UNIVERSITY OF AUCKLAND Waipapa Taumata Rau NEW ZEALAND | BUSINESS SCHOOL

# Economic Policy Centre

Pensions and Intergenerational Equity

## Who is asked to bear the cost of fighting inflation today?

**Tim Hazledine**

### *PIE Commentary 2023-01*[1]

PIE highlights intergenerational equity issues and shares the concern that the worst-off, including many retired people with few assets and families struggling with low wages and high housing costs are being asked to pay the price of fighting inflation. Has the high current rate of inflation been mis-diagnosed as demand driven? We republish this commentary by **Tim Hazledine, Emeritus Professor of Economics**, University of Auckland with thanks to the Sunday Star Times.[2]

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Am I the only person getting angry about this? We are being told - from Left and Right - that our major economic problem now is inflation: increases in prices and wages.

And what is our government doing about it? Nothing. New Zealand governments no longer do economic policy. They have outsourced the whole policy business to their wholly owned, wholly independent, subsidiary, the Reserve Bank of NZ – our central bank.

And then, to compound their negligence, they haven't given the Bank the tools they would need to do the job. It is like you hire someone to come and cut your grass. And then you say: 'Sorry, we don't have a proper lawnmower. You will have to the job on your hands and knees with these old hedge clippers. They are a bit blunt, I'm afraid.'

The blunt instrument that sits alone in the Reserve Bank's toolkit is, of course, the interest rate. But they have certainly set to work with a will with this, more than doubling mortgage interest rates.

So why would this cure inflation? In the words of the Bank's Chief Economist, it will work by 'slowing spending'. This is monetarist-speak for throwing people out of work and bankrupting businesses. The idea is that by adding one or two percentage points to the

[1] PIE Commentaries are opinion pieces published as contributions to public debate, and do not necessarily reflect the view of the Pensions and Intergenerational Equity Hub.

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unemployment rate, the remaining ninety-some percent of the workforce and their employers will be too scared to increase prices and wages in case they are the next to go.

But will it work? They tell us that inflation is 'too much money chasing too few goods' – that is, total demand in the economy getting ahead of total supply. But why will deliberately chopping supply by throwing people out of productive work narrow this purported imbalance?

Inflation is price increases. But the interest rate is a price – the price of money – and for many households with mortgages this is the most important price they pay. And the Reserve Bank has just doubled it!

It seems that our anti-inflation monetary policy is two steps backwards, before… well, we aren't sure what the pay-off would be.

What is the alternative? If our elected government accepted its duty of care over the economy, what could it do?

First, they need to diagnose the problem correctly. This is not, or mostly not, an orthodox demand-pull inflation. With unemployment still around 4 per cent, our economy is not 'over-heated'. We've had unemployment around this level for twenty years now without inflation.

It's a Covid inflation: supply-push from the pricing side of the market. The initial transportation logjams caused by lockdowns gave shippers – especially container shippers – the excuse to drastically hike their prices. In the confusion, many other sellers of many other products discovered that they suddenly had, as one analyst put it: "real pricing power". And, boy, did they use it!

It is absurd to expect these national and multinational corporations from being deterred from exploiting their pricing power by increases in NZ home mortgage rates.

So what could we do?  We could give another wholly government-owned independent subsidiary – the Commerce Commission – a mandate to shine light on pricing and pricing practices throughout our economy, with power to enforce rollbacks when they find blatant abuse of market power. We could extend our very successful drug-buying agency, Pharmac, to sourcing other products and services – including medical services – at lower prices from international suppliers. Government could descend from the Beehive to enter into tri-partite discussions with unions and employer organisations, to seek some agreement on what, as a nation, we can and cannot afford to pay our workers. We could provide instant cost-of-living relief by cutting GST – something easily to be paid for from the torrent of extra tax revenues generated by inflation.

Or we can just wait. As the Covid smoke screen wafts away, inflation is already falling globally and it will fall here, whether or not we inflect the utter misery of unemployment on 75,000 workers and their families. So let's not.

Keynesian economists have a useful saying: "Anyone who recommends unemployment as the solution to our problems should themselves be the first to be made unemployed." Not a bad slogan for an election year, eh?

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