisers, helium, and industrial chemicals, and there is no prospect in any of those cases of a rapid restoration either.

Infrastructure damage is substantial, and that is true on all sides in this war. We're already seeing the evidence now that the damage to US installations in the Middle East is much larger than has been admitted, and that will probably also be true of the Gulf states like Kuwait, Oman, Saudi, and elsewhere. All of those will be suffering severe

disruptions as a consequence.

The result is that we know that there will be disruption to world GDP growth because there is a very strong link between the availability of oil and that GDP growth, something that we do not know how to break as yet. And therefore, if the oil supply to the world falls, as it's going to, and as will continue for some time to come, GDP growth is going to fall away and become negative. We are going to have a recession. We might have a depression. I'm not being melodramatic by saying so. I'm simply pointing out the obvious fact that without oil, we cannot have growth. In fact, we will get a decline in world GDP.

Downside shocks of this scale are far harder to manage than growth itself. Downside shocks create second-order effects, and that is what is the problem with them. Growth doesn't create such difficult situations, although let's be clear, climate change is a second-order effect of growth, and we've never learned how to manage that. But the situation with regard to a downturn is that there is going to be serious business risk, and that serious business risk is what threatens our economy, and that is why our politicians are so desperate for growth most of the time, because they know that businesses do not know how to manage decline. They only know how to manage the upside, and there's vast amounts of evidence of that from business and macroeconomic history over decades and even centuries.

Businesses face a severe risk of disruption when there is a downturn in economic growth for one simple and straightforward reason. Most of them lack the resources to survive disruption to their supply chains and to their ability to meet their customers' demands. The fact is, those disruptions are going to take place. They will have erratic supply chains into their businesses. They will have an erratic ability to meet their customers' demands. The consequence is that they will begin to make losses. Most of them do not have the ability to sustain losses. They don't have money put aside to cover this situation. They have worked as the neoliberal dogma says is justified on a just-in-time basis, keeping the minimum amount of resources in the business that they can get away with, and that is what is going to leave them cruelly exposed to failure at this moment.

At the same time, inflation in the cost of essential supplies to households will force those households to readjust their own spending. They will be buying those essential items, fuel, energy, and food, and they will not be spending on other items. That collapse in spending will only exacerbate the downturn that many businesses will be facing right across the economy, and in turn, that could create the threat to banks that I've talked about in another video.

In this environment, markets simply cannot work. That is my point. The signals they are receiving are too confused for rational judgments on pricing and supply decisions to be made. The news media, politicians, and financial markets are all already generating contradictory information, and fear alone in this situation is enough to distort normal

price and allocation mechanisms. But the deeper problem is not confusion, serious although that is. It is the problem of absolute shortages.

When supply is genuinely constrained, which is a situation that most of us know nothing about, markets ration by price and not by need. That excludes those with the least resources from the goods they most require. Price rationing fails when the goods in question are essential to life. Rationing by price is tolerable only when the goods involved are non-essential. Items used for conspicuous consumption can be priced out of reach without social harm in this environment. Those items, which are essentially unnecessary, can have the resources dedicated to their production reallocated to essential purposes through the use of higher taxes to cut demand for them, and that is what is required in a wartime situation. But essential needs must still be met, and that again is the purpose of those higher taxes. They release resources to ensure that essential needs for food, fuel, and heat are met to ensure survival.

We are seeing that crisis right now. People may not be able to get those essential goods, and some people may literally be unable to afford to heat their homes or buy food this winter as a result.

In that situation, physical rationing has to be the alternative to market rationing, as it was after the Second World War. Now, I'm not saying that this will be easy. It isn't going to be. But the case for it is already strong. The question is whether governments will act before the crisis forces our hand.

The hardest problem is identifying who has what needs and in what priority, and assuming digital access to guarantee supply is, in this situation, wholly unrealistic. The most vulnerable are the least connected people within our society, and any system we create must serve those who are in most need and not just those who are easiest to reach.

So let's look at road fuel as an example. People who own cars probably need their cars. They do, therefore, need an allocation of fuel. Some people do, of course, own two cars. They could abuse a system where we allocate fuel to vehicles. So we do need a system where people will be able to acquire a set allocation of fuel without having to make further application for special circumstances, like their need to drive for work, and that fuel should be available at an affordable price, but it might be a relatively limited amount.

The fact is, though, that many people who drive to work don't need to. We have already proved that people can work at home, and we are facing an absolute shortage here, and we do need to keep commercial vehicles moving. That is essential for the well-being of our economy, because without their ability to move, we have nothing to consume, including food. So, we do, therefore, need to have a strict allocation of fuel to each vehicle or person, if they have multiple vehicles, but we need to do this in a way that is accessible for all.

Now, in many cases, that will be via a phone app, and there's no reason why not. In some cases, that will be by some physical system, like a card mechanism. But I can't see why existing technology in petrol stations cannot be adapted for this purpose. We're only talking about adding an additional access restriction on supply.

And we might also need a system to work out whether people will be allowed to buy excess fuel at higher market prices. The answer to that question is we won't know, but we'll have to allow for it. And if there is an excess payment, we will have to ensure that the excess is deliberately taxed to ensure that the subsidy provided to a basic allocation can be afforded. This is complicated, but entirely possible.

The same is true with regard to the supply of energy for home usage. A two-tier tariff, something that has long been discussed, could be put in place with regard to basic energy pricing for households. A fixed allocation based on past household consumption could be set affordably. That price will be paid by everybody for the first part of their consumption. Consumption above that level will be charged at a higher market rate tariff. This ensures essential needs can be met before excess is freely priced, and the market is not abolished; it is overridden where need must come first, which is also true with the suggestion I've made for road fuel.

The principle is simple: essentials first, excess at cost, the excess being used to subsidise the essential need. Cross-subsidisation and reallocation will be built into this system from the outset. That is what the principle of justice within it is based upon.

Food, however, is a harder and more urgent problem, and it cannot be ignored. Fuel can be rationed relatively cleanly through registration and allocation systems.

Food is more complex. It is diverse, perishable, and consumed in various ways. How to come up with a rationing system for that situation is harder to imagine. It was done in World War II, but let's be clear, the variety of foods available to us then were much lower than they are now. But on the other hand, we have much more information now. And let's not pretend otherwise, almost everybody buys their food through supermarkets. And we will need to adjust supermarket sales systems through, for example, changes to loyalty card systems to impose limits on what people can buy. That will be necessary if there is an absolute shortage of food.

Essential items will have to be price-managed. They will be limited in supply, and again, a process of reallocation of resources through the pricing mechanism for those goods which are allowed in excess of basic supplies will have to be in operation to make sure that this is financially viable.

I have no immediate answers to all the questions in this case. It is complex. I'm not pretending otherwise, and sometimes honesty on my part is required, but I have no doubt such a system could be created. If we can create things like complex store cards, we can certainly create a rationing system sitting on top of them, and that is what is

going to be necessary at this moment, and you may have to nominate your chosen food supplier in the case of this situation arising, because that will be the way in which you get your allocation of food.

And that is my point. The fact is that the neoliberal state and the market have no answer to the crisis that we are facing, and this is going to become apparent. Neoliberal governments believe that markets self-correct, and that belief cannot survive this crisis. The state, in that case, cannot stand aside when people cannot eat, heat their homes or get to work if they have to. Intervention will come in that case. The question is when and on whose terms.

Intervention designed in advance is far better than intervention forced by emergency. We saw the cost of that in the COVID crisis. We need to be doing this work now because it is going to be necessary, and even if it goes to waste, let me be clear, we'll be ready for the time after this.

The cost of delay on this occasion will be paid by those least able to afford it. The moment of decision is coming. The question is whether governments are ready. Markets work well in stability. I'm not arguing otherwise, and that requires adequate supply and clear price signals, but none of those conditions applies now, and they will not be returning quickly.

The longer governments cling to market orthodoxy, the greater the damage will be. Physical rationing, price controls and deliberate allocation are not radical ideas. They've happened before. They will happen again. They are what wartime demands, and the task now is to revive proven tools like rationing before the crisis makes this choice for us.

That's what I think. What do you think? There's a poll down below. Please let us have your comments. Please do share this video if you like it. If you do, please subscribe to this channel. You'll get notifications of when we bring out new videos, although that is every day as a matter of course. And if you're willing to support the work that we do and would like to make a donation, we would be very grateful.

Poll

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