HSBC Global Research

24 January 2022

Fighting inflation

Are price controls about to make a comeback?

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Economics - Global

- Conventionally, inflation is managed through monetary policy
- Some, however, are calling for price controls instead
- Their siren voices should be resisted

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Heading for the inflationary rocks

Since the 1980s, the main objective of macroeconomic policy has been price stability. Yet, two years into the pandemic, the good ship "Build Back Better" is in danger of being wrecked on inflationary rocks. For much of last year, central bankers argued that inflation was mostly transitory. Now, the Fed's Jay Powell has "retired" the use of the word. That's hardly surprising. Inflation is rising in an ever increasing number of countries. And what started off as a story about energy prices and used cars is now far more widespread: in some parts of the world, both prices *and* wages are under significant upward pressure.

Some want to return to price controls

Fearing the consequences of severe monetary tightening – most obviously, the danger of another recession – some are arguing for the imposition of price controls instead, marking a return to thinking widely discredited during the stagflation of the 1970s. For the US, at least, the attractions are superficially obvious. Over the last two years, American profits have surged. Could it be that companies are taking advantage of pandemic shortages to push through exorbitant price increases?

Why the siren voices should be resisted

While such arguments may carry political resonance, economically they don't stack up. In the US, many of the sectors with the strongest profits growth have seen the smallest price increases. With tight labour markets triggering rapid wage increases (at least in the US), the rise in inflation cannot be explained by greedy companies alone. And it's far from clear how price controls would protect individual economies from what in many cases are worldwide inflationary squalls.

Learning the lessons from the Nixon era

In 1971, President Nixon introduced a price and wage freeze, followed three months later by bureaucratic arrangements to "manage" prices and wages from "on high". It was a disaster. Following many subsequent years of economic pain, Americans eventually acknowledged economic reality: when it came to excessive inflation, there was no substitute for tough and credible monetary action. It's easy enough today to kid ourselves that inflation is purely transitory, or that it can be brought to heel via a modern-day version of Nixon's measures. In truth, however, the pandemic has left us with too much demand and too little supply. It's time to wake up to reality.

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Fighting inflation

- Some are attacking the conventional wisdom on inflation…
- …calling for price controls rather than monetary tightening
- Both history and current economic reality suggest such controls would be unwise

From radical thoughts to conventional wisdom

In 1984, the then Chancellor of the Exchequer, Nigel Lawson gave a speech which, for those involved with UK economic policy in the years that followed, gained almost mythical status. The title of the 1984 Mais Lecture was "The British Experiment"[1]. Lawson went out of his way to overturn what he considered to be conventional post-War wisdom. "*It is the conquest of inflation, and not the pursuit of growth and employment, which is or should be the objective of macro-economic policy. And it is the creation of conditions conducive to growth and employment, and not the suppression of price rises, which is or should be the objective of micro-economic policy.*"

In subsequent decades, the Lawson mantra – seemingly so revolutionary at the time – gradually became the new conventional wisdom. Central banks were tasked primarily with the achievement of price stability. Faster economic growth and lower unemployment, meanwhile, could only be achieved lastingly through microeconomic supply-side reform, a view based empirically on the observation that employment in the US had grown more quickly than in Europe in the late-1970s and early 1980s, apparently reflecting a much more "flexible" labour market. Empiricism, however, only went so far. Lawson's conclusions also rested heavily on a philosophical belief in the supremacy of free markets: "*instead of microeconomic policy consisting of increasingly numerous forms of intervention and interference with market forces, its role is now seen as removing controls and allowing markets to work better*."

The conventional wisdom is called into question

The Global Financial Crisis – and, notably, its aftermath – triggered the first serious doubts about the Lawson mantra. On any conventional measure, price stability had been broadly achieved. How, then, could much of the world succumb to a financial bust – in which "market forces" had seemingly failed – and a broader economic meltdown? With economic growth in the developed world thereafter proceeding at a paltry pace, why did policymakers continue to focus on the achievement of price stability which, by then, seemed so easy to achieve (chart 1)? Surely there were more pressing concerns?

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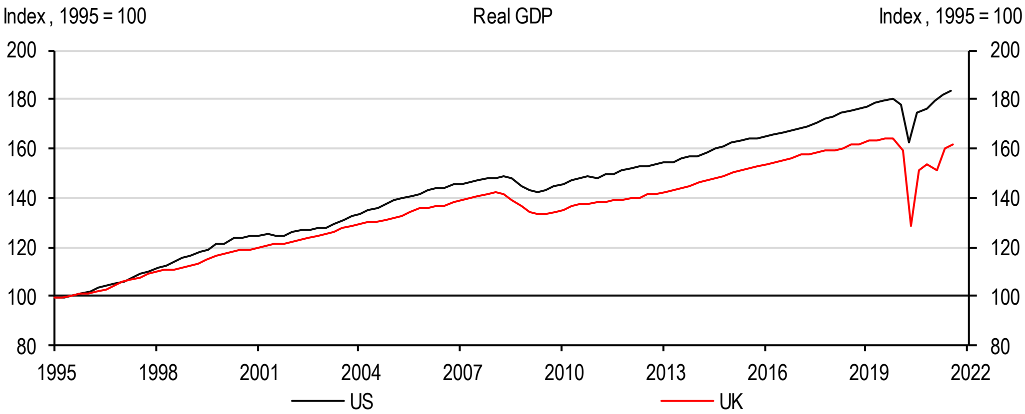
[1] Available at [Economic policy: The British Experiment (The Mais Lecture) | Margaret Thatcher Foundation]

1. The level of GDP in both the US and UK is a long way short of the pre-Global Financial Crisis trajectory



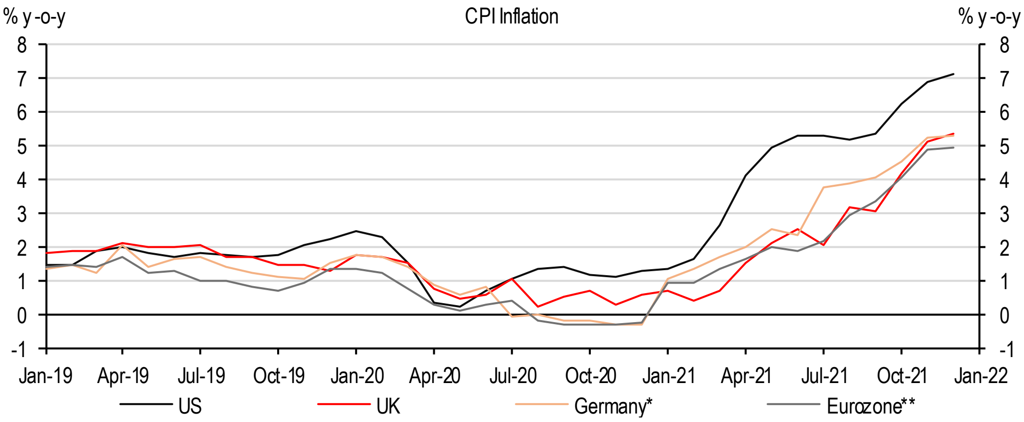
Source: Refinitiv Datastream

In time, of course, central bankers found themselves widening their policy ambitions: increasingly, they had to think about growth, unemployment, financial stability, fiscal sustainability and the "greening" of their respective economies. These "trade-offs" already contradicted the Lawson theology, which demanded a continuous and unrelenting macroeconomic focus on the achievement of price stability alone (a view which had already been long embraced by Germany's Bundesbank). For a while, however, the incorporation of these various trade-offs didn't seem to matter. Inflation for the most part remained well behaved.

The return of inflation

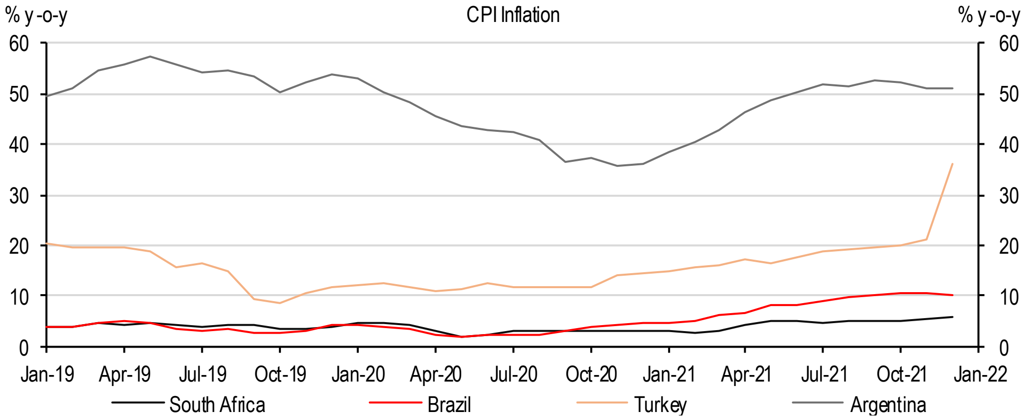
Today, however, inflation is behaving rather badly. US inflation, perhaps the most visible yardstick, reached 7.0% at the end of 2021, the highest annual rate since 1982. UK inflation has risen to 5.4%. The Eurozone, which for too long seemed to be condemned to relentless deflation, now has rather too much inflation, with the latest rate up at 5.0%. Within the Eurozone, German inflation is up at 5.3%, a distinctly uncomfortable number for a nation still psychologically scarred by the hyperinflation of the early 1920s. In the emerging world, inflation has been rekindled or maintained in, among others, South Africa (5.9%) Brazil (10.7%), Turkey (36.1%) and Argentina (51.2%). Admittedly, not all countries have succumbed: price pressures have, to date, risen only modestly in China (2.3%), Japan (0.8%) and Indonesia (1.9%). Still, for the world as a whole, inflation is a lot higher than forecasters had suggested a year or so ago.

2. Inflation has risen rapidly in much of the developed world…



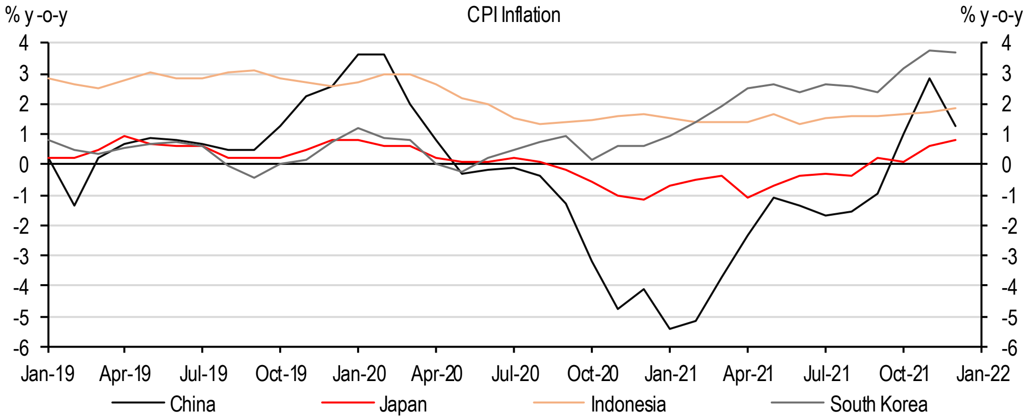
Source: Refinitiv Datastream Note: * Germany is national measure **Eurozone data is HICP

3…and in many parts of the emerging world…



Source: Refinitiv Datastream

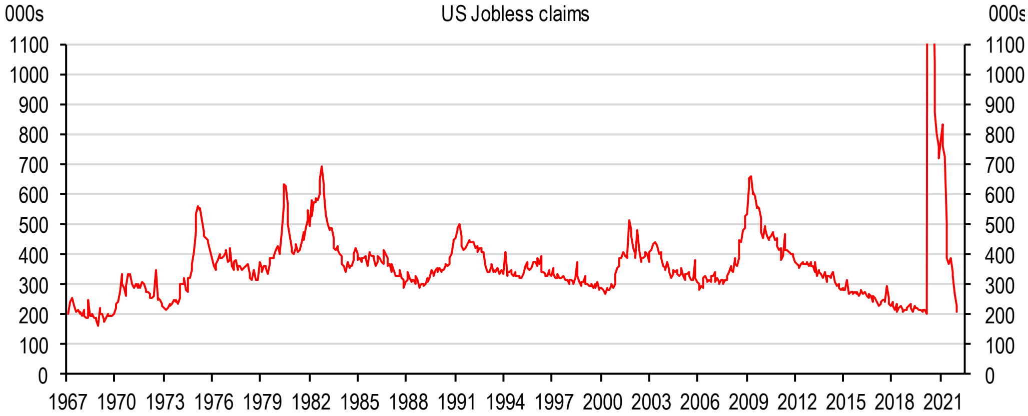
4….but parts of Asia have, to date, been mostly immune



Source: Refinitiv Datastream

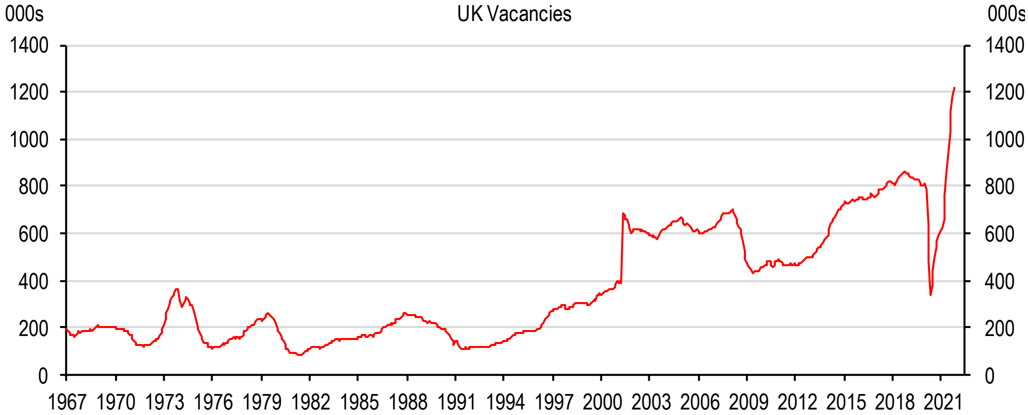
The initial response from many central banks was to argue that any rise in inflation was transitory and, thus, that there was no reason to worry. This was a knee-jerk response to the initial impact of the pandemic. Temporary lockdowns, associated with the displacement of both goods and workers, were triggering shortages and, hence, price pressures across a range of goods, most visibly semiconductors, energy and – an indirect consequence of the semiconductor shortage - second-hand cars. It seemed to follow that, with the roll out of vaccinations and the lifting of lockdowns, there would be a swift return to economic "normality". Yet even if some countries are no longer officially in lockdown (the US and UK are good examples), the world as a whole still is. China is still largely shut to outside visitors, Novak Djokovic has demonstrated that Australian border controls are both tough and (for him at least) complicated, and shortages now apply not just to goods but also to labour: US jobless claims are the lowest since the late-1960s while UK vacancies are the highest since then (charts 5 and 6).

5. US jobless claims, having spiked during COVID, are now around the lowest since the 1960s



Source: Refinitiv Datastream Note: *Jobless claims were recorded at 5985k in April 2020, 2784k in May 2020, 1605k in June 2020 and 1436k in July 2020.

6. UK vacancies are by far the highest on record



Source: Refinitiv Datastream

A conventional interpretation of this now rather more persistent increase in inflation is relatively straightforward, at least with the benefit of hindsight. From a demand perspective, the COVID-19 pandemic has been associated with huge stimulus. Interest rates were slashed to nothing (and sometimes beyond), quantitative easing programmes were, in some cases, expanded, and budget deficits widened enormously as governments built financial “bridges” to prevent companies and workers from plunging into lockdown chasms. Monetarists would point to an unprecedented acceleration in money supply growth.

From a supply perspective, the suspension of markets during lockdowns led to a loss of information that, in turn, meant that the last, now “historic”, price was increasingly irrelevant as a guide to future market conditions. As such, when markets reopened, supply shortages were revealed that could not be resolved easily or quickly: not enough semiconductors to meet rebounding demand for cars; not enough waiters to meet rebounding demand for meals in restaurants; not enough dockers to unload ships; and not enough truck drivers to transport goods from ports to warehouses[2].

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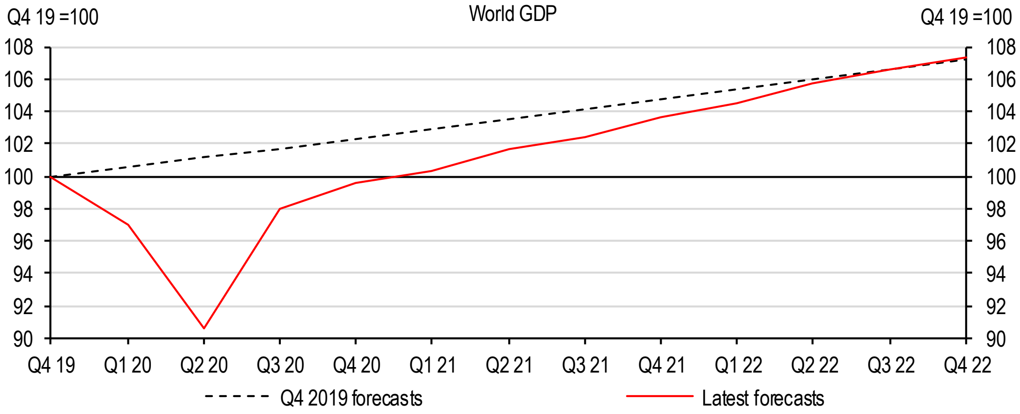
[2] For a detailed discussion, see King, S, *Fixing a Broken Economy: Shortages, Ignorance and Inflation*, October 2021, available at https://www.research.hsbc.com/R/10/D9TmBfqQjohf

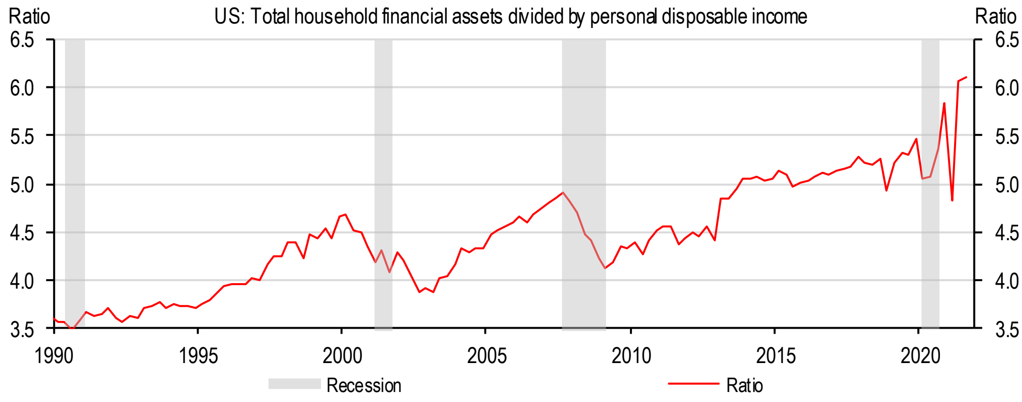
7. World GDP may be about to "overtake" its pre-COVID-19 path



Source: HSBC forecasts

An increasing number of forecasters now accept that global GDP will end up higher by the end of 2023 than it would have been in the pandemic's absence, implying a sizeable recovery in demand (chart 7). Yet if supply really is curtailed, the inevitable result would appear to be higher inflation. Some argue that, with the huge US fiscal stimulus over the last 18 months about to reverse into a sizeable fiscal contraction, recent inflationary trends will rapidly unwind. This argument, however, ignores another aspect of the pandemic story, namely that the value of American household financial assets is a lot higher than prior to the pandemic, thanks in part to continued monetary stimulus. Whatever the public sector takes away from demand, the household sector is more than capable of adding back, depending of course on how the assets are distributed between rich and not so rich (chart 8).

8. Household spending "potential" is a lot higher than it was



Source: Federal Reserve Economic Data

These arguments are entirely consistent with the Lawson view of the world: too much demand caused by a lack of macroeconomic focus on inflationary risks and, thanks to multiple lockdowns, too little supply caused by the failure of markets to operate effectively at the microeconomic level.

Out with the old, in with the very old: the "new" old approach

There is, however, a new story beginning to emerge which attempts to explain the rise in inflation not through macroeconomic error and supply-side failures but, instead, through corporate pricing power. It's a throwback to the 1950s and 1960s – with a sprinkling of 19th Century Marxism thrown in for good measure – and it rejects entirely the Lawsonian view.

One version of this comes from the White House. At the beginning of the year, the Biden Administration issued a *Fact Sheet* setting out policies designed to deliver a "*fairer, more competitive, and more resilient meat and poultry supply chain*"[3]. The *Fact Sheet* states that "*while dominant middlemen control so much of the supply chain, they can increase their own profits at the expense of both farmers – who make less – and consumers – who pay more…Even as farmers' share of profits has dwindled, American consumers are paying more – with meat and poultry prices now the single largest contributor to the rising cost of food people consume at home.*"

In other words, there is a direct connection between an oligopolistic industrial structure and the likelihood of unseemly price pressures. The same argument has been made – on a more sweeping basis – by Isabella Weber, an assistant professor of economics at the University of Massachusetts Amherst. In a widely-cited article in the Guardian newspaper – "We have a powerful weapon to fight inflation: price controls. It's time we consider it"[4] – she notes that "*a critical factor that is driving up prices remains largely overlooked: an explosion in profits…large corporations have used supply problems as an opportunity to increase prices and scoop windfall profits*". She adds that "*the Federal Reserve has taken a hawkish turn…but cutting monetary stimulus will not fix supply chains. What we need instead is a serious conversation about strategic price controls – just like after the [Second World] War*.

Her conclusion completely inverts the Lawson view. "*Today, there is…a choice between tolerating the ongoing explosion of profits that drives up prices or tailored controls on carefully selected prices. Price controls would buy time to deal with bottlenecks that will continue so long as the pandemic prevails.*" Others have sympathised. Stephanie Kelton, author of The Deficit Myth and a prominent supporter of Modern Monetary Theory, embraced Weber's thesis on Twitter. In The Deficit Myth, however, Kelton offered a rather more macroeconomic view: "*MMT recommends a different approach to the federal budgeting process, one that integrates inflation risk into the decision-making process so that lawmakers are forced to stop and think about whether they have taken the necessary steps to guard against inflation risk before approving any new spending*", adding that "*we don't want to allow excessive [public] spending to cause inflation and then fight inflation after it happens*".

There's a good argument to be made now that inflation risks were, frankly, completely ignored by governments in 2020 given the fiscal largesse on offer, and given that inflation at the time was far too low. That, however, would undermine the MMT claim that governments, and not central banks, can be trusted with the control of inflation. Far easier, instead, to argue that this latest dose of inflation is a "special case" in which conventional macroeconomic rules simply don't apply.

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[3] See https://www.whitehouse.gov/briefing-room/statements-releases/2022/01/03/fact-sheet-the-biden-harris-action-plan-for-a-fairer-more-competitive-and-more-resilient-meat-and-poultry-supply-chain/
[4] See https://www.theguardian.com/business/commentisfree/2021/dec/29/inflation-price-controls-time-we-use-it?aff_id=1262

Profits and price increases: a tenuous story

One way to assess the "special case" argument is to compare increases in profits with price increases: if this latest dose of inflation really is a special case, there ought to be some evidence to support the claim. The US Bureau of Economic Analysis subdivides US profits into industrial groups, as listed in table 9. The table shows profits in every quarter from the beginning of 2019. The columns on the right-hand side of the table show (i) the percentage increase in profits between the third quarter of 2019 (pre-pandemic) and the corresponding quarter of 2021 (beyond the worst of the pandemic) and (ii) the percentage point contribution to profits growth over the same two-year period: the numbers from the various industrial groups in this column add up to overall profits growth.

9. Some American companies have profited more than others

	2019				2020				2021			% change over two years	Ppt contribution over two years
Billions of USD, seasonally adjusted annual rates	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3		
Domestic industries	1799.2	1858.1	1859.3	1901	1690.4	1534.3	1981	1950.5	2085	2359	2404.8	29.3	29.3
Financial*	501.8	514.3	503.1	508.4	452.1	465.6	466.7	483.7	485	537.8	551.9	9.7	2.6
Nonfinancial	1297.4	1343.8	1356.2	1392.6	1238.4	1068.7	1514.3	1466.8	1600	1821.3	1852.9	36.6	26.7
Domestic industries	1716.8	1750.6	1732.8	1764.5	1602.8	1455.7	1906	1880.1	1995.4	2287.6	2362.6	36.3	33.9
Financial	522.2	540.1	532.2	538.3	486	500.6	502.4	521	519.9	576.9	597.5	12.3	3.5
Federal Reserve banks	61.1	68	64	63.3	81.6	89.7	106.1	94.4	83.9	114.4	128.7	101.1	3.5
Other financial**	461.1	472	468.1	475	404.5	410.9	396.4	426.6	436	462.5	468.8	0.1	0.0
Nonfinancial	1194.6	1210.5	1200.6	1226.2	1116.8	955.1	1403.6	1359.1	1475.6	1710.7	1765.1	47.0	30.4
Utilities	16.4	13.5	4.3	-3.3	0.6	11.1	10.4	19.6	20.9	11.9	20.4	374.4	0.9
Manufacturing	339.5	350.6	365.6	367.1	340.9	246.9	362.3	365.3	401.9	450.5	500.4	36.9	7.3
Durable goods	189.6	188.6	176.5	179	180.7	133.1	222.3	218	234.7	248.1	240	36.0	3.4
Fabricated metal products	22.8	22.2	20.9	21.9	24.1	11.5	27.2	27.7	26.6	25.3	13.4	-35.9	-0.4
Machinery	19.8	26.6	28	29	24.4	18.4	36.4	32.3	32.5	33.1	20.2	-27.9	-0.4
Computer and electronic products	67.6	61.5	56.1	62.3	64.4	63.4	63	77	93.1	97.8	111.7	99.1	3.0
Electrical equipment, appliances, and components	5	4.1	4.2	3.9	2.3	6.3	10.4	7.2	7.1	4	5.3	26.2	0.1
Motor vehicles, bodies and trailers, and parts	3.3	5.8	5.6	3.2	7.9	6.6	8.9	-1.1	-3	-10.7	-14.3	-355.4	-1.1
Other durable goods***	71.2	68.4	61.7	58.6	57.6	26.8	76.4	74.8	78.4	98.6	103.7	68.1	2.3
Nondurable goods	149.9	162.1	189.1	188.2	160.3	113.8	140	147.3	167.2	202.3	260.4	37.7	3.8
Food and beverage and tobacco products	50.9	52.3	58.1	59.7	65.4	76.2	78.7	78.7	79.3	75.1	101.3	74.4	2.3
Petroleum and coal products	11.1	14	24.9	16.9	1.2	-45.6	-55.6	-51.7	-21	2.7	11.2	-55.0	-0.7
Chemical products	58.8	64.7	72.4	75.9	69.8	70.3	78.6	79.6	72.9	90.7	107.7	48.8	1.9
Other nondurable goods****	29.1	31.1	33.8	35.7	23.9	13	38.3	40.7	36	33.8	40.1	18.6	0.3
Wholesale trade	117.6	110.7	123.4	119.6	131.9	101.4	125.4	136.2	112.6	137.6	155.4	25.9	1.7
Retail trade	144.5	153.6	158.2	180.3	171.2	209.7	250.2	242.9	280.2	307.6	270.2	70.8	6.0
Transportation and warehousing	38.3	35.2	39.2	37.6	22.8	6.5	22.7	24.8	34.5	64.4	47.4	20.9	0.4
Information	133.7	139	104.9	133.4	126.5	112	143.4	157.7	161	175.5	176.8	68.5	3.9
Other nonfinancial*****	404.7	408	404.9	391.5	322.9	267.6	489.2	412.5	464.4	563.3	594.5	46.8	10.2

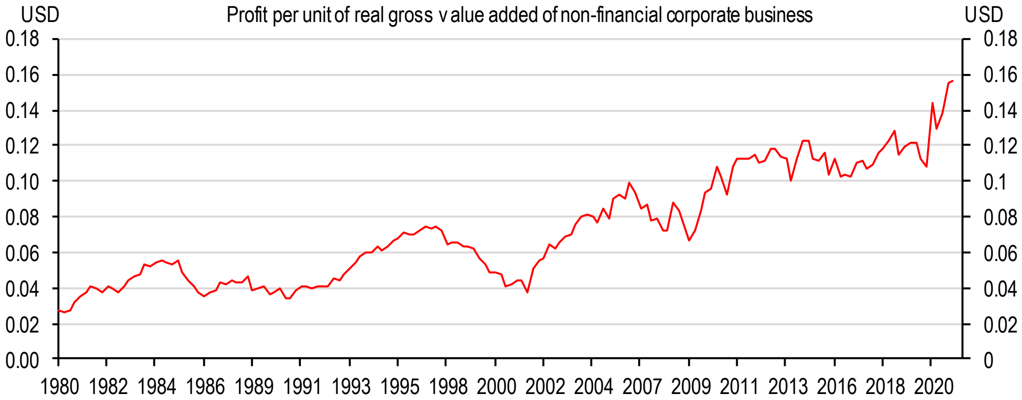
Source: Source: Bureau of Economic Analysis

Note: Estimates in this table are based on the 2012 North American Industry Classification system (NAICS)

*Consists of finance and insurance and bank and other holding companies. **Consists of credit intermediation and related activities; securities, commodity contracts, and other financial investments and related activities; insurance carriers and related activities; funds, trusts, and other financial vehicles; and bank and other holding companies. ***Consists of wood products; non-metallic mineral products; primary metals; other transportation equipment; furniture and related products; and miscellaneous manufacturing. ****Consists of textile mills and textile product mills; apparel; leather and allied products; paper products; printing and related support activities; and plastics and rubber products. *****Consists of agriculture, forestry, fishing, and hunting; mining; construction; real estate and rental and leasing; professional, scientific, and technical services; administrative and waste management services; educational services; health care and social assistance; arts, entertainment, and recreation; accommodation and food services; and other services, except government.

What is not in doubt is that domestic US profits have, indeed, grown enormously, up almost 30% over the two-year period. As such, the profit share in GDP has also grown hugely, with one such measure (and there are many) shown in chart 10. The lion's share of the profits surge comes from the non-financial sector, which contributed 26.7 percentage points of the overall 29.3% increase over the past two years. It's also true that, within these numbers, some pandemic-affected industries have done remarkably well: profits from utilities have risen 374%.

10. American non-financial companies have had a "good" pandemic



Source: Federal Reserve Economic Data

Yet the increase in utilities profits contributed only 0.9 percentage points – or a thirtieth – to the overall profits gain. Put another way, a big percentage increase in profits for an industry that makes only a very modest contribution to overall profitability is not, in itself, a game changer. Other industries carry far more weight in explaining the overall increase in profits. Chief among them are (i) manufacturing (7.3 percentage points), within which "computers and electronic products" contributed 3 percentage points and "food, beverages and tobacco" added a further 2.3 percentage points; (ii) retail (6 percentage points); and (iii) information (3.9 percentage points).

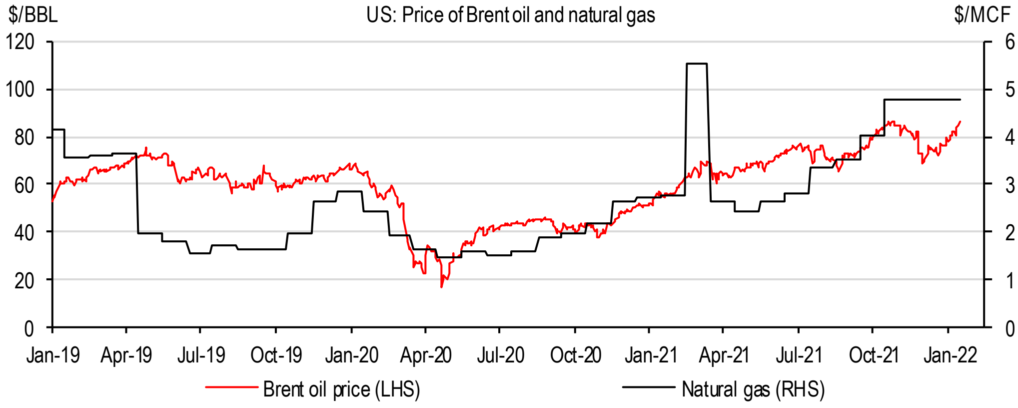
If profiteering is a key reason behind the overall acceleration in inflation in recent months, it would be reasonable to think that these major contributors to the overall increase in profits have also been major drivers of excess inflation: in other words, that these "super-profitable" industries have raised prices more than average. Given that all of the increase in US inflation – from 1.4% to 7.0% – has taken place since the end of 2020, we simply need to look at what the contribution to inflation from the "super-profitable" industries has been over the last twelve months. Prices of information technology commodities – including computers, peripherals, smart assistants, software and telephones – have risen a mere 0.3%. Food prices have risen by 6.3%, still less than the overall increase in prices. Video and audio services – including cable and satellite – have risen 2.6%, much less than the overall increase in inflation.

Admittedly, within the food category, meat prices have surged, up almost 15% on the year. Meat, however, has a weight of only 1.1% in the consumer price basket, implying that the impact on overall inflation from surging meat prices is negligible. Prices of information technology commodities, meanwhile, have been rising in recent months for the first time since records began, suggesting that previously deflationary forces are no longer operating. That reversal of fortune, however, can only go so far in explaining how overall inflation has managed to rise to 7%.

"Tailored controls" or wishful thinking?

Weber talks about "*tailored controls on carefully selected prices*". A starting point might be to sift through the various inflationary components and focus on those which happen to be rising more than average. Meat might fall into that category. But if meat does, how about "living room, kitchen and dining room furniture" (up 17.3%), used cars and trucks (up 37.3%), car and truck rental (up 36.0%) or hotels and motels (up 27.6%)? Are these all part of some kind of oligopolistic conspiracy associated with a cabal of greedy companies? And, even if they were, how might we explain the failure of "big pharma" – frequently regarded as a highly oligopolistic industry – to raise prices in any significant way during the latest inflation upsurge? The price of prescription drugs is unchanged in a year in which, apparently, market power is the key driver of the upsurge in inflation.

11. Can energy prices be subject to "tailored controls"?



Source: Refinitiv Datastream

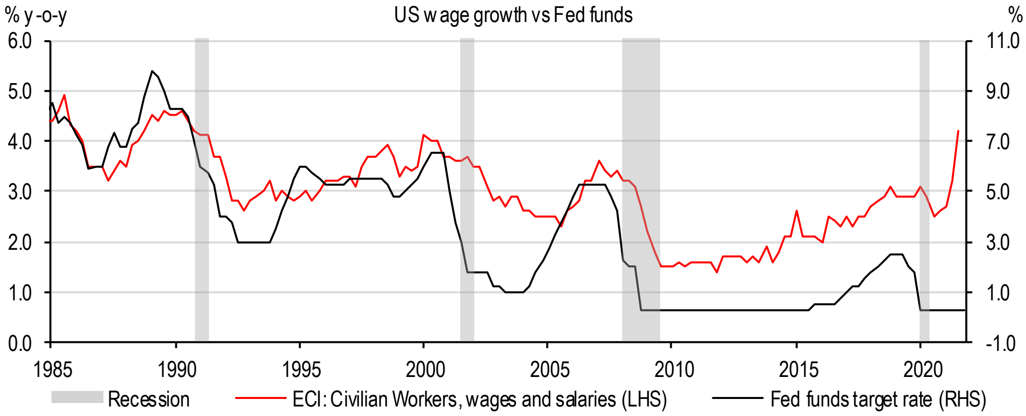
We can also make the argument in reverse. Rising energy prices have, of course, been a major contributor to the overall increase in inflation worldwide over the last 12 months. In the US, energy prices are up around 30%. It's most obviously a reflection of a huge increase in the worldwide price of hydrocarbons: what is true of the US is equally true in, say, Europe (chart 11). Admittedly, the US impact is bigger than elsewhere, but that primarily reflects the much lower level of taxes and duty on, say, US gasoline and, as a consequence, the much bigger proportionate movement in the retail gasoline price for any given movement in oil prices.

Imagine, however, that energy prices are subjected to "*tailored controls*". From the UK's recent experience, we know what happens: the imposition of an energy price cap for customers simply means that energy suppliers are unable to pass on the full extent of an increase in wholesale prices, with the inevitable result that some of those suppliers go bust. State intervention – in the form of subsidies – is then required to ensure that customers continue to receive their energy from the remaining operators. There are also potential long-term consequences. If "tailored controls" leave the return on equity unusually depressed, there's every chance that investment plans will be stymied. Lower prices in the short term will be followed by lower production in the long term, leading to both shortages and delayed price increases. (South Africa's frequent power cuts are a good example of the long term costs of imposing "fair" price ceilings).

Then there's the international dimension. If prices are rising globally – and supply chains operate across many borders – imposing "tailored controls" domestically may not be quite so easy. Take, for example, the semiconductor shortage and its impact on the car market. If new cars simply cannot be produced to order, it follows that "nearly new" cars which are already on the road will increase in value. Their increase, in turn, will lead to a ripple effect throughout the second-hand car market as a whole. How would "tailored controls" work in these circumstances? There would be no point imposing a price ceiling on semiconductors because that would simply mean semiconductor producers would export their chips elsewhere. There would equally be no point in imposing a price ceiling on car manufacturers: they, after all, cannot be held responsible for their inability to produce sufficient cars. As for imposing price controls on second hand cars, that is a non-starter, partly because any such attempt would doubtless lead to a huge expansion in the black market.

Finally, there's the labour market dimension. Sustainably higher inflation is not a story about prices alone. It is also a story about wages. It's true that profits have risen rapidly over the last two years. It's also true that, more recently, wages have started to head higher on both sides of the Atlantic (even if, with price inflation outstripping wage growth, real wages are now in many cases falling). As we've already noted, there are also increasing signs of what would traditionally be regarded as "tight" labour markets. If there is a case for "tailored controls" on prices, there might also, in time, be a case for "tailored controls" on wages. We'd then be back to the incomes and prices policies of the 1960s and 1970s. In truth, in any other circumstances interest rates would, by now, be rising rapidly. The bottom line is that, given recent wage developments, it's increasingly looking as though US monetary policy has been left too loose for too long (chart 12).

12. US wages are rising rapidly even as Fed funds remain at rock bottom



Source: US Bureau of Labor Statistics, Refinitiv Datastream

Nixon's gamble

On 15 August 1971, President Nixon announced that "I am today ordering a freeze on all prices and wages through the United States". After 90 days, a Pay Board and a Price Commission – the latter chaired by a youthful Donald Rumsfeld – were created, designed to "manage" prices and wages and to nip inflation in the bud. There were two major consequences. First, markets failed because prices could no longer easily signal either shortages or excesses. Production seized up. Second, by ignoring the macroeconomic conditions that had given rise to inflation in the first place – notably the absence of any kind of nominal anchor for inflation expectations – inflation itself became a much bigger problem. Stagflation was the result. The UK's attempts were, if anything, even more of a failure. A refusal to recognise that pursuing growth and low unemployment at all costs, regardless of the inflationary consequences, ultimately led to the 1976 IMF bailout.

Inflation is back… but price controls are NOT the answer

A little under a year ago, it was just possible to argue in favour of "tailored controls" on the basis that the first signs of inflationary pressure appeared in a limited number of areas, one reason why central bankers themselves argued that inflation might prove to be transitory. Today, inflationary pressures are much more widespread. In the US, rapid price increases are occurring in multiple areas. The same is increasingly so in many other economies too. The ambition to "build back better" has understandably led policymakers to exercise restraint regarding both the timing and pace of policy tightening. The danger with such an approach, however, is that inflation is stealthily able to creep back into our collective consciousness.

Under these circumstances, it's tempting to find policy "shortcuts". One such shortcut is price controls. Superficially, they offer policymakers an easy way out. They're politically appealing – governments can take credit for limiting people's energy bills, say, and can even argue that they're helping ordinary workers at the expense of predatory corporations – and they're seductively easy to understand. They also reflect a change in the broader political environment: ever since the Global Financial Crisis, public enthusiasm for "market solutions" has dwindled.

Irrespective of one's politics, however, it's important to recognise that some economic policies are better than others. It's all very well blaming high profits for the latest dose of inflation but, at least in the US, the profit share in GDP has been on a rising trend for around two decades. For most of that period, inflation was either falling or too low, not too high. True, monetary tightening designed to squeeze inflation out of the system can lead to a recession and, with it, a temporary increase in unemployment. Imposing price and wage controls, however, is likely to lead to a far worse outcome: lower rates of economic growth because markets are no longer able to function well, structurally higher rates of unemployment for exactly the same reasons, and higher rates of inflation because policymakers fail to recognise the root cause of the problem.[5]

That's what happened in the 1970s. And, if the political and policy debate really is shifting, it could be about to happen again.

[5] For a more theoretical critique of price controls, see https://noahpinion.substack.com/p/why-price-controls-are-a-bad-tool__;!!LSAcJDlP!n7gkH79Xyyhum1tDR5fQPZn57Rjh1Sh1NXVu-1JzXbl_Wf81Ts6iEigwWN25w_Lhbw$

Disclosure appendix

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