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Inflation phobia, myths and dogma exacerbate policy responses*

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This article offers an alternative narrative on contemporary inflation and policy responses to it. It argues policy responses to inflation have been driven by unfounded beliefs underlying current inflation myths and phobia. These are rooted in neoliberal ideology and dogma, especially influential since the neo-classical counter-revolution against Keynesian macroeconomics. They prevent better understanding of the nature and causes of inflation, leading to inappropriate policy responses exacerbating the situation. Misdiagnoses, policy confusion and anti-labour bias are exposed before offering an alternative narrative and concluding remarks.

Keywords: *inflation targeting, central bank independence, growth, monetary policy, neoliberal*

JEL codes: *B22, B52, E12, E31, E58, E65*

1 INTRODUCTION

The world is once again in the grip of inflation, with Kenneth Rogoff (2022) terming this 'The Age of Inflation.' Pundits, such as Rogoff, and leading central banks – for example, the US Federal Reserve (Fed), the Bank of England (BoE) and the European Central Bank (ECB) – and international financial institutions – for example, the International Monetary Fund (IMF), the World Bank and the Bank for International Settlements (BIS) – are all loudly warning about the dire consequences of inflation.

Inflation hawks, like Frederic Mishkin (2022), believe central bank independence must be jealously protected to slay it. Larry Summers has urged the Fed 'to keep tightening, even as "collision" looms' (Anstey 2022). Lisa Cook of the Fed's Board of Governors insists, 'more rate hikes [are] needed to combat inflation' (Rugaber 2022). Meanwhile, sequenced interest rate hikes by the Fed, BoE and ECB, followed by most other advanced countries' central banks, have been driving the world economy to recession.[1]

Higher interest rates have slowed the world economy and triggered capital outflows from developing countries, depreciating their currencies besides lowering export earnings.

* The arguments in this article were developed over recent years in our opinion editorials for the IPS (Inter-Press Service News and Views from the Global South).
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1. See Brockett and Curran (2022). Between July and September, 'the world's 20 major central banks have together raised interest rates by 8.6 percentage points' (Romei 2022).

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Together, these are causing devastating debt crises in many developing countries, as both Bretton Woods institutions (BWIs) – the IMF and the World Bank – warn.[2] However, policy advice from the BWIs has varied confusingly. By late 2022, both were urging stronger anti-inflationary measures, mainly by raising interest rates, arguing – without offering any convincing evidence – that not acting with immediate decisiveness would mean worse later.

As warned by the United Nations (UNCTAD 2022), such policy-induced world recession and prolonged stagnation are likely to inflict worse damage than the Global Financial Crisis (GFC) in 2008 and COVID-19 since 2020. For UNCTAD, believing central banks can bring down inflation with higher interest rates – without generating deep and prolonged recession – is an 'imprudent gamble.' Rising US interest rates and dollar appreciation are raising import costs, inflationary pressures, debt servicing and borrowing costs everywhere. These, in turn, are worsening fiscal balances, undermining economic recovery prospects (United Nations 2022).

This article offers an alternative narrative on current inflation, discussing its causes, consequences and policy responses. Policy responses to inflation have been driven by inflation phobia and myths due to neoliberal ideology and dogma, especially since the neo-classical counter-revolution against Keynesian macroeconomics. The obscure understanding of the nature and causes of inflation led to inappropriate policy responses that have exacerbated the crisis. The article begins by highlighting unfounded beliefs underlying the phobia. It debunks these myths associated with neoliberal ideology and dogma. It exposes misdiagnoses, policy confusion and anti-labour bias before offering an alternative narrative and concluding remarks.

2 INFLATION PHOBIA

Inflation phobia mongers typically invoke exaggerated rare instances of hyperinflation – when inflation was greater than 50 per cent for at least a month (Cagan 1956). However, 'since 1947, hyperinflations … in market economies have been rare' (Fischer, Sahay and Veigh 2002, p. 876). There was no hyperinflation episode during 1947–1984, except in Chile in 1973, which lasted a month.

Table 1 lists countries that experienced hyperinflation after World War II (WWII). Several features deserve highlighting:

- No advanced country experienced hyperinflation.
- Some of the worst hyperinflations were associated with the end of the Soviet Union.
- Other hyperinflation episodes, for example, Chile and Nicaragua, were also associated with political turmoil.
- Post-Soviet hyperinflation was due to sudden price deregulation associated with 'shock therapy.'
- Very few hyperinflations lasted more than two months.

2. 'Risk of global recession in 2023 rises amid simultaneous rate hikes', World Bank press release, 15 September 2022, available at: https://www.worldbank.org/en/news/press-release/2022/09/15/risk-of-global-recession-in-2023-rises-amid-simultaneous-rate-hikes (accessed 23 October 2022). 'Recession warning from the IMF', available at: https://www.weforum.org/agenda/2022/10/global-economy-news-this-week-oct/ (accessed 23 October 2022). 'UNCTAD warns of policy-induced global recession', available at: https://unctad.org/news/unctad-warns-policy-induced-global-recession (accessed 23 October 2022).

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Table 1 Post-WWII hyperinflation episodes

Countries	*Period*	*Duration (months)*
Latin America		
Argentina	May 1989–Mar. 1990	11
Bolivia	Apr. 1984–Sep. 1985	18
Brazil	Dec. 1986–Mar. 1990	4
Chile	Oct. 1973	1
Nicaragua	Jun. 1986–Mar. 1991	58
Peru	Sep. 1988; Jul–Aug. 1990	1, 2
Africa		
Angola	Dec. 1994–Jun. 1996	19
Congo DR	Oct. 1991–Sep. 1992	12
	Nov. 1993–Sep. 1994	11
Former Soviet republics		
Armenia	Oct. 1993–Dec. 1994	15
Azerbaijan	Dec. 1992–Dec. 1994	25
Belarus	Apr. 1991, Jan–Feb. 1992	1, 2
Estonia	Jan–Feb. 1992	2
Georgia	Sep. 1993–Sep. 1994	13
Kazakhstan	Apr. 1991, Jan. 1992	1, 1
Kyrgyzstan	Jan. 1992	1
Latvia	Jan. 1992	1
Lithuania	Jan. 1992	1
Moldova	Jan–Feb. 1992	2
Russia	Apr. 1991, Jan. 1992	1, 1
Tajikistan	Apr–Dec. 1993, Aug–Dec. 1995	9, 5
Turkmenistan	Nov. 1995–Jan. 1996	9
Ukraine	Apr. 1991–Nov. 1994	44
Uzbekistan	Apr. 1991, Jan–Feb. 1992	1, 2
Former Yugoslavia		
Serbia	Feb. 1993–Jan. 1994	12

Notes: Cagan (1956) defines hyperinflation 'as beginning in the month the rise in prices exceeds 50 per cent and as ending in the month before the monthly rise in prices drops below that amount and stays below for at least a year. The definition does not rule out a rise in prices at a rate below 50 per cent per month for the intervening months, and many of these months have rates below that figure.'
Source: Fischer, Sahay and Veigh (2002), Table 2, p. 840.

Hence, paranoia about hyperinflation or accelerating inflation lasting for years has little basis. After scrutinizing the accuracy of data and the consistency of various measures and definitions of hyperinflation, Hanke and Krus (2012, p. 11) concluded, 'Hyperinflation is an economic malady that arises under extreme conditions: war, political mismanagement, and the transition from a command to market-based economy – to name a few.'

Even episodes of 'high inflation' are rare. Dornbusch and Fischer (1993) distinguished high inflation, in excess of 40 per cent yearly, from hyper-inflation in their study of 131 countries with data since 1950. They categorized annual inflation between 15 and 30 per cent, lasting at least three years, as 'moderate'! They found most episodes of moderate inflation triggered by commodity price or other external shocks, not by monetary policy excesses. Importantly, 'Very few transit to higher inflation' (ibid., p. 12). In most cases, prices either remained moderate, or returned

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to ‘low-inflation’ levels under 10 per cent. Of the 48 cases, average annual inflation rates of 32 were below 15 per cent in the following three years, ten averaged between 15 and 30 per cent, while only six averaged over 30 per cent.

3 INFLATION MYTHS

The discourse on inflation often invokes unfounded narratives. For example, it is generally presumed that inflation, once begun, inevitably becomes uncontrollable. Also, it is widely believed that inflation harms growth; hence, inflation has to be contained sooner rather than later. Such accounts have become widespread and influential, even dominant, since the neoclassical counter-revolution against Keynesian macroeconomics in the late 1970s and early 1980s.

3.1 Inflation accelerates?

A popular myth is that once inflation begins, it has an inherent tendency to accelerate. So, inflation must always be contained: ‘Don’t let inflation “genie” out of the bottle,’ urged IMF Chief Economist Pierre Olivier Gourinchas (France24 2022).

Such assertions have no empirical basis, as Table 1 shows and the research cited earlier (Fischer, Sahay and Veigh 2002; Dornbusch and Fischer 1993; Hanke and Krus 2012) confirms. Bruno and Easterly (1998, p. 6) only found inflation very likely to accelerate after exceeding 40 per cent – ‘it is where the risk of even higher inflation rises sharply.’ Like Dornbusch and Fischer, they also concluded, ‘the moderate range of 15-30% does not usually accelerate to extreme levels.’

In fact, average inflation in the Organization for Economic Cooperation and Development (OECD) member countries has never exceeded 16 per cent in the past six decades (1960–2021), including the oil-shock years. This was also true when labour had more bargaining power, or wages were indexed to consumer prices, as in some countries in the 1970s. As Figure 1 shows, inflation did not accelerate during the ‘Great Inflation’[3] era, when the US inflation rate averaged 6.6 per cent, peaking at 13.6 per cent in 1980. Experiencing worse, UK inflation averaged 10.3 per cent yearly, peaking at 24.2 per cent in 1975. In New Zealand, which pioneered inflation targeting (IT) to keep it around 2 per cent, inflation averaged 10.3 per cent, peaking at 17.2 per cent in 1980. In Germany and Sweden, with more centralized wage bargaining, inflation during the ‘Great Inflation’ era averaged 4.3 per cent and 7.8 per cent, respectively. The OECD average then was 8.7 per cent, peaking at 15.5 per cent in 1974.

There is simply no evidence to support the presumption that inflation automatically accelerates once prices begin to rise. Instead of accelerating, inflation declined within a year of peaking in all OECD countries.

Some might claim that the decline in inflation was due to central banks acting preemptively. That is, had central banks not applied the brake with tightened monetary policies, inflation would have accelerated. However, there have been no rigorous studies to establish the counterfactual. Instead, the acceleration of inflation is simply

3. Lasting from 1965 to 1982, it led the Fed and other central banks to prioritize inflation and reorient monetary policy accordingly. Prioritizing price stabilization, i.e., ending inflation, became the new orthodoxy, eventually leading to the inflation targeting monetary policy framework in the early 1990s. See https://www.federalreservehistory.org/essays/great-inflation (accessed 25 October 2022).

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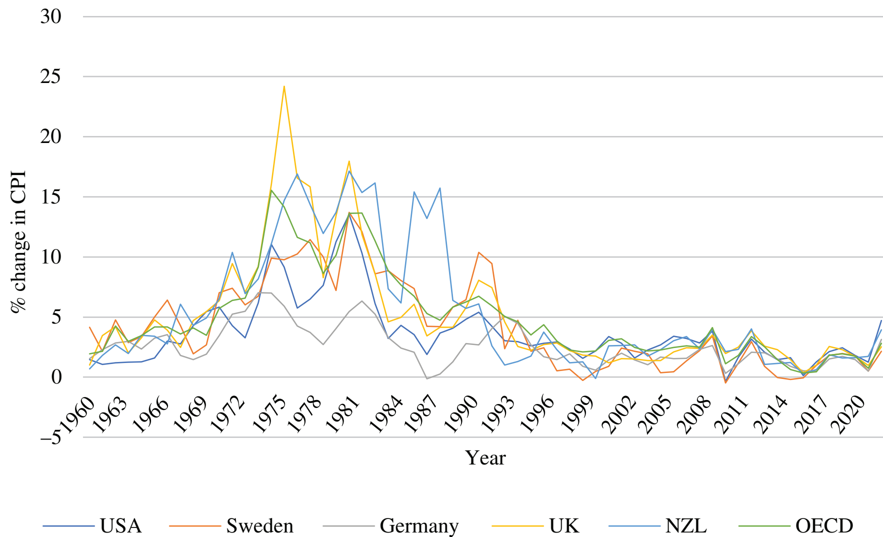

Source: World Bank, online data.

Figure 1 Annual inflation, 1960–2021

presumed and asserted using anecdotes from rare instances of hyperinflation (see Debelle 2017).

3.2 Inflation chokes growth?

'Once-in-a-generation inflation in the US and Europe could choke off global growth, with a global recession possible in 2023,' claimed the World Economic Forum's *Chief Economists Outlook* (WEF 2022). Earlier, its senior contributor, Milton Ezrati (2022) headlined his unfounded claims with his article, 'Inflation will lead inexorably to recession.'

The popular neoliberal narrative is that inflation hurts growth. *The Atlantic's* Annie Lowrey (2022) headlined her claims, 'Inflation is bad… .' Usually, causation is presumed to run from inflation to growth. Thus *The Economist* (2022a) recited the mantra, claiming, 'It hurts investment and makes most people poorer.'

Economists investigating such claims have found little supporting evidence. Most nonetheless recommend low single-digit inflation. For example, a Reserve Bank of Australia (RBA) study found 'Average inflation is … a fragile explanation of economic growth' (Andersen and Guren 1995, p. 37). Yet, the study concluded, 'While the results are not as robust as one would like, the most obvious interpretation of the evidence … is that the negative correlation between inflation and growth arises from a causal relationship.' Similarly, Stanley Fischer, Don Brash, Miguel Mancera and Josef Tosovsky (1995, p. 281) concluded, 'however weak the evidence, one strong conclusion can be drawn: inflation is not good for longer-term growth.' Robert Barro (1996, p. 168) asserted, 'the magnitude of [negative] effects are not that large, … [but] are more than enough to justify a keen interest in price stability.'

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Then World Bank Chief Economist Michael Bruno and William Easterly (1998, p. 3) asked, 'Is inflation harmful to growth?' Using data from 31 countries for 1961–1994, they concluded, 'The ratio of fervent beliefs to tangible evidence seems unusually high on this topic, despite extensive previous research.' They found only inflation over 40 per cent was associated with significantly lower real growth.

OECD evidence for 1961–2021 – in Figures 2(a) and 2(b) – supports Bruno and Easterly, contradicting the narrative favoured by major central banks, the BWIs, the BIS and influential pundits. The inflation–growth relation is overwhelmingly positive if 1974 and 1975 – severe recession years – are excluded. The relationship does not become negative even when these two years are included, implying

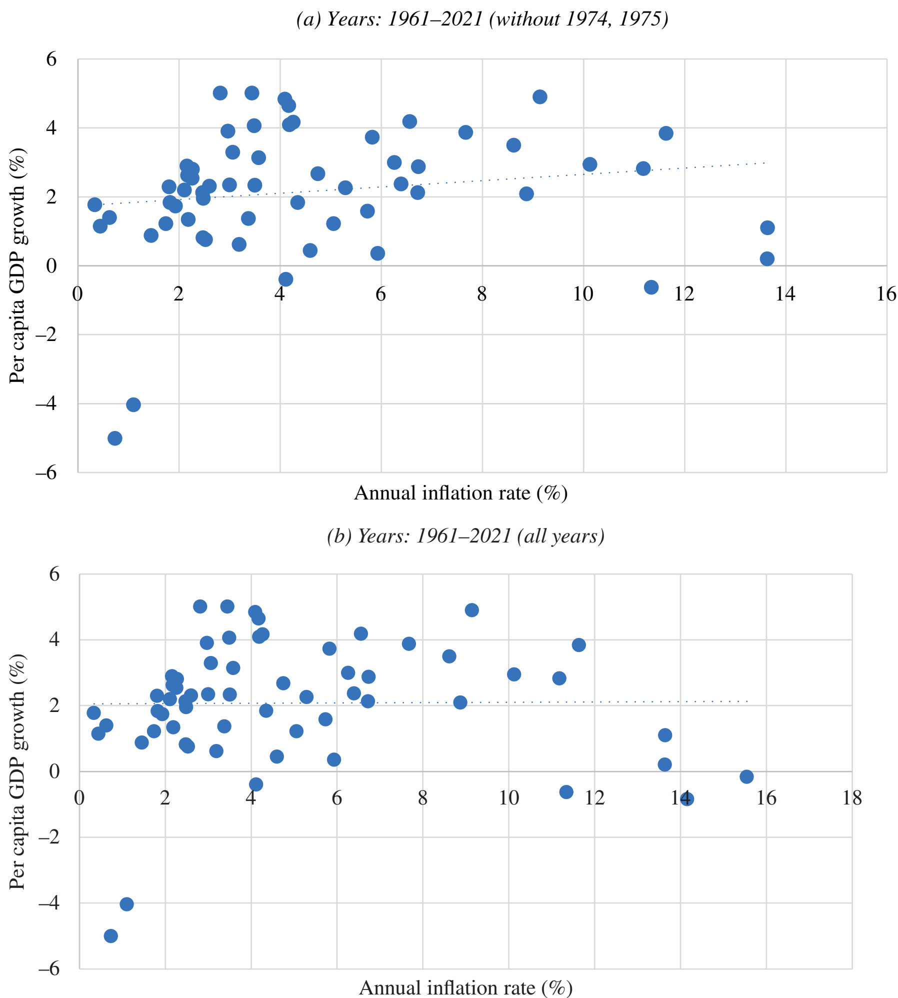

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Figure 2 OECD inflation–per capita GDP growth relationship

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inflation did not harm growth. Nor is there any evidence that pre-emptively guarding against inflation has accelerated growth.

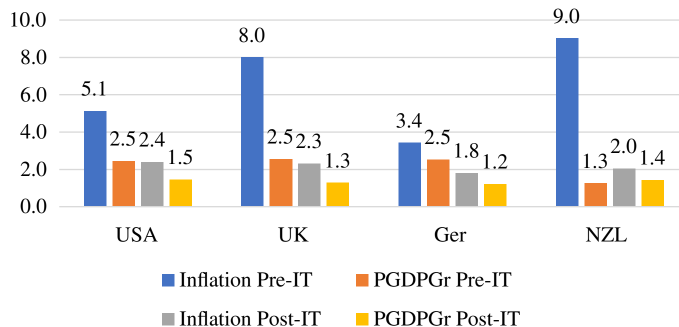
To summarize, contrary to popular narratives and conventional wisdom, the inflation–growth relationship is positive as long as inflation remained moderate in the range of 15–30 per cent. Thus, as Dornbusch and Fischer (1993, p. 1) stressed, 'such [moderate] inflations can be reduced only at a substantial … cost to growth.' Bernanke, Gertler and Watson (1997, p. 136) concluded that output decline or recession in the 1970s did not result 'from the change in oil prices, per se, but from the resulting tightening of monetary policy.' So, it is not inflation that causes output to decline, but rather, inappropriate and draconian efforts to curb inflation have inadvertently repressed growth.

3.3 Inflation targeting for what?

Pierre Fortin (1993, p. 18) has cautioned against central banks' over-zealous anti-inflationary stances: 'Strong claims that there are large macroeconomic benefits to be reaped … are not presently founded on robust quantitative evidence. They are premature.' A 1998 Bank of Canada working paper similarly concluded, 'the current state of economic research – both empirical and theoretical – provides little basis for believing in significant observable benefits of low inflation such as an increase in the growth rate of real GDP' (Ragan 1998, p. v).

To evaluate the benefits of a low inflation or an inflation-targeting framework, we selected New Zealand – as the Reserve Bank of New Zealand (RBNZ) was the first central bank to officially adopt inflation targeting; the US – as the Fed is the most important central bank globally; the UK – as the BoE has been a historically important central bank to this day; and Germany – long reputed for being averse to inflation since WWII.

None of these countries has had sustained economic growth since achieving their inflation target of 2 per cent or less. Average per capita GDP growth has declined in the US from 2.5 per cent (pre-inflation targeting) to 1.5 per cent (post-inflation targeting), from 2.5 per cent to 1.3 per cent in the UK, and from 2.5 per cent to 1.2 per cent in Germany, while there was a negligible increase in New Zealand (Figure 3).



Notes: pre-IT: 1961–1990 for UK & USA; 1971–1990 for Germany; 1978–1990 for New Zealand; post-IT: 1991–2021 for all four countries.
Source: World Bank.

Figure 3 Average per capita GDP growth & inflation, pre- & post-IT (%)

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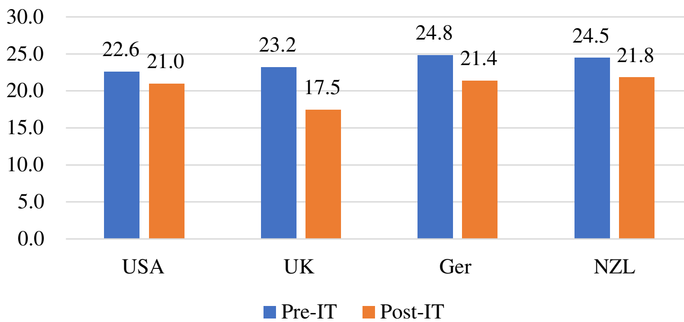
Long-term declines in average per capita GDP growth are consistent with these countries' falling (average) investment rates with inflation targeting (Figure 4). It is claimed that high inflation creates uncertainty, and thus retards investment. But clearly, very low inflation did not incentivize investment.

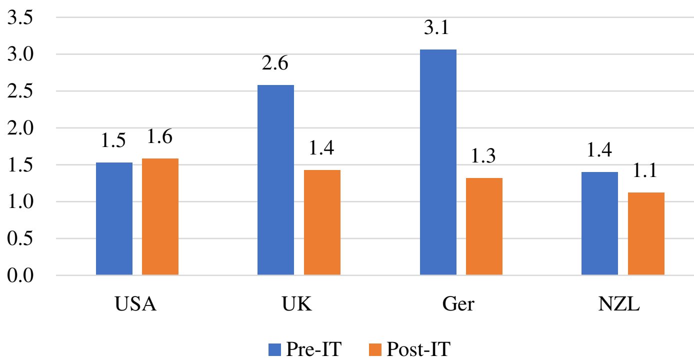
Post-inflation targeting average productivity growth in the UK, Germany and New Zealand was lower while it was more or less unchanged in the US (Figure 5). With lower investment rates, productivity growth declined in all four countries under inflation targeting (Figure 6). Brookings Institution research shows that since 2004, US output per hour worked only grew by 1.4 per cent annually, 'half its pace in the three decades after World War II' (Moss, Nunn and Shambaugh 2020, p. 2).

To put things in perspective, most advanced economies have seen productivity slowdowns since the early 1970s, for example, in the euro area. This was blamed on higher inflation and stagflation. However, low inflation, including inflation targeting, has failed to reverse declining productivity, which has fallen faster since the GFC.



Notes: pre-IT: 1971–1990; post-IT: 1991–2021.
Source: World Bank.

Figure 4 Investment–GDP pre- & post-IT, average (%)



Notes: pre-IT: 1971–1990; post-IT: 1991–2021.
Source: OECD.

Figure 5 Average productivity growth (%)

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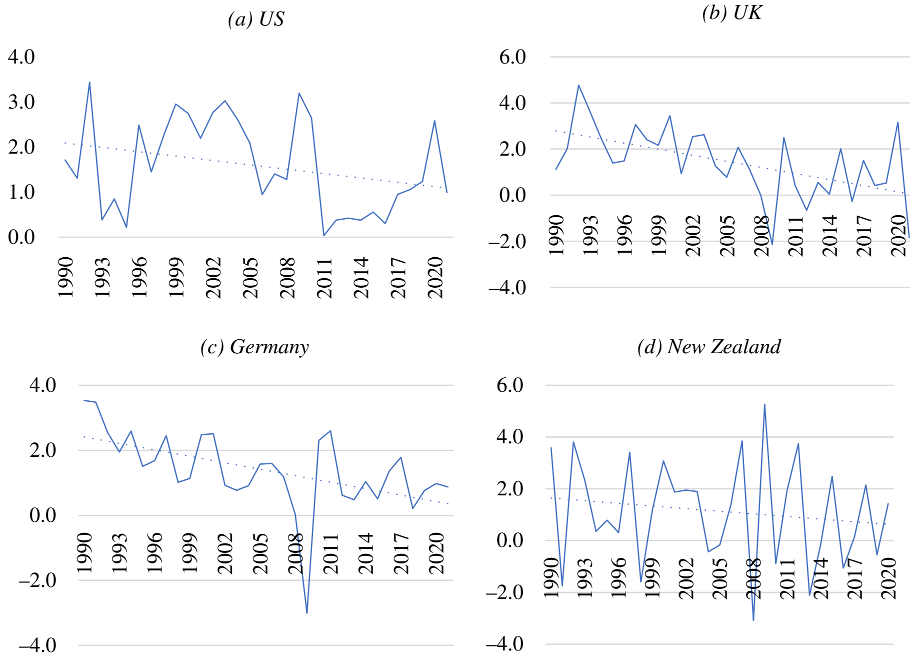

Source: OECD.

Figure 6 Productivity growth post-IT in the four countries under study

Meanwhile, the ECB's strict inflation-targeting framework has seen a marked slowdown in productivity growth in the euro area during 1999–2019 (Deutsche Bundesbank 2021).

Many explanations have been offered. After all, low inflation, the information technology or digital revolution and market reforms were all supposed to improve economic performance. Moss, Nunn and Shambaugh (2020) suggested slower investment and lower economic growth have been due to contractionary macroeconomic policies, which have reduced productivity growth, especially in the US.

Similarly, *The Economist* (2022b) has observed, 'Drooping demand crimped incentives to invest and innovate.' It attributed declining UK productivity growth to cutbacks in innovation spending due to 'austerity policies' and 'severe reduction in credit,' among other factors. It had 'no doubt that the cost … was huge,' arguing 'Britain's GDP per person in 2019 would have been £6,700 ($8,380) higher than it turned out to be,' had the productivity growth rate not fallen after the GFC.

4 IDEOLOGY AND DOGMA

The IMF's Article IV states, '*each member* shall: (i) endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with *reasonable price stability*, with due regard *to its circumstances*' (emphasis added).[4]

4. https://www.imf.org/external/pubs/ft/aa/pdf/aa.pdf (accessed 9 October 2022).

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Yet, since the anti-Keynesian counter-revolution, most central bankers have been obsessed with fighting inflation, insisting on lowering it to under 2 per cent, despite the likely harm to economic progress. This formulaic response is prescribed even when inflation is not mainly due to surging demand. It is also claimed that central bank 'independence' – from political processes and governments – is necessary to pursue credible policies to lower inflation.

Over two decades after the inflation-targeting fad began, an IMF team acknowledged economic progress with low inflation was a 'divine coincidence' (Blanchard, Dell'Ariccia and Mauro 2013). Then IMF Chief Economist Blanchard and his co-researchers suggested an inflation rate of around 4 per cent for developed countries would allow more monetary policy space. Almost a decade later, he argued such a higher rate would not 'de-anchor' inflation expectations or adversely impact central banks' anti-inflation credibility (Blanchard 2022).

4.1 Universal 2 per cent inflation target?

The 2 per cent inflation target has become a 'global norm,' noted US Fed chair Jerome Powell (2019), and virtually an 'economic religion' (Irwin 2014). Many presume the target pursued by central bankers has sound analytical, empirical and scientific bases. But it has none, and is simply an article of faith.

New Zealand was the first country to adopt a 2 per cent inflation target in 1989. According to Irwin (2014), 'The figure was plucked out of the air.' Don Brash (2013, p. 29), Governor of the RBNZ at the time, later acknowledged it was based on a chance remark by then New Zealand Finance Minister Roger Douglas, 'during the course of a television interview on April 1, 1988, that he was thinking of genuine price stability, "around 0, or 0 to 1 percent."'

Brash understood his task was to get the inflation rate under 2 per cent. Preparing the RBNZ's annual report up to March 1989, he was 'confident that inflation could be reduced below 2 percent by the year to March 1993.' He discussed this with the Minister of Finance, who asked 'whether it might be feasible to achieve that by the end of calendar year 1992 – he liked the sound of "0 to 2 by '92"'! Thus, '"0 to 2 by '92" became the mantra, repeated endlessly' (Brash 2013, p. 29). Brash and his colleagues 'devoted a huge amount of effort' to preaching his new gospel 'to everybody who would listen – and some who were reluctant to listen' (Brash 2013, p. 32).

4.2 Independent central banks?

How do central bankers seek and gain credibility despite dogmatically pursuing an inflation target with neither empirical nor theoretical justification? After 14 years of pursuing inflation targeting, Brash (2002, p. 3) could '*not* prove,' but nonetheless '*believe*(d) that the inflation targeting regime did help to change expectations and behaviour at the *margin*' (emphasis added). He confessed it was 'less clear that the adoption of an inflation target was in fact successful in reducing the costs of disinflation.'

However, former Reserve Bank of Australia Deputy Governor Guy Debelle (1996, pp. 74, 76) found that in New Zealand, Canada and Australia, 'there was no gain from increased independence [of central banks] in terms of less costly disinflation.' Instead, he found, 'central bank independence … may increase the costs of achieving low inflation.'

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Undoubtedly, inflation has fallen, averaging around 2 per cent over the past three decades in most advanced OECD countries. To what extent can this be attributed to central bank credibility or the inflation-targeting monetary policy framework? After all, inflation was already falling for some years before central bank independence was legislated and inflation targeting was formally adopted.

Early evaluations, for example, by Debelle (1996), argued other reforms contributed to lowering inflation, for example, labour market deregulation and privatization. According to Jenkins (1996), the claimed tight central bank independence (CBI)–low inflation relationship was due to the 'placebo' effect of omitting other relevant variables. Subsequent research has not offered more favourable assessments. For example, Debelle (2017, p. 5) observed, 'How much [low inflation] can be attributable to central bank independence or the inflation target is difficult to disentangle … [Favourable] assessment mostly relies on *assertion*, *rather than empirical proof*' (emphasis added). While doubting 'nice' outcomes imply causation or correlation, he concluded a 'significant disinflationary impulse' was due to China's integration into the world economy. Rossi (2021) also found 'central bank independence has no clear effect on inflation.'

Other factors may also have contributed to overall low inflation worldwide, including demographic change, technological progress and cheaper supply chains (Sánchez and Kim 2018). For Jenkins (1996, p. 241), 'there is no apparent relationship between the degree of independence and real economic performance (e.g., the level and variance of unemployment).' Ratner and Sim (2022) – both on the US Fed Board of Governors – also doubt the 'Volcker shock' was crucial to bringing down inflation in the early 1980s. Instead, they argue labour's declining bargaining power, not Volcker's steep interest rate hikes, tamed inflation.

The historical role of central banks is also moot. Milton Friedman – whom many central bankers revere – famously blamed the 1930s' Great Depression on US Fed actions and inactions (Friedman and Schwartz 2008). Instead of providing liquidity support for businesses struggling with short-term cash flow problems, it squeezed credit, businesses and economies. Epstein and Ferguson (1984) claim Fed action promoted the interests of commercial banks, rather than economic recovery. Wheelock (1992) concluded, 'Federal Reserve errors seem largely attributable to the continued use of flawed policies' to defend the 'gold standard,' and the Fed's flawed understanding of monetary conditions.

Bernanke, Gertler and Watson (1997) argued major damage from the 1970s' oil-price shocks was due to the 'tightening of monetary policy' response. Barsky and Kilian (2002) mainly attributed the 1970s' stagflation to the Fed's 'go-stop' monetary policy, worsened by policymakers' 'misperceptions,' while Nelson (2022) primarily blamed central banks' 'faulty doctrine.'

John Taylor (2009) ascribed the 2007–2008 financial crisis to Fed monetary policy – 'too much [easy money] for too long' during Alan Greenspan's 'Great Moderation' following the 'dotcom bubble' bust. This enabled credit expansion culminating in the GFC. More worryingly, the 'near-consensus view' is that independent central banks failed to achieve – let alone protect – financial stability (Wachtel and Blejer 2020).

Easy credit plus stock and housing market bubbles involved rapid credit and loan growth, worsening asset price bubbles. Regulatory oversight became increasingly lax as investors 'chased yield.' Leverage grew, using 'dodgy' 'derivative' products, making better risk assessment difficult. Debelle (2017, p. 7) noted, 'The goal of financial stability has generally been left vague.' Hence, central banks failed to see significant financial fragility building up.

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Similarly, as unconventional expansionary monetary policies in the wake of the GFC provided vital liquidity, fuelled asset price bubbles and enabled unviable enterprises to survive, the net effect was to undermine productivity growth. As Raghuram Rajan and Viral Acharya (2022) have noted, since the GFC, 'the financial sector has become [increasingly] dependent on easy liquidity … . To compensate for quantitative easing (QE)-induced low return … , [holders of safe long-term government bonds] increased the risk profile of their other assets, taking on more leverage, and hedging interest rate risk with derivatives.' Additionally, the indiscriminate 'whatever it takes' attitude of central banks failed to link supply of additional liquidity to productivity-enhancing investments, or desirable transitions, for example, accelerating use of renewable energy or easing critical supply bottlenecks.

5 MISDIAGNOSED, INAPPROPRIATE AND BIASED POLICIES

The recent inflationary surge became evident about a year after the COVID-19 pandemic hit the world. The Ukraine war and related punitive economic sanctions have catalyzed price increases. In a worldwide *Reuters* survey of nearly 500 economists in July 2021, over 70 per cent saw rising inflation in key economies as temporary, caused by supply chain breakdowns.[5] Governors of systemically important central banks, such as the US Fed, BoE and ECB, as well as the IMF MD concurred.[6]

However, Summers (2022) insisted recent U.S. inflation was not transitory, dismissing such views as 'wishful thinking,' especially noting the Biden Administration's large COVID-19 recovery package. Summers argued, 'The painful lesson of the 1960s, 1970s and the 1982 recession is that excessive demand stimulus leads not just to inflation, but to stagflation and ultimately recession, as inflation must eventually be brought under control.'

Summers based his argument on US wage growth without acknowledging the significantly different circumstances of the 1970s' wage–price spirals. First, post–COVID-19 lockdown wages growth was not due to workers' collective bargaining, as in the 1960s, or 'wage-indexation,' linking wages to inflation during the 1970s. Workers' bargaining power has declined greatly since the 1980s, with increasing labour market deregulation and casualization. Meanwhile, foreign direct investment accelerated 'offshoring' as technological changes reduced labour needs. Many workers also turned to self-employment, informal work and working 'off-the-books.'[7]

These developments have made the Phillips' curve an even less appropriate caricature for guiding anti-inflationary policies. As noted by Janet Yellen (2019), 'the slope of the Phillips curve – a measure of the responsiveness of inflation to a decline in labor market slack – has diminished very significantly since the 1960s. In other words, the Phillips curve appears to have become quite flat.'

5. https://www.reuters.com/world/the-great-reboot/economists-say-inflation-wont-last-ceos-beg-differ-2021-07-28/ (accessed 27 October 2022).
6. https://www.reuters.com/business/why-fed-chair-powell-still-thinks-high-inflation-is-temporary-2021-08-27/; https://www.bbc.com/news/business-58098118; https://www.reuters.com/world/europe/ecbs-lagarde-says-many-causes-inflation-spike-temporary-cnbc-2021-09-24/; https://www.reuters.com/article/us-usa-economy-imf-inflation-idUSKBN2BB1XR (accessed 27 October 2022).
7. https://www.jdsupra.com/legalnews/tempted-to-pay-employees-off-the-books-86839/ (accessed 27 October 2022).

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Thus, high U.S. job vacancy rates at present could be consistent with weaker labour bargaining power. Hence, the resurgence of inflation could be unrelated to any ostensible labour market 'tightness.' Ratner and Sim (2022) found that when labour's bargaining power is weak, firms become more likely to announce job vacancies. Thus, a low inflation–low unemployment environment can be consistent with high vacancy rates.

The pandemic has greatly increased 'gig work,' especially in higher-income countries (Pulignano and Piasna 2021). More 'piecework,' labour flexibility and other illusions of independence have also meant less bargaining power, as well as greater work and income insecurity.

Second, apparent wage increases may be due to statistical anomalies (Rouse and Gimbel 2021). An estimated third of the US non-farm workforce – many low-paid – quit their jobs in 2021, with many citing health and safety reasons.[8] Many believe full employment, albeit in poorer paying work, since the Obama GFC recovery effort, has allowed labour to be more selective, as manifest in the US 'Great Resignation.' While better-paid workers remained in employment, many who switched jobs sought and saw improvements, according to the Pew Research Center.[9]

The changing composition of employment can also raise average wages. Consider a job market with three workers – A, B and C, with hourly wages of $10, $20 and $60, respectively. The average hourly wage is $30. If worker A quits, the average hourly wage – for workers B and C – will be $40. This raises the average hourly wage by $10 – not due to wage growth, but changing workforce composition. Higher reported wages in the US also reflect the one-time impacts of increasing the minimum wage, especially when paid by major employers nationwide such as Target, Southwest Airlines, CVS Health and Walgreens in the US.

Various US government measures after 2008 – by the Obama, Trump and Biden administrations – have maintained full employment, unlike in Europe and most other OECD countries offering more generous welfare benefits to the unemployed than the US. By 2021, as the US economy began to recover from the COVID-19 pandemic with widespread vaccination efforts, many employees began 'voting with their feet' by opting for 'exit.' Neither 'loyalty' nor 'voice' had more to offer in an environment of increased casualization and diminished unionization. The 2021 'Great Resignation' is thus due to the outcome of new circumstances. Conversely, recent US Fed interest rate hikes have slowed employment growth, thus disciplining the labour force, especially lower-paid employees.

As the consequences of the Ukraine war and sanctions on food, fertilizer and energy prices became more evident in 2022, inflation hawks insisted higher prices required steep interest rate hikes, to reverse the effects of earlier 'unconventional monetary policies,' especially 'quantitative easing.' For example, the IMF initially agreed the recent inflationary spike was temporary, due to supply disruptions and commodity (e.g., food and oil) price surges. However, by October 2021, it was suggesting inflation would be more than temporary (IMF 2021, p. 46). It advised differently, urging policymakers to 'be on the lookout and be prepared to act, especially if … prolonged supply disruptions, rising commodity and housing prices, permanent and unfunded fiscal

8. https://www.bls.gov/cps/effects-of-the-coronavirus-covid-19-pandemic.htm (accessed 27 October 2022).

9. https://www.pewresearch.org/fact-tank/2022/03/09/majority-of-workers-who-quit-a-job-in-2021-cite-low-pay-no-opportunities-for-advancement-feeling-disrespected/ (accessed 27 October 2022).

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commitments, a de-anchoring of expectations, combined with mismeasurement of output gaps' materialize.

However, disagreements remain over the relative contributions of supply and demand factors in the current inflationary surge. Former BoE Governor Mervyn King agreed with Summers,[10] asserting inflation was mainly due to excess demand created by expansionary monetary policies, most recently in response to the pandemic, resulting in 'too much money chasing too few goods.'[11] While acknowledging COVID-19 measures had induced supply shocks, he insisted that all central banks 'made the mistake thinking that they should print a lot of money to support the economy.'[12]

While Summers and King appear to share Friedman's (2006, p. 181) view that 'inflation is always and everywhere a monetary phenomenon,' Celasun et al. (2022) found about 40 per cent price increases for manufacturers due to pandemic supply disruptions. They also found diverse supply disruptions – and supply shock estimates – across countries and sectors. For them, demand shocks were also diverse, being larger in countries where consumer spending had grown more compared to the pre-COVID-19 period.

It is highly likely that large pandemic-response–induced fiscal imbalances and monetary expansions would increase inflationary pressures in the face of supply disruptions, exacerbated by food and energy price hikes due to war and sanctions. Current inflationary pressures resemble the immediate post-WWII situation, with pent-up demand for consumer goods unleashed before war-disrupted supplies were restored. Inflation reached nearly 20 per cent in 1947 before collapsing. Current demand still faces supply disruptions due to China's 'zero-COVID' lockdowns, the Ukraine war and sanctions. Many younger workers continue to face special difficulties, for example, parents of young children facing inadequate childcare facilities. Thus, the mismatch between available jobs and the employment people want has also grown (Pizzinelli and Shibata 2022). However, such situations are very unlike the episodes that major central banks, the IMF, BIS and others, such as Summers and King, cite to make their alarmist case for prioritizing anti-inflationary efforts.

5.1 Policy confusion

Earlier, there seemed to be a broad consensus that contemporary inflation is transient and temporary. Then, IMF Managing Director Kristalina Georgieva doubted the world faced a runaway inflation threat. Thus, she urged policymakers to carefully calibrate fiscal and monetary policies, with more 'specificity,' as no 'one size fits all.'[13] Similarly, BoE Chief Economist Huw Pill stressed the central bank was not going all out to tighten monetary policy. Instead, he advocated a more nuanced approach,[14] reasoning, 'As the pandemic recedes and the level and composition of global demand and supply

10. In an interview with Fox News in May 2022.
11. https://www.youtube.com/watch?v=B6Zb_AvxT8g (accessed 28 October 2022).
12. https://www.smh.com.au/world/europe/central-banks-got-it-wrong-during-covid-says-former-governor-20221024-p5bs7n.html#:~:text=London%3A%20The%20world's%20central%20banks,England%20governor%20Mervyn%20King%20says (accessed 28 October 2022).
13. https://www.reuters.com/business/imf-chief-says-too-early-say-if-world-facing-sustained-inflation-2022-02-03/ (accessed 7 October 2022).
14. https://www.tradingview.com/news/reuters.com,2022:newsml_L8N2UF4JE:1-boe-s-pill-says-he-opposed-bigger-hike-to-avoid-foot-to-floor-signal/ (accessed 7 October 2022).

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normalize, these inflationary pressures should subside.'[15] In June 2022, an IMF policy note advised allowing 'a full pass-through of higher international fuel prices to domestic users' (Amaglobeli et al. 2022). It advised accepting the supply-shock causes of contemporary inflation and protecting the most vulnerable.

However, a tougher anti-inflationary policy stance has since emerged. For example, in July 2022, the IMF chief economist had urged, 'bringing [inflation] back to central bank targets should be the top priority … . Central banks that have started tightening should stay the course until inflation is tamed.'[16] Although he acknowledged, '[t]ighter monetary policy will inevitably have real economic costs,' without any evidence or reasoning, he insisted, 'delaying it will only exacerbate the hardship.' Similarly, in September 2022, the BIS chief economist urged major economies to 'forge ahead with forceful' interest rate hikes despite growing threats of recession.[17] He did not seem to care that the rate hike gamble to fight inflation might not work and its costs could be astronomical and protracted.

Asked at a US Senate hearing if the Fed was prepared to do whatever it takes to control inflation – even if it harms growth – Powell replied, 'the answer to your question is yes.'[18] He acknowledged, 'supply is a big part of the story,'[19] and the Ukraine war and China's pandemic restrictions have pushed prices up. He also admitted higher interest rates may increase unemployment, but insisted meeting the 2 per cent target was 'unconditional.'[20] He claimed, 'we have the tools and the resolve to get it down to 2%,' insisting 'we're going to do that.'[21]

Similarly, while recognizing 'very big supply shocks' as the primary cause of inflation, BoE Governor Andrew Bailey also vowed to meet the 2 per cent inflation target, allowing 'no ifs or buts.'[22] ECB President Christine Lagarde did not expect to return 'to that environment of low inflation,'[23] admitting 'inflation in the euro area today is being driven by a complex mix of factors.'[24] Yet, she insisted on raising 'interest rates for as long as it takes to bring inflation back to our [2%] target.'[25]

In August, the BIS head had urged shifting focus from managing demand to enabling supply. He warned central bankers had for too long assumed supply adjusts

15. https://www.reuters.com/world/uk/boes-pill-says-size-duration-inflation-spike-bigger-than-expected-2021-10-07/ (accessed 7 October 2022).
16. https://www.imf.org/en/Blogs/Articles/2022/07/26/blog-weo-update-july-2022 (accessed 7 October 2022).
17. https://www.reuters.com/markets/europe/global-markets-bis-urgent-2022-09-19/(accessed 7 October 2022).
18. https://www.nytimes.com/2022/03/14/business/economy/powell-fed-inflation-volcker.html (accessed 11 October 2022).
19. https://www.marketplace.org/2022/05/12/fed-chair-jerome-powell-controlling-inflation-will-include-some-pain/ (accessed 11 October 2022).
20. https://www.reuters.com/business/finance/feds-powell-says-commitment-curbing-inflation-is-unconditional-2022-06-23/ (accessed 11 October 2022).
21. https://www.marketplace.org/2022/05/12/fed-chair-jerome-powell-controlling-inflation-will-include-some-pain/ (accessed 11 October 2022).
22. https://www.bloomberg.com/news/articles/2022-07-12/boe-s-bailey-says-goal-is-to-curb-inflation-no-ifs-no-buts (accessed 11 October 2022).
23. https://www.bloomberg.com/news/articles/2022-06-29/new-inflation-era-leaves-powell-and-lagarde-seeking-answers (accessed 11 October 2022).
24. https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp220628~754ac25107.en.html.
25. https://www.reuters.com/markets/rates-bonds/ecb-will-raise-rates-until-inflation-falls-back-2-lagarde-says-2022-07-22/ (accessed 11 October 2022).

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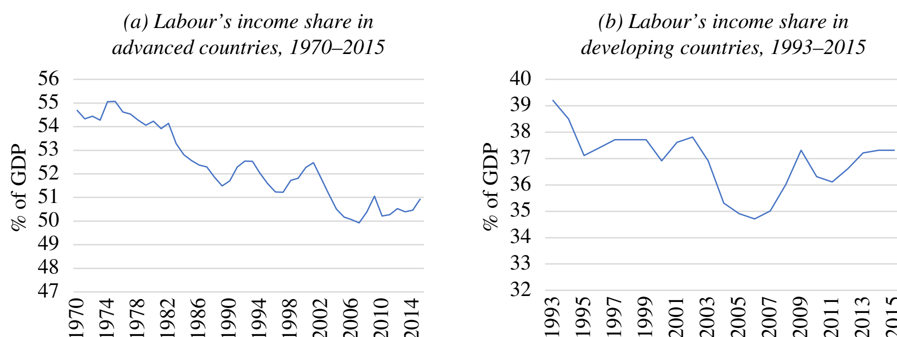
automatically and smoothly to shifts in demand.[26] He warned, 'Continuing to rely primarily on aggregate demand tools [i.e., the interest rate] to boost growth in this environment could increase the danger, as higher and harder-to-control inflation could result.'

Similarly, commenting on a World Bank study (Guénette, Kose and Sugawara 2022) in September, the Bank President urged reducing the focus on demand management to counter inflation.[27] The study had correctly noted, 'A slowdown … typically calls for countercyclical policy to support activity,' and acknowledged, 'the threat of inflation and limited fiscal space are spurring policymakers in many countries to withdraw policy support even as the global economy slows sharply.' He suggested, 'policymakers could shift their focus from reducing consumption to boosting production … to generate additional investment and improve productivity and capital allocation … critical for growth and poverty reduction.' However, he did not offer much practical guidance beyond the usual platitudes, for example, central banks 'must communicate policy decisions clearly while safeguarding their independence.'

Anti-labour

The World Bank chief thought it necessary to address 'labour market constraints,' to increase participation rates and re-employ displaced workers to increase supply to reduce prices. For decades, the Bank has urged measures to promote labour market flexibility. Since the 1980s, such policies have accelerated declining productivity growth and real incomes for most workers. They have thus reduced labour's share of national income, increasing inequality (Figure 7).

Policy fights over inflation have many dimensions, including class. As Michal Kalecki (1943, 1971) and Henri Aujac (1950) showed, inflation is primarily an expression and outcome of class conflict (or conflicting claims) over the distribution of national output and income, for example, firm prices vis-à-vis workers' wages. As noted earlier, labour's bargaining power has declined significantly since the 1980s.



Source: IMF, *World Economic Outlook*, April 2017.

Figure 7 Labour's income share in advanced and developing countries

26. https://www.bloomberg.com/news/articles/2022-08-26/world-economy-needs-policy-reset-to-revitalize-growth-bis-says?leadSource=uverify%20wall (accessed 11 October 2022).
27. https://www.worldbank.org/en/news/press-release/2022/09/15/risk-of-global-recession-in-2023-rises-amid-simultaneous-rate-hikes (accessed 11 October 2022).

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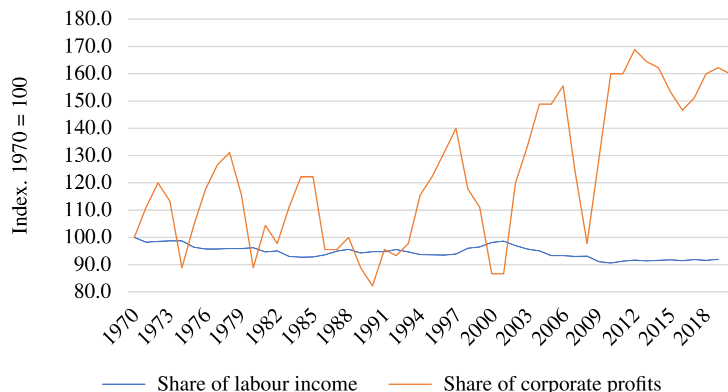
Yet, as before, workers are being blamed again for the resurgence of inflation, even though most policymakers agree contemporary inflation is mainly due to supply chain disruptions, and higher interest rates are unlikely to reverse specific higher prices, for example, for food, fertiliser and fuel. Nevertheless, most central bankers claim interest rate hikes are necessary to prevent ‘second-round’ effects of ‘wage–price spirals.’

The BIS chief backed rate hikes, warning wage–price spiral risks are ‘flashing red,’ and calling for ‘front-loaded’ interest rate hikes to avoid 1970s-style stagflation.[28] At the launch of the BIS annual report in June 2022, he said, ‘With the prospect of higher wages as workers look to make up for the purchasing power they lost, inflation could be high for long.’

But research at the IMF (Baba and Lee 2022) and RBA (Suthaharan and Bleakley 2022) has found no such wage–price spirals in recent decades. According to them, experience and evidence suggest very little likelihood in current circumstances, although some nominal wages have risen. Thus, Ross Garnaut observed, ‘the spectre of a virulent wage-price spiral comes from our memories and not current conditions.’[29]

Instead, policymakers should be more concerned with rising profit margins or ‘profit–price spirals.’ Profit margins had already risen, even before the Ukraine war and sanctions. US trends (Figure 8; also see Konczal and Luisani (2022) and Ratner and Sim (2022)) prompted the *Bloomberg* headline, ‘Fattest profits since 1950 debunk wage-inflation story of CEOs.’[30] Aggregate profits of the largest UK non-financial companies in 2021 rose 34 per cent over pre-pandemic levels (Hayes and Jung 2022). The RBA Governor acknowledged that recent trends have made it ‘easier for firms to put their prices up.’[31]



Source: US Federal Reserve Bank of St Louis. https://fred.stlouisfed.org/graph/?graph_id=936564&rn=963#

Figure 8 US profit and labour income shares of GDP

28. https://www.afr.com/policy/economy/wage-inflation-flashing-red-bis-warns-20220626-p5awo5 (accessed 15 October 2022).
29. https://www.smh.com.au/business/the-economy/how-the-psychology-of-humans-explains-the-inflation-resurgence-20220922-p5bkbz.html (accessed 22 October 2022).
30. https://www.bloomberg.com/news/articles/2021-11-30/fattest-profits-since-1950-debunk-inflation-story-spun-by-ceos (accessed 22 October 2022).
31. https://www.afr.com/policy/economy/don-t-gouge-on-profit-margins-rba-warns-business-20220916-p5bimd (accessed 22 October 2022).

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Policymakers should address stagnant, even declining real wages in most economies in recent decades. These have hurt 'low-paid workers much more than those at the top,' as the OECD *2018 Employment Outlook* has 'worryingly' noted (OECD 2018).

6 DEALING WITH INFLATION – POLICY AND INSTITUTIONAL INNOVATIONS

There is little doubt that contemporary inflation has many sources. Hence, it has to be dealt with accordingly on multiple fronts. Almost 70 years ago, with Kalecki leading economic research, the United Nations emphasized:

> There is little evidence that credit restraints, however essential they may be in the short run, can in themselves provide an adequate long-term answer to the need for maintenance of higher inventories or for expansion of capacity in key bottleneck industries, or for increasing the mobility of resources. There is equally little empirical support for a belief that monetary policy can by itself provide a suitable and effective substitute for appropriate wage-price policies by labour, management and government. *A single economic policy seems no more likely to overcome all sources of imbalance which produce rising prices and wages than is a single medicine likely to cure all diseases which produce a fever* (United Nations, 1957, pp. 6–7; emphasis added).

Moreover, the reduced steepness of the slope of the Phillips curve implies contractionary policies may not be appropriate for addressing inflation, even when it occurs mainly due to surging demand. With a flatter Phillips curve, reducing inflation would require greater unemployment increases or much deeper recessions. Hence, Summers urged much steeper interest rate hikes for the Volcker-style anti-inflationary strategy, preferred by Fed chair Jerome Powell. But as Yellen (2019) pointed out, this would also raise the 'sacrifice ratio' in terms of more unemployment and lost output.

6.1 Interest rate, blunt tool

By June 2022, over 80 central banks had raised interest rates.[32] However, raising interest rates may not be the right policy tool for several reasons. First, the interest rate mainly addresses the effects, not the causes of inflation – which may be many. In the current situation, interest rate hikes cannot curb food or oil price increases. While critical supply blockages persist, general consumer prices will rise, despite higher interest rates.

Second, raising interest rates too often and by too much can disrupt productive and efficient businesses and investments along with those less so. Higher interest rates may cause businesses to cut investment spending. Thus, supply bottlenecks, especially of essential goods, are likely to be worse, pushing up prices.

Third, besides slowing the economy, higher interest rates discourage investment in new technology, skill-upgrading, plant and equipment, adversely affecting the economy's long-term potential.

32. https://www.bloomberg.com/news/articles/2022-06-29/new-inflation-era-leaves-powell-and-lagarde-seeking-answers#xj4y7vzkg?leadSource=uverify%20wall (accessed 21 October 2022).

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Fourth, higher interest rates will raise debt burdens for governments, businesses and households. Borrowing increased after the GFC, and even more during the pandemic. Most people are indebted, with even the poor borrowing, if they can, usually to ‘smoothen’ consumption. Thus, the poor are hurt in many ways: losing jobs and earnings, coping with less social protection and having to borrow at higher interest rates.

Monetary tightening also constrains fiscal policy. A slower economy implies less tax revenue, while demand for more social welfare spending increases. Higher interest rates also increase living costs as household debt-servicing costs rise, especially for mortgages. Living costs also rise as businesses pass on higher interest rates to consumers. Instead of helping people cope with rising living costs, increasing interest rates only makes things worse, hastening economic slowdowns. Thus, workers not only lose jobs and incomes, but also are forced to pay more for mortgages and other debts.

6.2 Supply-side policies

Addressing supply bottlenecks can involve tax incentives and differentiated credit policies. However, discredited supply-side solutions – for example, more labour market deregulation, or further tax cuts for the rich and for foreign investors – must be exposed and discarded. Differentiated credit and tax incentive policies should optimize liquidity and credit allocation to support key sectors, while avoiding bubbles and overheating in sectors such as real estate or industries with overcapacity.

This would require macroeconomic policy coordination with sectoral strategies. McCulley and Pozsar (2013, p. 2) concluded, ‘fiscal-monetary cooperation … can help solve the problem that each authority faces on its own … . In the cooperation framework the central bank overtly subjects itself to become a partner of the fiscal authority in stimulating economic growth.’

According to Buiter (2016, p. 1), fiscal-monetary policy coordination can create fiscal space, but it is up to the government ‘to make appropriate use of this fiscal space.’ This is the key point – monetary policies should be designed to finance needed productive public investments – for example, in infrastructure, renewable energy, education and healthcare.

6.3 Revisiting central bank independence and inflation targeting

Effective macroeconomic cum sectoral policy coordination requires going beyond central bank independence. The neoclassical counter-revolution against Keynesian macroeconomics asserted money is ‘neutral,’ insisting central bankers cannot affect real economy variables, for example, output, employment and investment. Thus, it has ‘discounted the role of money in … monetary policy more than is justified’ (Meyer 2001, p. 14).

However, money is far from neutral, impacting the real economy significantly. Policymakers should instead be primarily concerned about the real economy – i.e., output, employment and sustainable development. Therefore, central banks should at least have a dual mandate – for price stability as well as orderly economic growth or maximum employment (Gordon 2020).

Even Friedman (1985) opposed central bank independence, expecting bankers’ views to dominate, as they have. Showing the financial sector’s excessive influence, Posen (1995) also objected to central bank independence. Hence, Debelle (2017) argued, a combination of ‘goal dependence’ and ‘instrument or operational independence’ of central banks, under strong democratic or parliamentary oversight, may be

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best for developed countries. Membership of central bank governing boards needs to be broadened to avoid dominance by financial interests and to represent broader national interests.

6.4 Social partnership, not class war

Inflation and policy responses inevitably involve social conflicts over economic distribution. Interest rate hikes inflict the burden of combating inflation on the most vulnerable – typically low-paid unskilled workers – presenting it as unavoidable 'short-term pain for long-term gain.' Needless to say, elite policymakers rarely suffer, or even share the pain.

Consensual approaches underpinned the post-WWII reconstruction and progress, associated with the Keynesian 'Golden Age.' However, critics claim they also created rigidities blocking further progress, especially with rapid technological change. Economic liberalization in response has involved deregulation to achieve more market flexibility.

However, this approach has also produced greater economic insecurity, inequalities and crises, besides slowing productivity growth. Such changes have also undermined democratic states and empowered authoritarian regimes. Meanwhile, rising inequalities and more frequent recessions have strained social trust, jeopardizing security and progress.

Therefore, policymakers should consult all major stakeholders to develop appropriate policies involving fair burden-sharing. The real need then is to design alternative policy tools through social dialogue and complementary arrangements to address economic challenges in more equitable and cooperative ways.

In Germany's 'free collective bargaining,' trade unions and business associations engage in collective bargaining without state interference, fostering cooperative relations between workers and employers. The German Collective Bargaining Act does not oblige 'social partners' to enter into negotiations. The timing and frequency of such negotiations are also left to them. Such flexible arrangements are said to have helped small and medium enterprises. Although Germany's 'social market economy' has no national tripartite social dialogue institution, labour unions, business associations and government do not hesitate to democratically debate crisis measures and policy responses to stabilize the economy and safeguard employment, for example, during the GFC.

A similar 'social dialogue' approach was developed by Australian Labour Prime Minister Bob Hawke from 1983. This contrasted with the more confrontational approaches pursued in Margaret Thatcher's UK and Ronald Reagan's USA – where punishing interest rates inflicted painful recessions. The Australian Prices and Incomes Accord, between the government and unions, moderated wage demands in return for 'social wage' improvements. This consisted of better public health provisioning, pension and unemployment benefit improvements, tax cuts and 'superannuation' – involving required employees' forced savings, in the form of income shares, and matching employer contributions to a workers' retirement fund. Although business groups were not formally party to the Accord, Hawke brought big businesses into other new initiatives such as the Economic Planning Advisory Council.

This consensual approach helped reduce both unemployment and inflation. Such consultations have also enabled difficult reforms – including floating exchange rates and reduced import tariffs. They also contributed to the developed world's longest

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uninterrupted economic growth streak – without a recession – for nearly three decades, ending with the pandemic in 2020.

A variety of such approaches exist. For example, Norway's *kombiniert oppgjior*, from 1976, involved not only industrial wages, but also taxes, salaries, pensions, food prices, child support payments, farm support prices and more.

'Social partnerships' have also been important in Austria and Sweden. A series of political understandings – or 'bargains' – between successive governments and major interest groups enabled national wage agreements from 1952 until the mid-1970s.

7 CONCLUDING REMARKS

The current economic tragedy leads to what some may call a 'perfect storm' of wrong-headed policies driving the world to stagflation, somewhat different from the episode of the late 1970s. Undoubtedly, the earlier era of unconventional monetary policies following the 2008–2009 GFC could not be sustained indefinitely. Economic slowdown tendencies were already evident even before they were exacerbated by new Cold War measures, and the pandemic, which gave a new lease of life to quantitative easing for relief and recovery.

Following the invasion of Ukraine, sanctions and other weapons of economic warfare have worsened supply disruptions, increasing prices. Ostensibly in response to such inflationary pressures, US Fed-led interest rate hikes around the world have strengthened contractionary tendencies without addressing the supply-side disruptions underlying the price rises. Thus, the concerted contractionary monetary measures not only fail to address the main roots of contemporary inflation, but also strengthen contractionary tendencies.

Meanwhile, governments are losing chances to boost productivity, achieve low carbon transformation and cut inequalities. Therefore, governments must rise to the extraordinary challenges of our times with pragmatic, appropriate and progressive policy initiatives. To do this well, they must boldly reject the ideologies and dogmas responsible for our current predicament.

Instead of reacting to inflation by raising interest rates – a blunt 'one-size-fits-all' instrument – policymakers should consider various causes of inflation and how they interact to determine how best to address it. Each major source of inflation may need appropriate policy measures, rather than one blunt interest rate instrument for all. But central bankers still consider raising interest rates the main, if not only, policy tool against inflation – a universal hammer for every cause of inflation, all seen as nails.

Increasing interest rates may slow price increases by reducing demand but does not address supply constraints, the main cause of inflation now. Raising interest rates only makes recessions worse, especially when not caused by surging demand (Gramlich 1979). The latest inflationary surge is clearly due to supply disruptions because of the pandemic, war and sanctions. Anti-inflationary policy in the current circumstances should therefore change from suppressing domestic demand with higher interest rates, to improving supplies.

Raising interest rates increases credit costs for all. Instead, macroeconomic policies should support economic diversification, by promoting industrial investments and technological innovation. Financial constraints on desired industries to be promoted (e.g., renewable energy) should be eased. Meanwhile, credit for undesirable, inefficient, speculative and unproductive activities (e.g., real estate and share purchases)

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should be tightened. Each goal may need customised policy tools instead of a general, but blunt approach to policy ends.

A class war is being waged in the name of fighting inflation. All too many central bankers are raising interest rates at the expense of working people's families, supposedly to check price increases for them. Raising interest rates only reduces spending and economic activity, hurting them without mitigating 'imported' inflation, for example, rising food and fuel prices. Recessions will further disrupt supplies, aggravating inflation and worsening stagflation.

Instead, a consensual approach sharing the burden of adjustment is socially and economically less costly. This consensual approach not only helps reduce both inflation and unemployment simultaneously, but also is critical for introducing other reforms for inclusive social and economic progress. Thus, the need of the hour is to discard the neoliberal inflation narrative and to design alternative policy tools through social dialogue to tackle economic crises in more progressive ways.

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