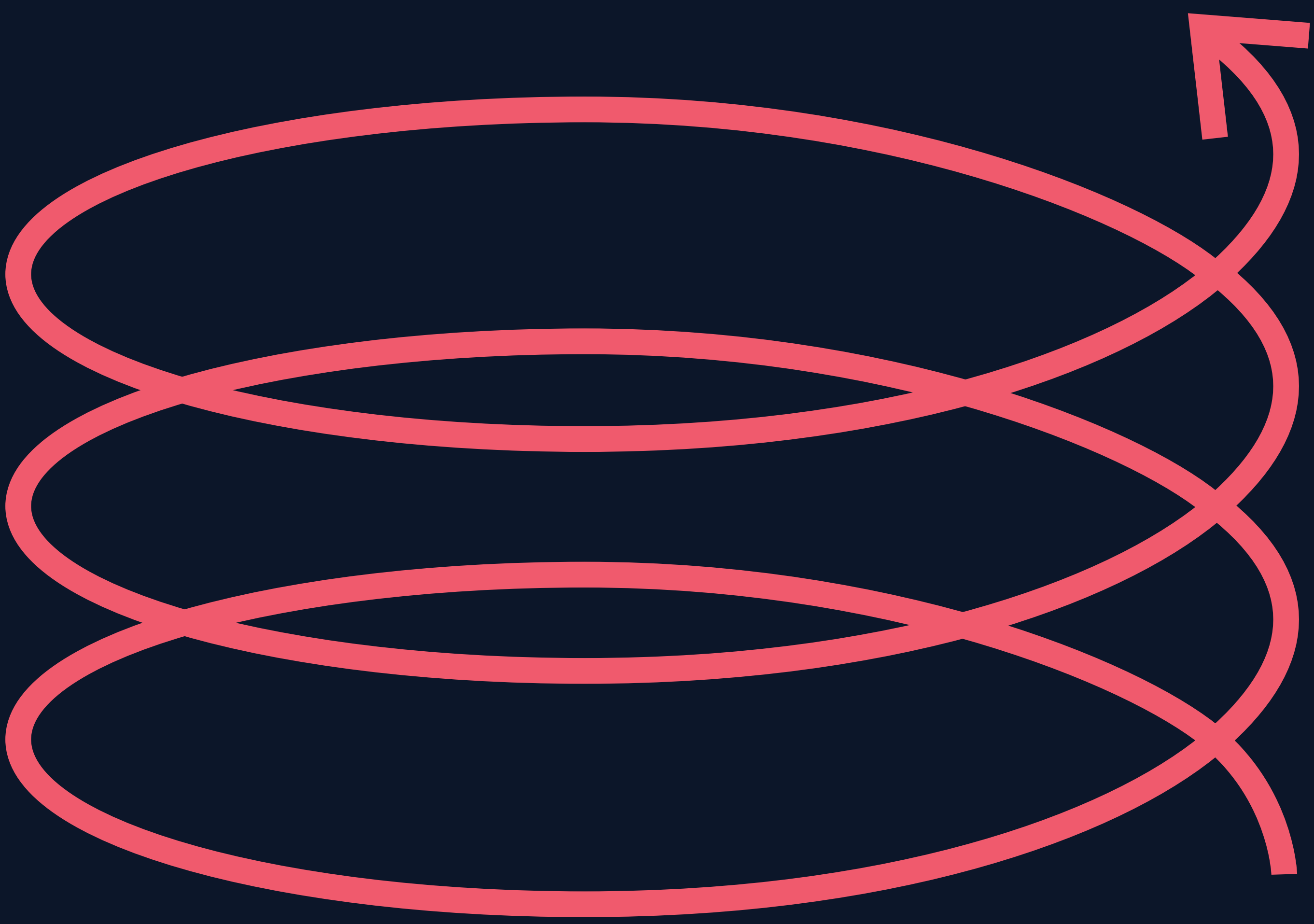
The True Causes of Inflation: Weak Production and High Profits

Costas Lapavitsas, James Meadway and Doug Nicholls

Sept 2022



PEF Progressive Economy Forum

GFTU
GENERAL FEDERATION OF TRADE UNIONS

EReNSEP
European Research Network on Social and Economic Policy

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1. Introduction

The "cost of living crisis" in the UK can be simply summed up: prices, especially of essentials, are too high, and wages, and other working-class incomes are too low. The basic steps to resolving the crisis are simple: prices, especially of essentials, must be brought down, and wages, salaries, benefits, and pensions must be increased.

This pamphlet shows that the big businesses dominating production and distribution make huge profits out of high inflation, while working people lose out. It sets out factual evidence to illustrate that the source of record profits is the fall in real wages as inflation rises. A large part of the income of working people is transferred directly into the profits of big business.

The pamphlet also shows that the deeper roots of the "cost of living crisis" lie in the unique weaknesses of the productive side of the British economy. These weaknesses can be clearly seen in very low investment and poor productivity growth for many years.

These arguments are made to clarify how the government and trade unions could in practice deal with the problem of inflation. The answer must be wage increases to stop the income of workers from falling. It must also include price controls and regulation of profits to stop the transfer of income from workers to big business. More fundamentally, the answer must involve sustained public intervention to deal with the weaknesses of production, especially of manufacturing, and to rebalance the economy in favour of industry and other productive sectors. The UK must become more self-reliant in the years ahead.

The plain argument that high prices go together with high profits, falling wages, and weak production is often distorted and hidden by mainstream commentary in the media and elsewhere. To explain the crisis, it is usually argued that wages are too high, or that the government has "printed" too much money. It is also argued that events far away, such as the war in Ukraine, are solely to blame.
This pamphlet shows why these arguments do not work. The causes of the crisis are ultimately to be found in relations of property and power in the economy that have created deep problems because production is focussed on profit making. It

is vital that working people should avoid paying for the "cost of living crisis" and the UK economy is put on a different course for the benefit of the vast majority.

The pamphlet is the product of close collaboration between the General Federation of Trade Unions (GFTU), the Progressive Economics Forum (PEF), and the European Research Network on Social and Economic Policy (EReNSEP) at the School of Oriental and African Studies, University of London (SOAS). We wanted to produce a tool for education courses, a strong set of arguments to strengthen campaigning by placing the current crisis in a historical context, and to look forward to fresh solutions. Naturally along the way we had to bust the myths spoken daily about inflation, usually by those who benefit most from it.

The route ahead of the UK must be the reverse of that taken over the last forty years, led by Margaret Thatcher. Markets cannot be relied upon to run society, and pioneer advanced technology and environmental protection. Nor obviously can they ensure that our primary needs of food, homes, energy, transport, and utilities are affordable.

Britain's extreme unleashing of market forces involved unprecedented privatisation and selling of public assets, wholesale deindustrialisation, and deregulation of the finance sector. It included the systematic introduction of anti-union legislation and break up of collective bargaining and the erosion of the value of pensions as well as continual downward pressure on wages.

Corporate economic and political power was tremendously strengthened and, as a result, big businesses have been able to help themselves to extraordinary profits. Their means of doing this, often with additional government funding, as trade union leaders have pointed out, are shameful for an advanced country.

No amount of windfall taxes, lower taxes, household subsidies and the like will stop this profit binge. Major structural change is needed. If this is not done, the current toxic mix of weak investment, low productivity, and high inflation will lead to stagflation that has historically had dire consequences across the world.

It is very encouraging that unions are rising again to the challenge, but this time we need to work with community organisations, campaign groups, and small businesses to create a new coalition. The aim should not be just to protest against the injustices of capitalism and defend the rights of working people. Rather, it should be to develop a new economic strategy ensuring the essentials of life, good jobs, and civilised conditions for all.

2. Some definitions

There is nothing mysterious about how the economy operates. It is about how we work with each other to produce the things that we need and use, from cars to construction to telesales. But the way we do this is organised primarily around profits, which are obtained by a small group at the top of society. And so, understanding how the economy works is about understanding property and power: who owns the resources and commands the wealth produced by society, and who creates it for them?

This is not how economic issues, including the "cost of living crisis", are typically presented to us. In the news and elsewhere, the economy seems like a vast and strange machine that makes demands on us, or forces us and our families to take economic pain. Reporting on economic affairs in the UK usually focuses on the complex workings of financial markets that are often presented as being as unpredictable as the weather with only a few "experts" able to understand them.

To cut through the confusion, we must first clearly define some of the jargon normally used.

"Inflation" is the rate at which prices are increasing on average. If inflation is 9.4%, it means that prices have gone up 9.4% since this time last year. So, something which was £10 this time last year is likely to cost £10.94 this year. The major effect of prices rising is that the value of money falls – you can buy less than you used to be able to with each £1 when prices go up, and the higher the rate of inflation, the faster your money falls in value.

It is important to remember that the inflation figure is only an average, and most goods and services will change in price faster or slower than the average figure. To find this average rise from all the different price changes, government statisticians at the Office for National Statistics (ONS) put together a "basket of goods" which is supposed to represent what an "average" household would consume in a month – what share of their income is spent on food, or housing, or fuel, and so on.

The average household does not really exist, of course, as people buy many different things every month. This can be a problem when dealing with inflation since people on lower earnings consistently spend proportionally more of their income on essentials like food and energy than the better-off. As a result, the price rises for essentials will tend to hit the poorest much harder than the inflation rate suggests.

There are two main ways for the ONS to calculate the inflation rate: the "Consumer Price Index" (CPI) and the "Consumer Price Index with Housing costs" (CPIH). CPI is the figure most usually quoted by the media, since it is also the inflation figure the Bank of England is supposed to be trying to control. The older "Retail Price Index" (RPI) is still sometimes cited but has not been the official measure of inflation for a decade.[1] Because all three measures involve slightly different ways of calculating the "average" price rise, they tend to give slightly different rates of inflation. For simplicity, we only use CPI in this pamphlet – but it is worth remembering RPI is typically higher than CPI.

The CPI is often referred to as the "headline" rate of inflation because it is based on the standard basket of goods, including food and energy. The "core" rate of inflation, on the other hand, excludes food and energy prices on the grounds that these prices are highly volatile and do not reflect what is going on at a deeper level.

The headline rate can contain enormous price variations that matter greatly to the standard of living of working people. In July 2022 headline inflation in the UK stood at 8.8%. But motor fuel prices had risen by 42.3% compared to a year ago – well above the headline figure. Clothing prices, on the other hand, rose only 6.2% in the same 12-month period – so they are still rising, but at a slower rate than the headline figure.

"Real terms" refers to economic figures after taking account of inflation. For many decades, inflation has always been above zero – in other words, prices have steadily risen, but at different rates. This means that whatever £1 buys for you today, it is likely to buy less in the future, since the price of everything you could buy with that £1 is likely to have risen by the rate of inflation.

If we want to understand the true change in someone's income, we obviously need to take account of the fact of constantly rising prices. This is the value in

[1] RPI lost its National Statistic status in 2013.

“real terms”, and it is easy to work it out for changes in income - just subtract the rate of inflation from the change in income to find the change in real terms. For instance, if a pay award this year is 10%, but inflation is 5%, the real terms pay increase is 5%. If the pay award is 2%, however, the real terms change in pay is a fall of 3%.

In the first half of 2022 the fall in real wages in the UK was extraordinarily high by historical standards.[2] In August 2022 the main measure of inflation (the “Consumer Price Index”, CPI) stated that prices on average were rising by 9.6%. This was the highest rate of inflation for forty years. The Office for National Statistics also estimated the change in wages and salaries over each month. Their estimate of “Average Weekly Earnings” (AWE) showed that wages and salaries, excluding bonuses, rose by only 4.3% in July 2022. This means that the real value of wages and salaries fell, on average, by 5.3%.

“Supply and demand” refer to how we produce, buy, and sell goods and services by using money. “Supply” refers to the amount of a good or a service available to buy at any point in time. If there is an increase in that amount, its supply has increased. When we take all the goods and services produced in the country, we have aggregate supply.

The pandemic of Covid-19, and the lockdowns imposed to deal with it, caused severe disruption in how goods and services are produced and sold – whether semiconductors or restaurant meals. Aggregate supply was reduced. It is very important to remember that the disruption caused by Covid-19 came after ten years of persistent underlying weakness in the production of goods and services in the UK. The weakness of aggregate supply across society is the key to understanding inflation.

“Demand” is about how much of a good or service is wanted at any point in time and, crucially, whether those wanting the good or service have the money to pay for it. If demand goes up, it means more people are trying to buy a good or service with the money they have. Demand, in other words, must be effective and, in our society, this means being backed up by money. It is very important to realise that a large part of demand also comes from firms which buy machinery, raw materials, energy, and other inputs from other firms. When we take demand (backed by money) across the whole of society, we have aggregate demand, which is also key to inflation.

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[2] Real wages fell by around 3% year-on-year to June 2022 (see https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/averageweeklyearningsingreatbritain/august2022).

These two ideas matter because in a market for any good or service, we would usually expect the price to be set by firms competing for customers. But how they do that depends on several factors, two of which are crucial for the "cost of living crisis". The first is what is happening to aggregate supply and demand across the economy. The second is what the property structure of an industry looks like, which enterprises control supply, and how much market power they have.

If aggregate demand is boosted, then we can expect people with money to try and buy many types of goods and services. We can also expect firms to meet this demand by increasing supply in their own markets but at the same also trying to raise prices since demand is generally strong and they are chasing after profits.

Clearly, much will depend on how strongly firms will be able to increase aggregate supply. If aggregate supply is restricted, prices will rise rapidly and consistently, that is, there will be inflation. Firms will, of course, still be making profits. In important sectors and markets of the economy, where huge enterprises have great power over supply – for instance, in energy – we can expect firms to increase prices in targeted ways to ensure massive profits. Inflation offers endless opportunities for speculative profits by those who own and control the productive resources of society. The price is paid by the rest of us.

With these fundamental ideas – inflation, real terms, and demand and supply – we have enough to start to deal with the wrong arguments presented by the mainstream about inflation, and to show what is really happening in the "cost of living crisis" and how it should be confronted.

3. The weakness of aggregate supply and the impact of Covid-19

Everyone recognises that Covid-19 was a catastrophic shock for the world economy. With new variants circulating, and lockdowns and restrictions recurring in different parts of the globe even in 2022, along with the continuing pressure on healthcare systems, the pandemic will be a source of serious difficulties for a long time yet.

If we set aside the public health aspect of Covid-19 and look only at its economic impact since early 2020, we can easily identify a crucial part of the inflationary surge that we are experiencing. Lockdowns and other restrictions were implemented by governments across the world from early 2020, starting with the lockdown of Wuhan in China on 21 January. At the height of the efforts to suppress the disease, some two and a half billion people lived under some form of serious restriction.

Such unprecedented restraints placed on so many countries across the world inevitably had a massive impact on economic activity. Aggregate demand collapsed as people were not allowed to live normally, and demand especially for services like airline travel or shopping on high streets or restaurant meals, fell very sharply. Aggregate demand also fell as enterprises postponed their investment plans in the face of great uncertainty.

Responding to the collapse in aggregate demand, many enterprises rapidly cut back supply – especially of services – in many cases, going bankrupt, or in others making staff redundant. The shock to aggregate supply was great, particularly as in the UK the supply side has been weak for many years.

In 2020 several countries in lockdown plunged into one of the worst recessions seen in history. Only extensive UK government support, provided mostly to 1.9 million enterprises, prevented even more widespread unemployment and misery. Support included increased spending to pay for workers' wages, such the £70bn furlough scheme in Britain. It also included subsidies, tax relief, postponement of tax obligation, and other measures. At the same time, credit was made widely available by central banks and the rate of interest was brought practically to zero to encourage spending.

Governments, in other words, gave a significant boost to aggregate demand, which started to become obvious in 2021 as the restrictions and lockdowns were gradually lifted, or softened. At the same time, those who have higher incomes were able to accumulate savings at the peak of the restrictions. When the world started to open up again in 2021, their spending increased rapidly. Aggregate demand was further boosted.

At that point the weakness of supply became obvious, especially in the UK. The surge in aggregate demand met a constrained supply and, inevitably, the prices of many goods and services began to rise. A great pulse of inflation was felt around the world from the summer 2021, with the UK at the forefront.

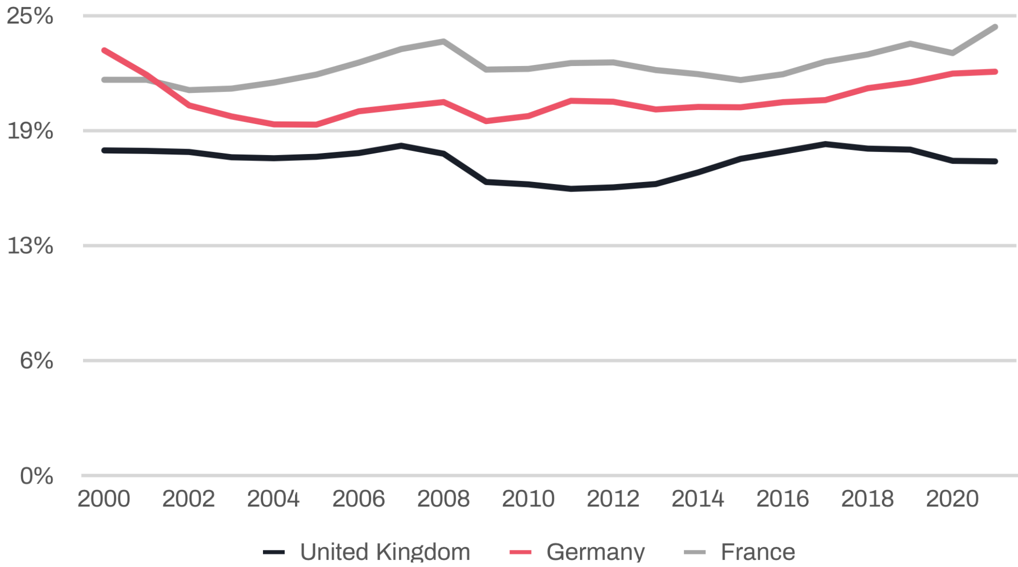
The weakness of aggregate supply in the UK is the result of trends and policies that have transformed the country during the last four decades. It reflects the loss of manufacturing industry, the resulting reliance on imports, the extraordinary scale of privatisation, and the dramatic changes in energy provision.

It also reflects the further shift of the economy toward services, affording even greater power to the financial sector, with the City of London enjoying unprecedented freedom to transfer money capital across borders and make speculative profits. The result has been a huge imbalance in economic power and vitality between London and the South-East and the rest of the country. Vast areas of Britain that used to excel in manufacturing have been mired in stagnation and poverty for decades.

There are two simple ways of showing the deep and persistent weakness of aggregate supply in the UK.

The first is the country's very poor record in investment over a long time, including during the last decade. Investment is obviously the driving force of aggregate supply as enterprises renew their productive capacity and improve technology. But those who own and control productive resources in Britain have failed to invest in strengthening the country's productive structure, as is clear from the simple graph below. Britain has consistently performed worse than Germany and France.

Fixed Investment (% of GDP), 2000-2020



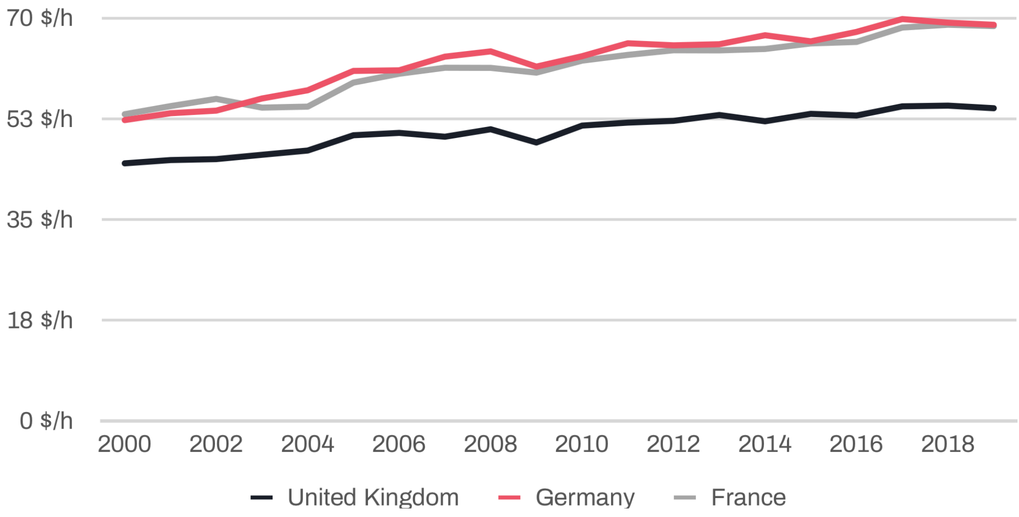
Source: World Bank and OECD

The second is Britain's equally poor record on productivity.[3] The most important factor of production in any country is the labour force. Aggregate supply depends ultimately on how productive the labour force is, that is, on how efficiently and quickly workers produce the goods and services that we all need. If productivity grows slowly, or even stops growing altogether, aggregate supply will not be able to respond promptly to changes in demand. The country's productive capacity will be in trouble.

Britain has had an appalling record on productivity growth for a long time and especially during the last ten years, as can be seen in the following graph. Once again, the UK has performed worse than Germany and France, even though both of these countries also performed badly anyway.

[3] The two main measures of productivity are the Output per hour worked, to measure labour productivity and the MultiFactor Productivity (MFP), which measures the changes in output unexplained by the changes in the labour and capital inputs (adjusted by quality proxies).

Labour productivity, 2000-2019



Source: National accounts, ICP PPP estimations, multiple other sources in Feenstra, Robert C., Robert Inklaar and Marcel P. Timmer (2015), "The Next Generation of the Penn World Table" American Economic Review, 105(10), 3150-3182, available for download atwww.ggdc.net/pwt

It goes without saying that weak investment and weak productivity growth are closely related. If enterprises do not invest systematically, the labour force cannot become more productive. Even more fundamentally, though, the most important source of productivity growth in an economy is manufacturing industry. For, manufacturing creates many opportunities for other economic activities to grow and expand and so improve the productivity of labour across the economy.[4]

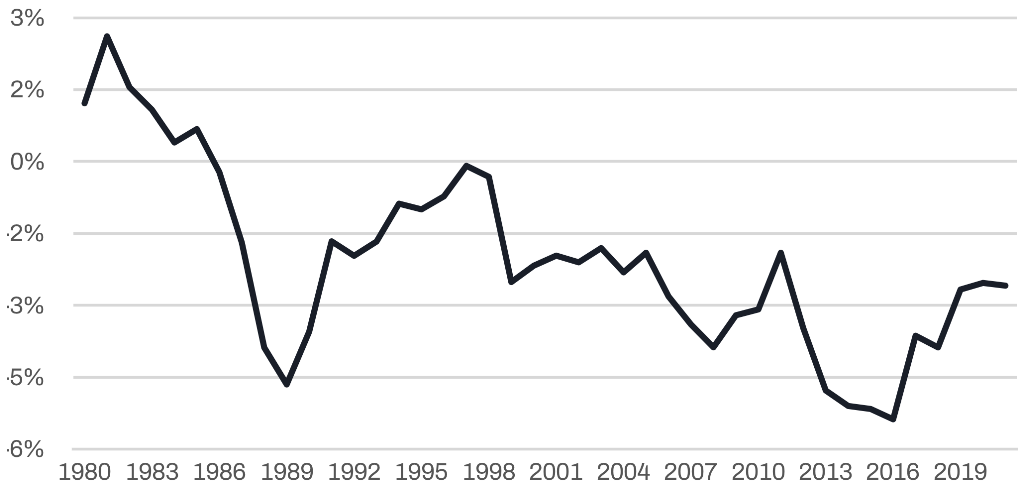
Weak productivity growth in Britain is the price the country is paying for the wrong policies of several decades that have favoured services, and especially the financial sector. From being the workshop of the world, we are now an importer of goods made by other countries and exporter of liquid money capital and trader on international money markets.

As the country's capacity to manufacture what it needs to meet the demands of its own people declined, so it was forced to import more. This is hardly the most environmentally friendly option, considering the distances that have to be covered across the world to transport imports. Just as important was the effect on the current account of the UK, which is mostly the comparison between the value of what we export and what we import. With the Thatcher government's

[4] Hence the reason for the pamphlet Rebuild Britain, Rebuild British Manufacturing: A strategy for Revival, 2022, available at https://rebuildbritain.org.uk/wp-content/uploads/2021/11/Rebuild-British-Manufacturing.pdf.

assault on industry, the current account moved into negative territory permanently, as can be seen in the simple graph below.

UK Current Account, % of GDP



Source: World Bank and International Monetary Fund

We became dependent on overseas supply in many crucial areas, such as energy. Historically, the National Union of Mineworkers warned of the dire consequences of running down domestic energy supply and relying on privately owned, overseas providers. Agricultural workers also warned of the impact on prices and the environment of the vast importation of foodstuffs.

The other blow to the productive side of the British economy was the unprecedented and wholescale privatisation of services and utilities. Instead of the surpluses made in particular utilities or services, for example the railways, returning to the public purse to reinvest in service improvements, health and safety and price reductions, they were used to line the pockets of their private owners. Public wealth that could be dedicated to increasing productive capacity was wasted to pump up company directors' bank accounts.

And, of course, the blows to working people, who are the most important part of the supply side, were never ending. In addition to downward pressure on wages, there was a sustained assault on the once excellent British system of workplace pensions with defined benefit schemes guaranteeing greater certainty in retirement. The early moves to sell off social housing stock and liberalise the housing market were also a recipe for homelessness and shutting the door to independence for young people joining the labour force.

Britain's forty-year commitment to deindustrialisation, wholesale privatisation, global financial speculation, and overreliance on imports of goods, has helped create the perfect storm in the pandemic, whereby we cannot even meet our own needs. Life's essentials, housing, food, fuel have become cruelly and unnecessarily unaffordable.

It cannot be overstressed that inflation rose sharply in the UK in 2021 because aggregate supply was unable to respond to the boost to aggregate demand. The true problem of the country lies clearly with supply, which is unable to produce efficiently what we need to live and prosper. And yet, as prices rose rapidly in Britain, large enterprises were able to make enormous profits at the expense of workers and the rest of society.[5]

Then, in February 2022, Russia invaded Ukraine. The two countries are large suppliers of some critically important commodities. Russia is the world's largest supplier of natural gas, especially to Europe, and a huge producer of oil. Russia and Ukraine between them are the world's largest exporters of wheat, cooking oil, and a few other agricultural products. Both also have large exports of critical raw materials, including fertiliser and some rare earth minerals used especially in electronic goods.[6]

War disrupted Ukraine's economy dramatically, affecting agricultural production and making exports far harder. Sanctions, imposed by NATO countries and their allies, in turn affected the Russian economy, restricting sales of crucial exports like oil and gas. The result was to ratchet the prices of those key commodities greatly upwards. Natural gas prices, already rising across Europe and Asia as lockdowns ended, skyrocketed in February and March 2022, before falling back a little later in the year.

Again, the result was to push inflation up still further, right across the globe. The impact of natural gas price rises has been particularly severe in Europe, where electricity supplies and, often, home heating and cooking depend on natural gas.

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[5] Lord Hendy QC put the point very clearly: "… the price of these commodities does not reflect the actual cost of supply (which has not increased), it reflects that cost plus the maximum amount of profit which the producers can extract." (https://morningstaronline.co.uk/article/f/transfer-wealth-labour-capital-unparalleled-1930s)

[6] For example: ""Together, Russia and Ukraine account for almost 30 percent of total global exports of wheat, nearly 20 percent of global exports of corn (maize) and close to 80 percent of sunflower seed products, including oils. The war has largely shut off grain exports from Ukraine and is affecting Ukrainian farmers' ability to plant the 2022 crop… Global food and fertiliser prices were near record highs even before Russia invaded Ukraine in February 2022." Daniel Maxwell, "War in Ukraine is pushing global acute hunger to the highest level in this century", *The Conversation*, 27 April 2022 available at: https://theconversation.com/war-in-ukraine-is-pushing-global-acute-hunger-to-the-highest-level-in-this-century-181414

These big, real changes in the conditions for supplying some essential goods have in turn created opportunities for speculators to gamble on price movements. By borrowing money and using it to buy up future supplies of essentials like oil, gas and corn, speculators in financial markets can force up prices and so make additional profits from shortages. Where financial market traders, ranging from hedge funds to the trading divisions of big oil companies, are poorly regulated, the opportunities for this sort of gambling are increased. Prices have been very high, and also unstable as a result.[7]

However, while speculation has undoubtedly added to some of the international price movements that we have seen in the last twelve months, it is not solely to blame for the price rises. It has simply added another unpleasant twist to the squeeze being felt by working people across the world as financiers look to exploit real instability and difficulties in markets.

Finally, some have looked to blame Britain's exit from the European Union, completed in early 2021, as a key factor in accelerating inflation. They point to higher inflation in the UK than remaining EU members, with inflation excluding food and energy prices, about 1.3% higher than Germany and 3% higher than in France and Italy.[8]

But whilst the Tory government has not handled Brexit at all well, and disruptions to trade have undoubtedly been felt in many sectors of the economy as well as having an investment impact, Brexit is not the decisive factor in inflation. Eastern European EU members have seen exceptionally high inflation, with 20.3% inflation in Latvia, 17.4% in Czechia and 12% in Poland. Moreover, longer standing EU members, like Spain, currently have comparable inflation rates to the UK. Clearly Brexit cannot be blamed for this pattern.

The most important component of rising inflation in the UK is restrictions in supply, worsened by profiteering. If there are UK-specific issues they are primarily the result of long-term productivity failures and weak investment that pre-date Brexit.

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[7] Antonia Juhasz, "Why are gas prices so high? These obscure traders are partly to blame", *Guardian*, 28 April 2022, available at https://www.theguardian.com/environment/2022/apr/28/gas-prices-why-are-they-so-high-traders; Rupert Russell, "Wall St is mostly to blame for rising commodity prices", *Jacobin*, 12 August 2022, available at https://jacobin.com/2022/08/food-gas-oil-prices-speculation-war-ukraine

[8] Adam S. Posen, Lucas Rengifo-Keller, "Brexit is driving inflation higher in the UK than its European peers after identical supply shocks", *Petersen Institute for International Economics*, 24 May 2022, available at https://www.piie.com/research/piie-charts/brexit-driving-inflation-higher-uk-its-european-peers-after-identical-supply

Initially, in the summer and autumn of 2021, there was a widespread expectation amongst mainstream economists that the inflationary "shock" would be only temporary since it resulted from the temporary disruption of the lockdowns. But it gradually became clear that inflation was going to rise much higher than many economists expected and would remain high for a long period of time. The Bank of International Settlements, an important oversight body for the global financial system, even argued that we have entered a new "high inflation regime", where price rises will remain much higher than in the past.[9]

No one would disagree about the effect on inflation by initial shock of the pandemic, followed by the shock of the war in Ukraine. But what we have to deal with today is increasingly the question why inflation is staying high. As we have argued, the fundamental reason is the weakness of supply. But the mainstream arguments in the media and elsewhere are very different. Two mainstream arguments stand out. The first claims that there is too much money in the economy generally. The second – related to the first – claims that workers (and perhaps pensioners and those on benefits) receive too much money as their income. Both are wrong and would take Britain down a disastrous path.

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[9] See the Bank for International Settlements, *Annual Report 2022*, June 2022 available at: https://www.bis.org/publ/arpdf/ar2022e.pdf

4. The problem is not "too much money"

There are economists and others who will try to explain persistently high inflation by claiming that there is "too much money" in the economy. They are usually known as Monetarists, or supporters of the Quantity Theory of Money, who were very influential in Margaret Thatcher's governments. For working people today this view would immediately sound odd – the problem right now for most of us is the exact opposite. Prices are too high, and we do not have enough money. "Too much money" would be a problem that most people would dearly love to have.

Nonetheless, for some politicians in the Conservative Party, this is the preferred explanation. Tories, such as former Cabinet minister Iain Duncan Smith, have blamed the Bank of England for "printing huge sums of money" (in Duncan Smith's words) with "Quantitative Easing" (QE).[10] The BBC quoted former Tory leadership contender Tom Tugendhat saying:

> *"...what's triggering inflation is the lack of sound money... we have not been tough enough on the money supply.*
>
> *"I'm afraid the quantitative easing that has been pumping up the economy and inflating a sugar high... and it's triggering this inflation."*

Thatcherite thinktanks, for instance, the Institute of Economic Affairs (IEA), make the same point.[11] They are wrong, but it is important to go through the reasons why.

Quantitative Easing is the programme implemented by the Bank of England since early 2009 to create very substantial amounts of new money electronically. Originally, this was done by the Bank in response to the global crisis of 2007-9,

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[10] See George Grylls, "Sunak 'fuelled inflation by printing huge sums of money during pandemic'", *The Times*, 18 July 2022, available at https://www.thetimes.co.uk/article/sunak-fuelled-inflation-by-printing-huge-sums-of-money-during-pandemic-xfjp8bls8

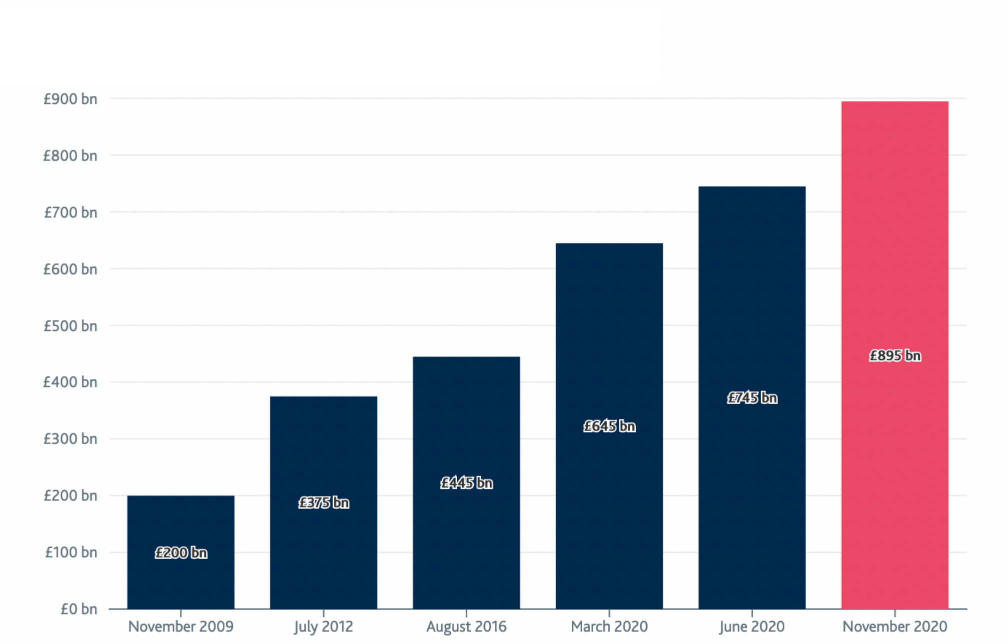
[11] IEA offers several publications and posts linking Inflation and QE, for example George Maher, "Lessons from Ancient Rome about the perils of quantitative easing", 28 September 2021, available at https://iea.org.uk/lessons-from-ancient-rome-about-the-perils-of-quantitative-easing/

which hit the financial sector very hard, with the idea being to support the wider economy by making sure there was plenty of money available to banks and enterprises at low interest rates. The Bank ran the programme again in 2012 and 2016, and then again, on a huge scale, as Covid-19 hit the British economy in early 2020.

QE works by relying on many large financial institutions (especially commercial banks) holding their own accounts with the Bank of England itself, which they use as their "reserves" - something like their own emergency savings accounts. When the Bank of England operates its QE programme, it puts more electronic money into these reserve accounts. In return, the Bank of England takes financial assets from those financial institutions worth the same amount.

In simple terms, the Bank of England buys bonds (mostly public but also private) from banks and beefs up the accounts they hold with it. The outcome is to introduce a huge amount of newly created money into the financial system. This was £200bn by the end of 2009, with smaller increases over the rest of the decade. But by the end of 2020 the total amount of new money pumped into the financial system was £895bn, as the graph below shows.

Amount of Quantitative Easing, Bank of England purchases of bonds in £billion



Source: Bank of England

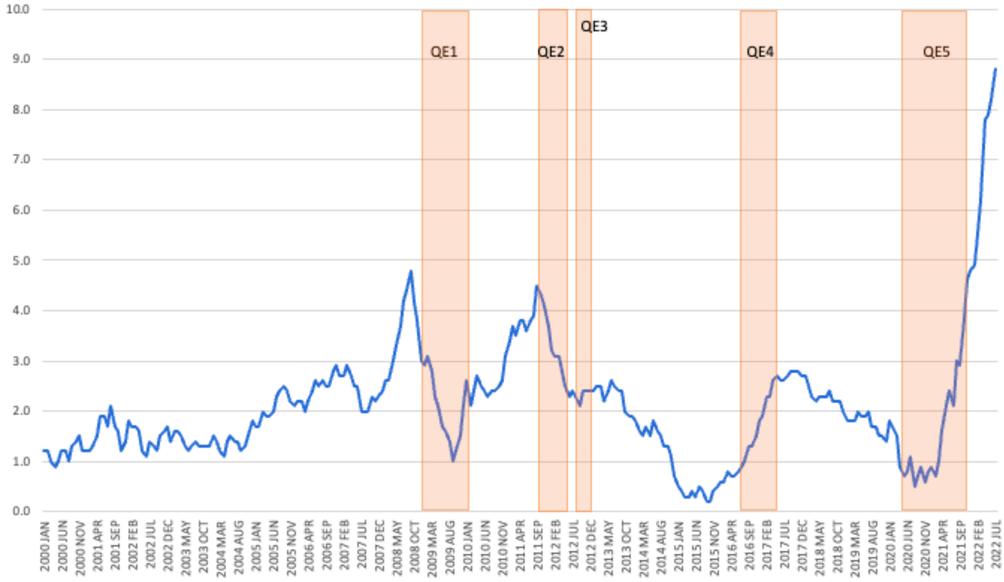
This is, obviously, a huge amount of money. It is, for instance, nearly five times the entire budget of the NHS for 2021-22, or almost five twenty times the budget for the Defence Forces for the same year. But what matters for inflation is what happens to the money.

For the supporters of free markets and Monetarists, the idea that creating more money automatically leads to inflation is very old one. Milton Friedman, one of the architects of the turn to free market capitalism in the 1970s and 1980s and leading Monetarist, argued in the 1960s that "inflation is always and everywhere a monetary phenomenon". He meant that if inflation was happening, it could always be explained by changes in the amount of money in the economy.

When free market supporters today claim that QE leads to inflation, they are trying to make the same point. Their argument is that, if more money is put into the economy, unless there also a growth in the number of things to buy, this new money will automatically lead to price rises. There will be more money chasing the same number of goods and services and so (the theory goes) people supplying the goods and services will have an incentive to put up their prices to obtain some of that extra money now circulating in the economy.

But the argument does not stand up as far as general inflation is concerned. There is no obvious link between QE, which has been used since April 2009, and general inflation, as the graph below shows. Since QE started in early 2009, inflation has repeatedly fallen to very low levels, even turning negative in May 2016. For significant periods of time, prices were falling, despite the new QE money in the economy.

UK monthly inflation (CPIH measure), 2000-2022



Source: ONS and Bank of England

On the other hand, QE has led to some, very specific, price increases. By creating new money and handing it to major financial institutions, the Bank of England has helped push up the price of financial and property assets. This happened because those financial institutions took the newly created money and used it to trade in financial assets (such as shares) and real estate. As a result, share prices and, especially, property prices in Britain were consistently pushed up, even as the rest of the economy suffered during covid.[12]

Rising share prices and, even more, rising property prices and rents represent increases in financial wealth. So, while the supply side of the British economy was being run down and in stagnation in the 2010s, and there was the rise of zero hours contracts and the casualised gig economy worsening the incomes of the majority, QE directly contributed to even greater wealth inequality. The worst aspect of it is that, by increasing wealth inequality, QE made it even harder for first-time buyers, especially in the large urban centres, to buy a home.

But there was no obvious link between QE and inflation during the last decade.

[12] The House of Lords Economic Affairs Select Committee, summarising the evidence on QE and inequality, said that "On balance, the committee found that QE is likely to have exacerbated wealth inequalities in the UK. It said this was because QE's main effects act to increase the prices of assets, which primarily benefit wealthier households." House of Lords Economic Affairs Select Committee, "Quantitative Easing", 11 November 2021.

The important point for current inflation is that in the pandemic the impact of QE shifted. The exceptional government spending during 2020, including furlough and exceptional support for enterprises, was paid to a large extent through QE. To be more precise, the government spent more and borrowed to fund the expenditure. A large part of the new debt was bought by the Bank of England, and so a part of government spending was, in effect, financed by creating new QE money.

At the same time, the government encouraged banks to lend more, often by guaranteeing enterprise debt, and so banks increased their lending and created even more money. The control by private banks over personal and national debt is a key feature of the rigged economy that encourages prices and profits to spiral. Some of the additional money created by QE, then, went into the productive part of the economy, for example, the £70bn of furlough payments going directly to households.[13]

Because economic activity was deliberately suppressed by lockdown, with consumer spending falling rapidly and millions deliberately kept from working, this additional government spending simply replaced lost household and replenished business income. Much of it was turned into savings held by somewhat better-off households – household savings shot up to unprecedented levels over 2020 and into 2021. The ONS estimate that households saved £140bn extra during the lockdowns.[14] These savings are now providing a cushion for many households in the face of rising prices. But they are not causing prices to rise.[15]

To sum up, inflation today is not the result of more money being produced. QE has been used for over a decade in Britain with no obvious impact on inflation. When it was cranked up again during the pandemic, it acted to compensate for the dramatic collapse in demand and incomes that lockdowns started to generate.

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[13] The reliance of UK governments on private finance and thereby elevating its power and control over the economy is increasingly challenged within the Labour Movement; see the pamphlet R*ebuild Britain, Government Spending and Debt: A New Approach*, 2022, available at: https://rebuildbritain.org.uk/wp-content/uploads/2022/05/Rebuild-Britain-Finance-Booklet.pdf .

[14] See the calculations at https://www.ons.gov.uk/economy/nationalaccounts/uksectoraccounts/articles/economicmodellingofforcedsavingduringthecoronaviruscovid19pandemic/2022-06-06

[15] In fact, it was calculated that even the support provided by the government to households fails to compensate for the net real losses caused by rising inflation and specifically of by rising energy prices; see the calculations by Hirsch, Donald (2022). *"Is Cost of Living Support Enough?"*, available at https://jpit.uk/enoughtolive .

5. The problem is not that wages are too high

It is difficult to make the case that QE and "money printing" have caused inflation today. Instead, a more common argument is the claim that a "wage-price" spiral is either already operating or is about to kick in soon.

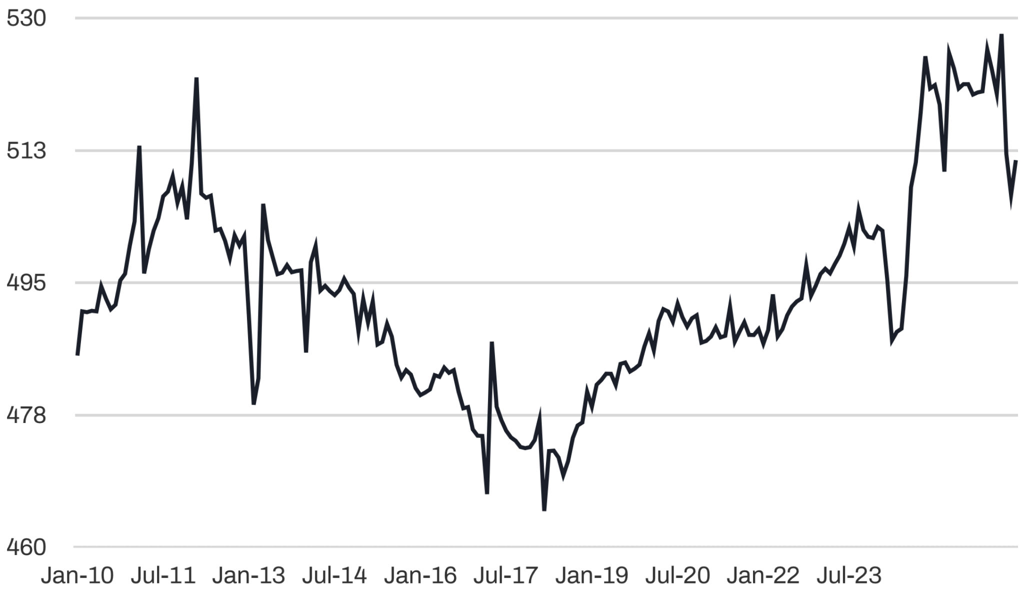
A "wage-price spiral" is meant to describe a situation in which, because wages are rising, companies are forced to push up the prices they charge. This in turn leads to worker demands for higher wages, forcing further price rises, and so on. Inflation, presumably, takes off.

This is the argument that Boris Johnson and other senior Tory politicians have used to deny workers in the public sector a pay rise that matched inflation.[16] The Governor of the Bank of England, Andrew Bailey, who earns around £500,000 a year, tried to make the same point when he said workers should exercise "pay restraint". In plain English "pay restraint" means not asking for pay rises that meet inflation.

It is immediately obvious what the problem is with this argument: wages for most people in Britain are low and have been so for a long time. For a decade and a half, even though inflation has been low for much of the time, wage and salary increases were even lower. As a result, in early 2020, when Covid-19 struck, average earnings in real terms were below their level a decade earlier. The graph below shows what has happened to real wages from 2006 to January 2020.

[16] See, for example, Boris Johnsons speaking at the G7 Meeting in Bavaria or the Tory Leadership Debates, available at https://www.pcs.org.uk/news-events/news/public-sector-pay-tory-hopefuls-show-contempt-workers

Real Average Weekly Earnings (seasonally adjusted), 2015£, 2006-2020



Source: ONS, Monthly Wages Survey. Note: for the Real Average Weekly Earnings, Total pay is used.

It is important for workers to realise how unusual this is. Except for periods of recession – which happen frequently but do not last long – wages in real terms have risen consistently since the end of the Second World War. But after 2010, that steady growth in real, earned income stopped. This is a “lost decade” that is unprecedented in modern British history. Only in the early years of the Industrial Revolution, in the late eighteenth and early nineteenth century, when factories were first being built and truly grim conditions were imposed on the workers herded into them, could we find something similar.

During this period, as the income of those who earn it through work declined, the income of those who derive it from wealth increased. The distribution of income in the UK became much worse. To realise how important this is, think first of everything that is produced in the economy annually – all the goods and services produced and sold in 12 months. Economists try to estimate the value of this output by using a measure called “Gross Domestic Product” (GDP). It is far from perfect, since it ignores important work contributions, for instance like housework and care work in families, but it still gives a reasonable guide to the value of output in the economy as a whole

Since all the output is eventually sold, GDP also gives the total “national income” out of which everyone who works in the economy, or who own wealth, would draw their own personal income.[17] This means that the share that everyone receives is important to deciding how fair the economy is. Think of it like slicing up a pie, with each slice going to those who either work for a living, or who own the wealth. How national income is divided tells us about what is happening in the economy – who is doing better, and who is doing worse.

The graph below shows what has happened to the size of the slice going to workers, and the size of the slice going capitalists, for the last thirty years. It is quite clear that the share of workers has shrunk for the last decade. Employed workers have been receiving a smaller and smaller share of the pie since 2010, when austerity began under the "Coalition" government of David Cameron.

Wages and salaries share of UK GDP, 1984-2019

Source: ONS National Accounts; Family Resources Survey; authors' own calculations.

Entering the pandemic in 2020, those at work in Britain were already losing out in two vital ways. First, on an individual level, most people at work were seeing the value of their wage or salary fall in real terms fall as it was not keeping pace with prices. Second, the fall in real wages and prices was happening as workers as a whole were seeing their slice of the economic pie get smaller and smaller. To put it plainly, the class of people who own and control resources and other wealth scored a victory over the class of people who have to work to earn a living. Workers have been losing out to capitalists for a long time in the UK.

It is a very similar story if we look at the other kinds of income that most people rely on. The number of the self-employed people has grown hugely in the last

[17] There are some exceptions to this, if we think about those who draw their earnings from abroad. But this is a very small part of the total in the UK and can be ignored here.

twenty years and reached four million in 2019. But average earnings for the self-employed have fallen dramatically since the crisis of 2007-9, dropping by 13% in real terms from 2008 to 2019. Over half of the self-employed were earning less than £300 a week in 2019.[18]

It is notorious that benefits have been radically cut since Cameron's "Coalition" government introduced austerity in 2010. On average, an out-of-work family was £1,600 worse off a year in 2021 than they would have been without the spending cuts.[19] For an out-of-work single parent things were much worse – the shortfall due to the cuts was £2,700. These huge declines in real terms were made much worse since the early 2020s. by

Pensioners, meanwhile, were supposedly protected by the "Triple Lock" on the State Pension. The Triple Lock guarantees a minimum annual increase in the State Pension that is equal to whatever is highest among the rate of inflation, or average pay growth, or 2.5%. But even if the State Pension was protected, other pensioner incomes, including several benefits that pensioners rely on, have been cut. The result is that the average income for pensioners has barely increased in a decade. In 2010, the average single pensioner income was £285 a week; by the end of March in 2020 it had reached £298.[20]

These disastrous falls for workers and pensioners took place before the pandemic. In 2020s workers' incomes were protected through furlough and other measures. However, the government's own forecasts now show that in the next few years real wages and the share of workers in national income are expected to fall even further.

Whatever it is that is driving inflation in the UK, it is not high wages. Wages have been low for a long time and are now falling very fast. As inflation creeps higher, this problem will get worse. There is no "wage-price spiral" in the UK. Instead, there is a brazen attempt to secure even more profits for the owners of resources and wealth, who benefited greatly during the disaster of the last decade.

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[18] Figures are for "solo" self-employed (ie those employing no other workers). Taken from Giulia Giupponi and Xiaowei Xu, "What does the rise of self-employment tell us about the UK labour market?", Institute of Fiscal Studies, 2020.

[19] Sarah Arnold, Dominic Craddic, Lukasz Krebel, "How our benefits system was hollowed out over 10 years", *New Economics Foundation*, 20 February 2021.

[20] These are the median figures for a single pensioner, before housing costs have been deducted. From Department for Work and Pensions, "Pensioners' Incomes Series: financial year 2019 to 2020", Table 4.3. At: https://www.gov.uk/government/statistics/pensioners-incomes-series-financial-year-2019-to-2020

6. The problem is that profits are too high

Sometimes economic phenomena can have very simple explanations. If prices are rising rapidly, but most people's incomes – whether wages, pensions, or benefits – are not going up so quickly, someone must be taking the difference between the two. It is not hard to work out who that is. The difference between much higher prices but incomes failing to keep up has been taken as greatly increased profits, especially by big companies.

Profits for the 350 biggest companies listed on the London stock exchange are 73% higher than they were in 2019, just before the pandemic.[21] For some, like oil and gas companies, the increases in profits have been spectacular.[22] Shell and BP between them made £40bn profits on their global operations last year – more than the £19bn increase in domestic energy prices. For reference, a person on the average 2020 UK wage would have to work 1,036,269 years to make £40bn![23] British Gas has just announced an incredible five-fold increase in its half-yearly profits.[24]

It is these profit increases, not increased wages that account for rising prices. If we add up the total amount by which prices have risen in Britain since October 2021 and compare it to the increase in profits, then the increase in profits

21 Unite the Union, *Unite Investigates: Corporate profiteering and the cost of living crisis*, June 2022.

22 As was argued powerfully by Lord John Hendy QC, "A transfer of wealth from labour to capital unparalleled since the 1930s", Morning Star, available at https://morningstaronline.co.uk/article/f/transfer-wealth-labour-capital-unparalleled-1930s

23 Average gross salary across the UK estimated by the ONS in 2020 is £38,600 for full-time employees (see https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/adhocs/13507annualsurveyofhoursandearningsasheestimatesofannualearningsfortheukenglandenglandexcludinglondonandtheregionsforthe90to99percentiles2019to2020).

24 See the reports in Noor Nanji, "British Gas owner Centrica and Shell see profits soar as bills rise", BBC, 28 July 2022, available at https://www.bbc.com/news/business-62330190

accounts for nearly 60% of the increase in prices; over the same period, the total increase in wages accounts for just 8%.[25]

There is no "wage-price" spiral in the UK. What exists is a relentless rise in profits that takes advantage of rising prices, boosting profit margins, and keeping prices high.[26]

It is important to understand what profits are to appreciate why they are such a problem for inflation today. To produce anything, any business, from the smallest to the largest, will need supplies. Typically, these will be plant and buildings to produce or sell goods and services, raw materials, such as water supply and electricity, and machinery and equipment necessary for production. Above all, businesses will need to hire workers with appropriate skills and willing to work. All of these are costs that must be met, or else nothing will be produced or sold. Buildings are rented, water and energy are regularly paid for, and workers receive wages.

Crucially, whilst wages are a necessary payment for production to happen, a cost that has to be covered, whether what is being "produced" are cars or calls answered in a call centre, profits are very different. They are what an enterprise can claim out of the sales revenue in addition to the necessary costs of production, such as wages and raw materials. The simplest way to think about it is as a "mark-up" on the costs of production, a regular percentage that the capitalist can add to the costs and claim as income. The bigger an enterprise can make its mark-up, the bigger will be its profits.

Profit mark-ups have been rising for some time. The Competition and Markets Authority reports that mark ups on costs charged by the biggest and most profitable companies in Britain rose from 58% in 2002 to 82% by 2020,[27] as the pandemic hit. The Bank of England knows this is happening. A report in May from its "regional agents", who are employed by the Bank to assess economic

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[25] These figures are from a report by Unite the Union, Unite Investigates: Corporate profiteering and the cost of living crisis, June 2022. Unite looked at the Office for National Statistics aggregate figures for "Gross Operating Surplus" (meaning profits) and found that they account for 58.7% of the increase in the amounts paid for goods and services since October 2021. The increase in "unit labour cost" (meaning wage and salary costs, plus any additional benefits paid by employers) accounted for only 8.3%. See: https://www.unitetheunion.org/media/4757/unite-investigates-corporate-profiteering-and-the-col-crisis.pdf

[26] It is a similar story across the developed world. From mid-2020 to the end of 2021, covering the pandemic, 53.9 percent of price rises in the US were driven by increased corporate profits. Only 7.9 percent of the price rises could be attributed to increasing labour costs, well below the average 61.8% average for 1979-2019. The remainder was due to a combination of non-labour costs like raw materials, energy, or machinery. Figures at Adam Tooze, "Chartbook #122: What drives inflation?", *Chartbook*, 17 May 2022, available at https://adamtooze.substack.com/p/chartbook-122-what-drives-inflation

[27] See: https://twitter.com/Frank_vanlerven/status/1521430860389621762?s=20&t=jsif9AId0tYa5Y9WKDHbJg

conditions throughout the country, found that “companies reported passing on the higher costs to consumer prices to a greater extent than normal.”[28]

Sometimes these high profits are justified by claiming that, today, it is pension funds that own companies and therefore pensioners benefit from high profits. This is not correct. Pension funds have been selling off their shareholdings of British companies for a long time. Today only 6% of the money saved in UK pension funds is invested in UK companies.[29] Just 0.2% of the total value of UK pension funds is invested in BP and Shell.[30] The majority of UK pension funds invest their capital in bonds, that is, securities issued by governments and corporations that are supposed to be paid regardless of the level of profits.[31]

It has to be said, finally, that not every enterprise has benefited from high prices since 2021. Many small businesses are also at the mercy of big suppliers who are driving up prices to make extra profits. The problem of inflation lies with big businesses that are in a position to exploit their market power and take advantage of rising prices. They make sure that the prices that must be paid by households and smaller businesses, including the self-employed, are higher. For big businesses, rapid inflation has meant a bonanza of profits.

In light of all that, the true causes of present-day inflation in the UK are clear:

- The aggregate supply of goods and services has been weak for many years.
- The pandemic delivered a major shock to aggregate supply and caused world-wide supply disruption. The war in Ukraine greatly exacerbated the disruption of supply, especially in energy and food.
- The UK government boosted aggregate demand to confront the pandemic, mostly by supporting enterprises but also by buttressing individual income through furlough and other means.
- The inability of supply to respond adequately to demand led to price increases for key goods and services in the UK and across the world.

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[28] Bank of England, *Monetary Policy Report May 2022*, 2022, available at https://www.bankofengland.co.uk/monetary-policy-report/2022/may-2022

[29] Mercer, *European Asset Allocation Survey,* 2019, Chart 5. At: https://info.mercer.com/rs/521-DEV-513/images/ie-2019-european-asset-allocation-survey-2019.pdf

[30] Philip Inman, “Windfall tax on oil giants won’t hurt British pensioners, thinktank finds”, *The Observer*, 8 May 2022.

[31] Mercer, *European Asset Allocation Survey,* 2019, Chart 5. At: https://info.mercer.com/rs/521-DEV-513/images/ie-2019-european-asset-allocation-survey-2019.pdf

- Big companies, even in sectors where supply was seriously disturbed, took advantage of rising prices to boost their profits, greatly increasing their mark-ups.
- Growing profits are behind the persistence of inflation in 2022 and beyond, not wages that have failed to keep up with rising prices.

Inflation in the end is a matter of struggle between workers and capitalists for the distribution of the value that is produced. If aggregate demand is pushing prices up and wages are not keeping pace with price increases, then quite simply capitalists are obtaining a larger share of the value produced in the country by having greater profits. The loss of income for workers in real terms is a direct gain for capitalists.

The extraordinary profits of big businesses in the UK and across the world in 2021-22 are not in the slightest due to technological or managerial efficiency, and much less the outcome of risk taking or opening up new avenues of production, as mainstream economists usually like to think about business profits. They are purely the result of an income transfer directly out of workers' wages into capitalist profits. They represent a tremendous worsening of income distribution in the UK after a terrible decade. In short, they are a national disgrace.

This is the proper light in which to appreciate an argument increasingly used by Andrew Bailey, the Governor of the Bank of England, amongst others. This is the claim that expectations of higher future inflation can turn into higher wage demands and so fuel the "wage-price spiral". Andrew Bailey argued that:

> *"Monetary policy has to be set… while keeping our focus on inflation and inflation expectations… I would pick out the risks from domestic price and wage setting, and this explains why at the MPC's last meeting we adopted language which made clear that if we see signs of greater persistence of inflation, and price and wage setting would be such signs, we will have to act forcefully."*[32]

Bailey and other mainstream economists claim that *expectations* of future inflation feed back into wage demands today, which then get turned by firms into higher prices, adding to *actual* inflation today.

[32] Andrew Bailey, Mansion House speech, 19 July 2022

But the evidence for an effect from expectations about inflation to actual prices is close to non-existent. A recent paper published by the US central bank, the Federal Reserve, surveying all the evidence available found that this belief "rests on extremely shaky foundations".[33] For most people, most of the time, "expectations" about future inflation have little impact on their behaviour today. Workers are certainly not in a position easily to claim, higher wages. Most businesses also do not have the kind of market power that a few giant multinationals enjoy and are also forced to take whatever prices the market pushes onto them.

At best, most of us, if we have an expectation of higher inflation in the future, might try to buy some durable goods sooner than we planned – buying a new TV now, rather than next year, for example. But this obviously is not an option for natural gas, or food, or petrol – all the things rising fastest in price right now.

Managing the "expectations" of future inflation is a smokescreen to persuade workers to accept the tremendous income loss and transfer to profits that is taking place at present. It is also the reason that the Bank of England gives for putting up interest rates. We will see in the last section why this will hurt workers, in particular, very much.

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[33] Jeremy B. Rudd, "Why Do We Think That Inflation Expectations Matter for Inflation? (And Should We?)", F*inance and Economics Discussion Series* 2021-062. Washington: Board of Governors of the Federal Reserve System, available at https://www.federalreserve.gov/econres/feds/files/2021062pap.pdf

7. How not to deal with high inflation

High inflation is clearly a source of huge profits for big businesses, but it also is a threat to the financial interests that are very powerful in the UK. Finance is about debt and the value of debt falls over time – if there is inflation of 10 percent, then £1 lent a year ago will now be worth around 90p of its original value. Financiers and other financial operators are worried that high inflation will disturb the mechanisms through which they lend money and make profits. Things could become even more complicated for financial interests if higher inflation in the UK weakened the pound relative to the dollar, or the euro. Financial transactions globally would be damaged, and the position of the City of London would take a knock.

To prevent further increases in inflation and protect financial interests, the Bank of England, like other major central banks around the world, is now pursuing what it calls a "tightening" of monetary policy. This means, primarily, that it is raising the interest rate it controls – the so-called "base rate" at which the BoE lends to commercial banks – and is also starting to reduce the amount of money being created through QE.

The theory is that by increasing the "base rate" the BoE will cause interest rates in general to rise. If interest rates go up, borrowing will become more expensive, but saving will look more attractive. Firms and households will choose to borrow less and will also spend less and save more. If there is less spending by firms and households, the thinking goes, aggregate demand will decline, and prices should begin to come down.

Except that this is not the whole story, or rather, it is a very prettified account of what is likely to happen. For, if aggregate falls, less will be sold. If less sold, firms will have less need to employ workers, and so unemployment would rise, and there could even be a recession. If unemployment rises and a recession takes shape, workers will be even less prepared to demand higher wages. Prices will fall as economic activity contracts, but businesses will also take part of the blow as less is sold, and some might be forced to close.

Controlling inflation through a recession is not something that those who make policy, or those who own resources and property, are easily willing to contemplate. There are significant dangers and costs that a recession would also mean for them. What is happening, then, is deliberate effort to create a political and economic environment that would frighten workers.

Governor Bailey's insistence that workers use "wage restraint" – that is, do not ask for wage rises that beat inflation – aims at the same thing. The Bank of England's bloodcurdling forecasts of prolonged recession and unemployment contribute to the same message. As the Financial Times put it, the Bank of England "wants us to feel poorer, spend less and be more fearful about demanding pay increases."[34] And, of course, the Tory Treasury, insisting that public sector workers cannot have inflation-matching pay rises, pushes in the same direction.

If it works, it might eventually have an impact on inflation, but profits would certainly be protected. It is more likely though that it will fail, and we will end with a recession together with still high inflation, what economists call "stagflation". For, cutting the real wages of teachers or call-centre workers or delivery riders in Britain does not make the gas we import from Qatar any cheaper. Not a single extra silicon chip will be produced. Similar arguments apply to raising interest rates. There is no interest rate in London so high that it will end the war in Ukraine.

Aggregate supply weakness and worldwide supply disruption is ultimately behind inflation. Destroying aggregate demand and clobbering the living standards of working people is an incredibly inefficient way of dealing with the problem, driven by the determination to protect profits. The proper answer is to protect the income of working people, shift the burden onto profits, and intervene to deal with the profound weakness of the supply side.

Government packages to help with winter fuel bills and the like, however welcome and in many cases making a difference between life and death, will not address the systemic and power relationships that we have highlighted here and will not stop the Board rooms from their corporate greed.

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[34] Giles, Chris, 2022, "The Bank of England Should Make it Clear when It Gives Us a Kicking", *Financial Times* (11 May)

8. For a real plan to tackle inflation

The policy that we need to deal with inflation should aim to protect the interests of the majority. It must not be driven by a relentless effort to protect profits, which creates terrible problem for society as a whole, as was shown in the previous sections of this pamphlet. A socially minded policy will have the interests of workers, the poor, and the self-employed at the forefront. For that, it must be based on three pillars.

First, wage rises should be at least equal to the rate of inflation across the board. There must not be any more income losses and certainly no income transfers from workers to capitalists. But this is only the first step. Wage rises should in truth be above the rate of inflation to begin to claw back some of the extraordinary losses that workers in the UK have had to endure during the last decade and more.

There is no reason why the very large, typically very profitable, companies that dominate employment in the UK, covering 40% of all employment, should not be making pay rises that at least match the rate of inflation.[35] There is also no reason why public sector workers should not be receiving pay increases that are at least equal to inflation, when the government was able to spend enormous amounts of money to protect enterprises in 2020-21. The key to winning these increases lies with union organisation and collective bargaining. Industrial disputes are already picking up rapidly, but we need unions to be active and to emerge in many more sectors.[36]

Above all, we need collective bargaining in all sectors. Inevitably this will mean sustained state intervention. New labour laws are urgently needed. The main target of anti-worker and anti-trade union legislation for more the four decades

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[35] Figures for employment in firms employing 250 or more people. From: https://www.gov.uk/government/statistics/business-population-estimates-2021/business-population-estimates-for-the-uk-and-regions-2021-statistical-release-html

[36] Wall, Tom, 2022, "Industrial Disputes in UK at Highest in Five Years as Inflation Hits Pay", *Observer* (2 April).

has been to break up collective bargaining. The legislation has also tried to render effective industrial and strike action as difficult as possible and to outlaw solidarity action between different groups of workers. In 1980, more than eighty percent of the labour received wages that were determined through some form of organised collective bargaining. Now it is less than twenty percent.[37] It is imperative to reverse this trend.

Second, to control inflation immediately it would be necessary to restrain big business profits. There is no way this would happen through persuasion, incentives, or cajoling the property owners. Enterprises will continue to raise their mark-ups as long as they are allowed to do it. The answer lies with *price controls* and regulation of the pricing and operations of key sectors of the economy, for example, through taxation. The aim should be to squeeze suppliers' profits, rather than households' real incomes, and thus bring prices under control.

For smaller businesses, on the other hand, which are also burdened by higher costs imposed on them by the major companies, taxation could be used to help mitigate the pressure. There is a good case for reductions in the taxes smaller employers face for employing workers, typically National Insurance Contributions. It would be politically wise for the workers' movement to look for allies amongst small businesses that are also feeling the squeeze of the inflation surge.

Domestic gas prices in the UK offers a classic example of such policies. The price of gas across the world, but especially in Europe, has surged in the last year. The UK has a weak form of price control at present, which this year has resulted in a 56% increase in household gas bills and is expected to lead to a further 77% increase in the autumn. Using this price control effectively would mean restricting the painful surges in domestic prices, freezing the price for households, and squeezing the outrageous profits of the major oil and gas suppliers, such as BP and Shell, to cover the cost of intervention.

More broadly, the energy system in the UK is privatised, and this helps account for part of the high prices and poor service that have befallen us. Bringing energy retailers back into public ownership would be a simple means to begin to deal with the problem. But the real profits in the energy system are being made at the other end of the pipe, by the companies pumping the fossil fuels out of the

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[37] The Institute for Employment Rights (IER) has mapped the history of this decline and its impact and proposed a comprehensive manifesto for the reintroduction of positive labour law and collective bargaining; see the IER resources available at https://www.ier.org.uk/resources/

ground. It has been estimated that an "excess profits tax" would bring in £13bn for government.[38] Even more radically, the UK could seriously consider moving oil and gas companies into public ownership, as is common across most of the world.

Third, and far more deeply and radically, confronting inflation is ultimately about dealing with the persistent malaise of aggregate supply that lies at its root. Britain needs a thorough rebalancing of its economy in favour of socially useful work rather than financial services. Coherent industrial policy is needed for that, which will rely on a restructuring of political power in the country, assigning far more responsibility to the regions compared to London.

Such an industrial policy will have to be based on a wave of public investment to renew the country's infrastructure as well as public property over key resources, including energy, transport, water, and more. It would also have to engage seriously with the energy transition and the catastrophic impact on the environment of unbridled capitalism in recent decades. Reliance on fossil fuels exposes this country, like all others, to the risk of international supply disruptions, and potentially higher prices in the future as reserves are depleted and more costly sources of fuel are brought into use. The International Energy Authority forecasts a 58% rise in the price of natural gas by 2030, for example,[39] but renewables costs have plummeted in recent years as technological improvements have come on-stream. Likewise, improvements in energy efficiency, especially for domestic use where Britain suffers from poorly insulated homes, would rapidly save on energy use.

None of this would be possible without profound change in finance, with public banking being properly reintroduced as well as controls on the export and import of capital and the exchange rate. None of it will also be achieved without a profound change in the balance of power at the workplace in favour of labour. In the end, the most precious productive resource that the country has are its people. Their rights and standard of living have to be protected and improved, their energies and collective strength must be mobilised, and their communal spirit must be rejuvenated, if the country is to get out of the terrible mess that it finds itself in.

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[38] Tax Justice UK figures, available at https://www.taxjustice.uk/blog/a-north-sea-excess-profits-tax-could-turn-the-tide-of-the-cost-of-living-crisis

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About PEF
The Progressive Economy Forum (PEF) was founded and launched in May 2018. It brings together a Council of distinguished economists and academics to develop a progressive and sustainable macroeconomic programme and to foster wider public engagement with economics. It opposes and seeks to replace the current dominant economic narrative based on austerity.

About GFTU
The General Federation of Trade Unions was established In 1899. It continues its strong role in supporting trade unions with research, free education and a range of practical support services.

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