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The Misguided Journey to Queflation

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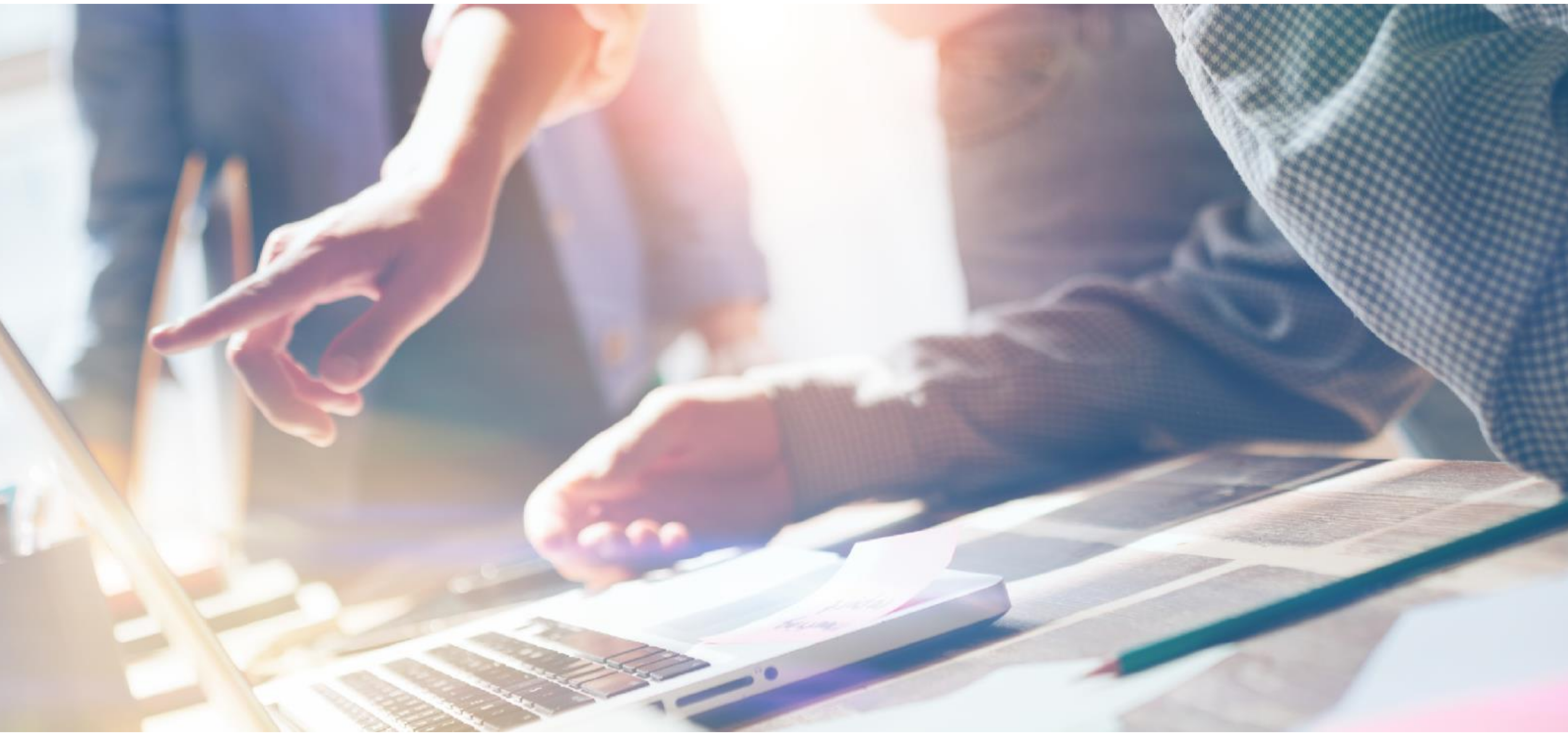

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The Misguided Journey to Queflation

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Inflation is always a clear and present danger. Consumers suffer because of price increases under conditions of high inflation. Authorities should therefore always guard diligently against inflation.

Many developed countries in the world currently suffer high inflation. This is due to the fact that governmental decision-makers were simply not diligent enough about monetary policies when price levels started increasing nor did they object to inflationary fiscal policies. The US Federal Reserve Board of Governors has been widely criticized for the initial delay of their response. (1)

At the time inflation began accelerating in developed economies, the authorities described the inflation as “transitionary in nature”. The view was that the high price increases would be of a temporary nature and would not develop into a long-term trend. Inflation was expected to disappear like magic, without any policy action. This thinking continues to dominate while others, such as Mohamed El-Erain of Allianz warns otherwise. He stated in February 2023 that “This comes at a time when it is critically important to keep an open mind about the trajectory of inflation, including by avoiding an over-simplified transitory narrative that risks obfuscating the real issues facing the US economy.” (2)

This view was clearly wrong, as inflation is never transitionary in nature. Owing to the mistaken view about transitionary inflation, central banks in many developed economies fell behind the curve in tightening monetary policy. Thus, there was no magic disappearance of inflation. Indeed, inflation remains high in the U.S. with a 6.4% annualized rate of January 2023 compared to January 2022. (3) Even with a tightening monetary policy, U.S. fiscal policy is very questionable. European Union Central Bank President Lagarde stated that the massive U.S. government stimulus is one reason why Europe is on a less aggressive monetary path. (4) The implication is similar to El-Erain’s view that U.S. fiscal policy is out of control.

Consumers act rationally in accordance with their expectations. If higher prices are expected in the future, consumers increase demand to avoid expected future price increases. Similarly, under conditions of a declining general price level, consumers expect lower prices in the future. Rational behavior under such conditions is to postpone demand, thus reaping the benefits of lower prices in the future. Currently, consumers are very skeptical of government inflation optimism. Their perception is reality as they continue to buy necessities and reduce the amount and quality of many other items. (5)

The proper policy response under conditions of accelerating inflation is tighter monetary policy with higher interest rates. However, although consumers dislike inflation, those consumers with debt repayment obligations also dislike higher interest rates. Higher rates are only welcomed by consumers who have savings and receive a rate higher than the inflation rate***.*** Likewise, there should be a realistic view of the fiscal policies of Government to limit inflationary pressures. The central bank cannot usually stop high inflation by itself except with draconian interest rates.

Authorities often try to find a solution to price increases without reverting to stricter monetary policy and higher rates. One temptation is the introduction of price controls. Such controls give authorities a false sense of self-assurance that they have done something to contain prices rather than to address the underlying causes of inflation from energy, food, and other basket essentials. Historically price controls have never worked well. Indeed, in March of 2022 Christopher J. Neely wrote on behalf of The Saint Louis Federal Reserve Bank a piece intitled "Why Price Controls Should Stay in the History Books." (6) It is interesting to note that there are two types of price controls: Ceilings and Floors. Ceilings include, among others, rent control; price controls on food/gasoline; and price controls on drugs. Floors center on minimum wages.

The downside of price controls is rationing and shortages. Consumers often cannot find any stock of goods***,*** when subjected to price controls, with prices kept at an artificially low level. The price means nothing, when there is nothing to buy at that price. The result is often smuggling and black markets. This results in goods changing hands at illegal and higher prices.

Under conditions of price controls and rationing, price increases are limited, and the rate of inflation is lower. The authorities therefore appear to have succeeded in their initial immediate objective, namely, to contain price increases. However, under these conditions, the price pressures have not abated. Indeed, it is quite possible when price controls are lifted that the prices of goods and services will again sharply rise.

Many countries have tried price controls and other forms of rationing, often during conditions of war. Under these conditions, consumers queue in the hope to purchase some of the limited available supply. Unfortunately, many consumers at the back of the queue must leave empty-handed after supply has been depleted.

As this type of inflation has no general description, let us call it ***queflation*. Demand pressures are visible in the length of queues, rather than in the published rate of inflation. While the rate of inflation is published, the length of queues is not measured and reported. The important point is that the inflationary problem is not addressed, it is merely suppressed.

Governments are often tempted to introduce price controls with concomitant queflation when the rate of inflation stays high or accelerates before general elections. At least it will seem that price increases are lower than before, with the economic consequences following only after the election.

The United States has generally been against price controls except during wars. One of the more notable exceptions was during the Nixon Administration when price controls were established. Nixon issued Executive Order 11615 (pursuant to the Economic Stabilization Act of 1970), imposing a 90-day freeze on wages and prices in order to counter inflation. This was the first time the U.S. government had enacted wage and price controls since World War II.

While the Biden and Harris Administration has been heavy handed with Executive Orders, they have not as yet made public announcements about inflation ***and*** price controls. Perhaps they are waiting for Democratic states to instigate such activities.

California could well be the starting point of such price control thinking. California Democratic Governor Gavin Newsom called a special session of the Legislators to develop a bill which would ultimately be some form of price control on oil refineries. To date, no action has been taken although the newly elected 2023 leadership of the legislature states that it will be a near-term priority. It is unclear at this point in time what will be in the final bill. However, there appears to be an attempt to limit the profit margin, with penalties if violated. This would be a variant of a windfall tax which historically has not worked in the US. Further, the money collected would be refunded to California residents. (7) This of course would be just before Newsom possibly enters the US Presidential contest. The oil industry believes that this will force prices up with supplies falling. The queflation would begin. Ironically, one of the reasons prices have advanced is the over regulation in California of the oil refining industry by both the state and federal governments. Many believe that to truly reel in the oil industry California should examine its maintenance practices and not tax profits. (8) At one time, in recent memory, we had a competitive marketplace with numerous refineries. They even had giveaways to buy gasoline from them. Today, the oil refining industry is an oligopoly marketplace and definitely does not engage in giveaways.

Far more disturbing is the recent passage of the so-called California Fast Food Recovery Act in September of 2022. This bill opens up an entirely dangerous regulation of all aspects of the fast food industry and will initially target chains with more than 100 locations nationwide. This law, however, has been blocked by the state courts in December 2022 until a ballot vote is concluded on the issue in 2024. (9)

It will be recalled that minimum wages are a form of price control. This law is a **state-sponsored sector-wide bargaining process.** Many will ask what is sector-wide bargaining. Sectoral bargaining—also known as multiemployer, industrywide, or broad-based bargaining—is a form of collective bargaining that provides contract coverage and sets compensation floors for most workers in a particular occupation, industry, or region.

The California law centers first on labor issues, including a socially-just compensation ($22 an hour initially with automatic increases) as well as working conditions as decided by the Fast Food Council. Labor unions are totally in favor of these state mandated sector-wide "employment" laws. (10) It should be noted that the fast food industry will have only four of the ten votes. (11) There is nothing that ultimately cannot be regulated by the newly created Fast Food Council! Since it is estimated that the prices of fast food will move higher, the council might address maximum sale prices. Thus, it is possible that the Fast Food Council will someday set a socially-just price for MacDonald's Big Macs!

The fast food industry is hard at work reflecting this new reality, if it comes to pass. The result will be a smaller work force, smaller outlets, and the introduction of AI. (12) This can be best noted by the addition at White Castle of "Flipper." Flipper is the new hamburger robot-chef. (13) (You can view Flipper at work on Youtube (14)) The industry is moving also on the ordering and payment methods. A good example is the food court at any one of the Costco outlets. They typically have but one person handing out the order which has been placed and paid for by the customer before getting in line. This is nothing more that self-checkout that is begining to dominate in many industries including grocery. (15)

Advancement of the Woke state agenda harbors the temptation to impose price control by state and federal governments. Consumers should beware of Queflation and skeptical as well as to price controls and rationing for solutions for inflation. Price controls will result in unintended consequences. Keeping prices lower will most likely lead to reduced supplies and shortages. Rationing, deteriorating product quality and the inevitable black markets arise to supply price-controlled products. The former Soviet Union is a textbook example of what can occur. Sophisticated economics should not take this path.

Footnotes:

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