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The Political Economy of the Cost of Living Crisis in the UK: What Is to Be Done?

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The Political Economy of the Cost of Living Crisis in the UK:

What Is to Be Done?

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Abstract

This paper analyses the political economy of the cost of living crisis in the context of the UK. The paper presents the long-term trends in the wage share, wealth inequality, labour's bargaining power, and the real wages in the UK. The first and second waves of inflation in 2021-22 are discussed presenting the trends in the profit margins. The policy responses by the conservative governments and the Bank of England are analysed, and their limitations are assessed. The paper concludes with short-run and medium-run policy alternatives to the cost of living crisis.

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1. Introduction

Soaring prices of energy, food, other essentials and rent in 2022 due to multiple supply chain disruptions after Brexit and the pandemic followed by Russia's invasion of Ukraine brought with it an intensive cost of living crisis, exacerbated by inequalities in class, race, gender, as well as the care and ecological crises. This paper analyses the developments and policy alternatives in the context of the UK.

While the squeeze in wages is not new, the current scale of cost of living crisis is the deepest in a generation. The Bank of England (BoE, 2023) expects inflation to come down to 3.9% by the fourth quarter of 2023, but the cost of living crisis will continue for many working class households. Inflation (CPI) in January 2023 fell to 10.1% from its peak of 11.1% in October 2022. Core inflation (excluding food, energy, alcohol, and tobacco prices) declined to 5.8% as of January 2023. However, inflation coming gradually down does not mean prices are falling; they are merely increasing at a slower pace and they will remain high, deepening the cost of living crisis for the many, whose nominal wages have not been increasing at the same pace as inflation. Meanwhile, the inflation in the prices of food and housing and household services (including water and energy bills and rent) are still substantially higher at 16.8% and 26.7%, respectively. Consequently, the inflation experienced by the poorest 10% of households is 11.7% as opposed to 8.8% for the richest 10% (Resolution Foundation, 2023).

In the UK inflation as of January 2023 is higher than that in the US (6.4%) and the euro-zone (8.5%) and coming down at a slower pace. The UK is forecast to have a poorer performance than the rest of G7 with a recession in 2023 (BoE, 2023 based on IMF, 2023) and at the end of 2022 it is the only G7 economy which has still not returned back to pre-pandemic levels of economic activity.

Particular vulnerabilities due to years of austerity implemented by the 2010-15 Conservative-Liberal Democrat coalition government, historically low investment in both physical and social infrastructure, a highly financialized economy, high debt levels of households and SMEs and Brexit hurting both investment and international trade with the EU -the most important trade partner, caught the country unprepared to deal with the pandemic and the cost of living crisis.¹

¹ BoE Monetary Policy Committee member Haskel (2023) estimates that the UK has lost about 1.3% of GDP worth of business investment due to Brexit. Elsewhere, the BoE (2023) outlook

Yet, fiscal and monetary policy responses are still centred around austerity and increasing interest rates to fight inflation with repeated warnings against wage-price spirals by government ministers and the BoE governor alike. Against this background, this paper aims to put the cost of living crisis and the wage disputes in historical context in order to arrive at an alternative policy framework to end both the cost of living crisis and the multiple intersecting crises of inequalities, care, climate change and energy.

Following this introduction, section 2 presents the long-term trends in the wage share, wealth inequality, labour's bargaining power, and the real wages in the UK. Section 3 discusses the first and second waves of inflation in 2021-22, presenting the trends in the profit margins. Section 4 presents the policy responses by the conservative governments and the BoE in the UK, assessing their limitations. Section 5 concludes with policy alternatives.

2. Putting the cost of living crisis in historical context of rising inequality

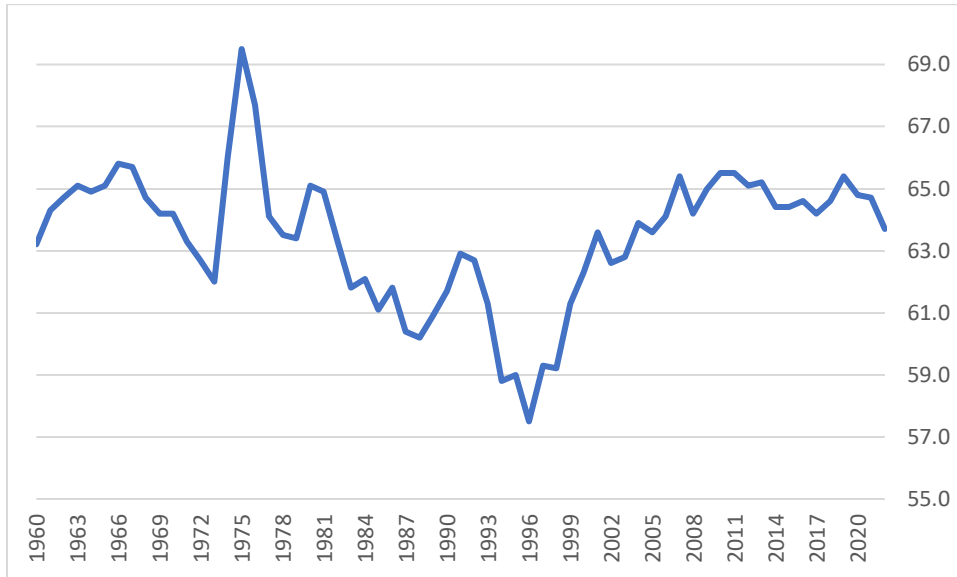
This section puts the current cost of living crisis in historical context by presenting the long-term trends in the wage share, wealth inequality, labour's bargaining power, and the real wages since the Great Recession in the UK.

The squeeze in wages is not new. The cost of living crisis of 2022 comes on top of decades of fall in the share of wages in national income due to the deterioration in the bargaining power of workers as a result in changes in the trade union legislation, labour market deregulation, structural change, neoliberal globalisation, and financialization, along with historically undervalued wages of key workers in the care sector and public services.

As can be seen in Figure 1, the wage share (adjusted) reached its peak in 1975 at 69.5%, and following a secular decline until 1997, despite a partial recovery since then, as of 2007 it was still about 4%-point lower at 65.4%. The years of austerity after the Great Recession, followed by the pandemic and now the cost of living crisis brought it down to 63.7% by 2022 -about 6% lower than its peak. Along with the rising top 1% share in income since 1980 from 6.8% to 12.7% as of 2021 (World Inequality Database), the fall in the wage share of the bottom 99% is even more dramatic.

estimates that the gap between the UK's current level of trade and its trajectory before the UK formally left the EU in 2019 would reach 3.2% of GDP by 2026.

Figure 1. Adjusted wage share as a ratio to GDP (% , at factor costs, 1960-2022)



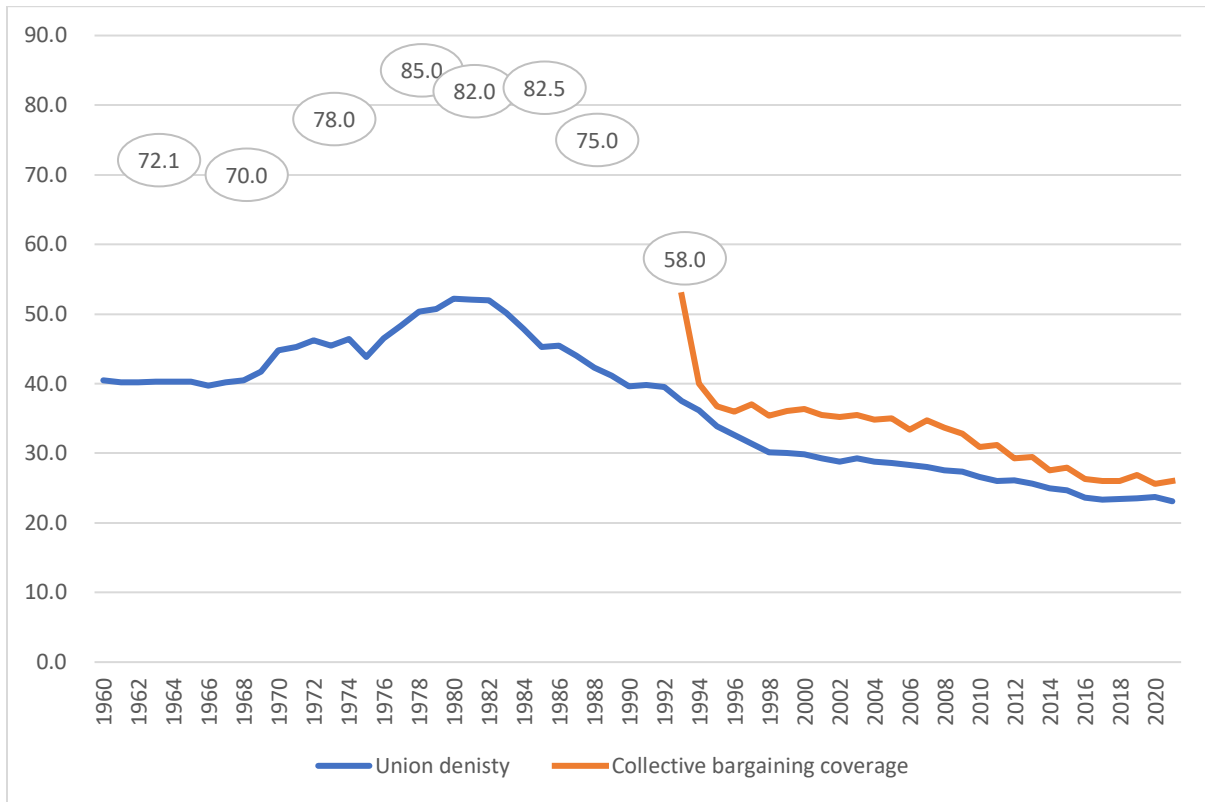
Source: Ameco

Wealth inequality, measured by the share of top1% in net household wealth has also been increasing along with the fall in the wage share from 17.8% in 1984 to 21.3% as of 2021 (World Inequality Database). During the pandemic, the wealth of UK billionaires grew by 22%, and the share of top1% in net household wealth increased further to 21.3% in 2021 from 21.1 in 2019 .

The fall in union density and collective bargaining coverage are the most remarkable explanatory factors behind this secular decline in the wage share and the rise in wealth inequality, and the effects of other factors such as globalisation has to be interpreted in that context.² As can be seen in Figure 2, union density fell from 52.2% in its peak in 1980 to 23.1% as of 2021. The fall in collective bargaining coverage is even more dramatic from 85.0% in its peak in 1975 to 26.0% as of 2021.

² Guschanski and Onaran (2022) shows that the effects of technological change are not econometrically robust after controlling for bargaining power. Tippet, Onaran, Wildauer (2022) econometrically estimate a high effect of union density on the rise in wealth inequality.

Figure 2. Union density and collective bargaining coverage (% , 1960-2021)



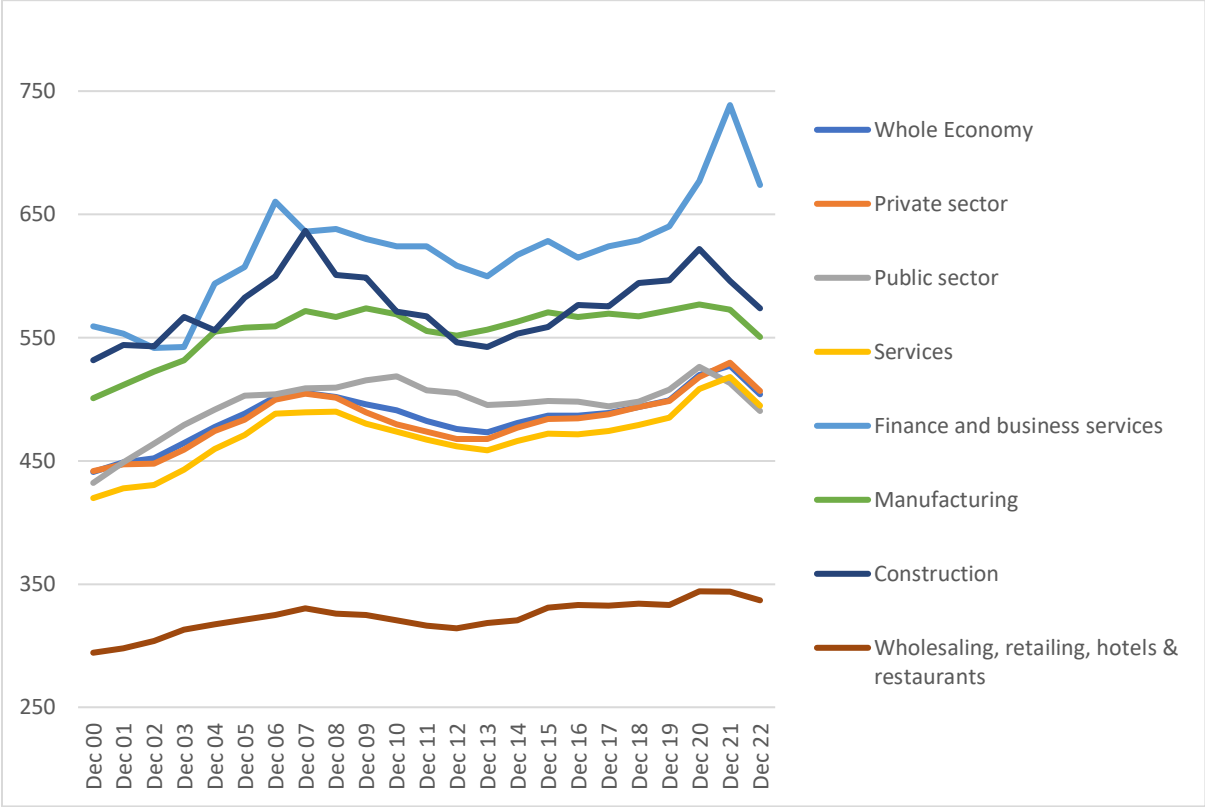
Source: BEIS.

Note: Data for collective bargaining coverage are not available on an annual basis before 1993.

Focusing on the decades since the Great Recession, and one component of the wage share, the real wage rates, the picture is rather dramatic, as can be seen in Figure 3. Real wages on average in the whole economy (total pay including bonuses and arrears, seasonally adjusted, deflated using CPIH (CPI including owner occupiers’ housing costs)) have been falling since the Great Recession and the years of austerity in its aftermath deepened the squeeze in wages, when nominal wages have been failing to catch up with the rise in prices year after year. The recovery since 2014 has been slow and incomplete, with real wages still lower than their 2007 level in 2019, and the cost of living crisis reversed any improvements since 2014. As of 2022 compared to 2007, real wages in construction and manufacturing are 9.9% and 3.7% lower, respectively. In the public sector, the fall starts with a delay in 2011 following the austerity program of the Conservative-Liberal Democrat coalition government, and as of 2022 public sector wages are 5.4% lower in real terms compared to 2010. The only sector where real wages are still substantially higher in December 2022 compared to 2007 is finance and business services, with a real increase of 5.9%. In

wholesaling, retailing, hotels & restaurants sector, the slow recovery seen during the pandemic with the change in the composition of the workers (with lowest earning workers losing their jobs due to public health restrictions and labour shortages having some impact on wages), is being reversed in 2022 as the nominal wages fall well behind inflation in this sector as well.

Figure 3 Real Average Weekly Earnings (total pay including bonuses and arrears, seasonally adjusted, deflated using CPIH in constant 2015 prices)



Source: Own calculations based on ONS data

The effects of the crisis and real pay cuts is also gendered. Women are at the frontline of the cost of living crisis, as those who are doing still more than 60% of the domestic unpaid care work³, including budgeting, shopping, cooking, caring, providing for the children, elderly, and the household, sewing, mending. These activities increase during cost of living crises to compensate for the loss in real income of the households, and this is not due to their own choosing; it is not a

³ See Onaran, Oyvatt, Fotopoulou (2022) for a gendered analysis of the distribution of paid and unpaid work in the UK.

hobby but a stressful daily survival struggle when women need to make difficult choices between eating and heating.

Women also constituting a larger proportion of the most vulnerable on the lower end of the wage distribution and those with precarious contracts. They constitute the majority of the workers in the public sectors such as health, social care, education, and childcare who have suffered from pay freezes and dismal increases since 2010. This situation has changed little after the pandemic, despite being clapped as key workers by policy makers. Households headed by women and single mothers are more likely to struggle with debt and soaring utility bills. Women also carried the brunt of the rise in the increased care needs after the pandemic with the rise in long-term illness against the backdrop of overstretched healthcare and social care services due to years of cuts in the National Health Service and social care, where many women had to leave paid work against their will.

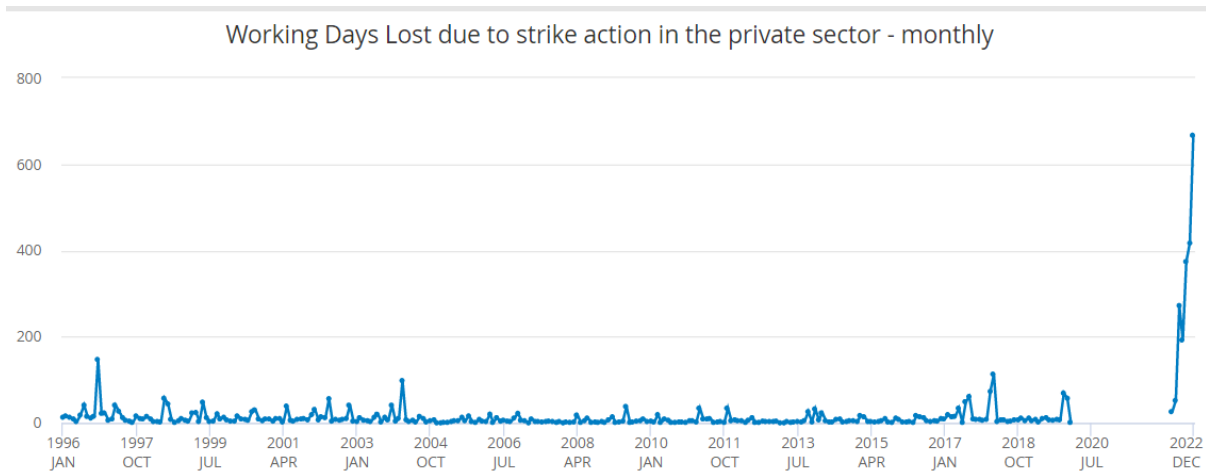
Against the background of these facts, it is difficult to see evidence for the BoE governor's warnings of the risk of wage-price spiral⁴. The big difference to the 1970s is the fall in the bargaining power of labour as indicated by the fall in trade union density and collective bargaining coverage as well as labour market deregulation that brought a rise in zero hours contracts and dogy self-employment.

It is yet to be seen whether the biggest strike wave of the past three decades will be able to stop the real cuts in wages. Nearly 2.5 million working days were lost to industrial action in 2022 (in cumulative) as a whole in the whole economy. 2 million of these days of strike were in the private sector -the highest in three decades. In historical standards taking the public and private sector strikes together, the record in 2022 is still much lower than the historical highs of late 1970s, but the severity of the cost of living crisis and the discontent among public sector workers led to 2023 starting with a historical escalation of public sector strikes in rail, education, and civil service.

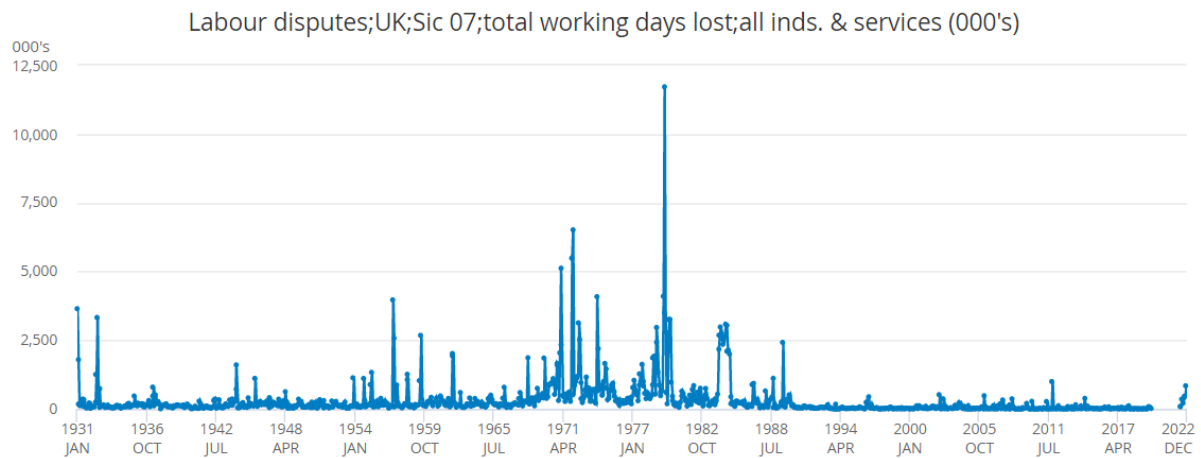
⁴ See section 4 for more details on the BoE governor's statements in an interview in February 2022.

Figure 4 Working days lost due to strike action (in 000 days)

4a. Private sector



4b. Whole economy



Source: ONS

3. The first and second waves of inflation

A critique of the warnings of wage-price spiral and the current government and BoE policies to tackle inflation requires an analysis of another distributional dimension behind inflation, i.e. the trends in the profit margins of the firms. This section discusses the first and second waves of inflation in 2021-22 to address a less analysed façade of conflict inflation.

The first wave of inflation in 2021-22 is due to the increase in critical imported input costs due to the supply chain disruptions after the pandemic and later due to Russia's invasion of Ukraine.

Brexit added further dimensions to the supply chain disruptions in the UK. Apart from these transitional aspects, longer term problems related to climate change disasters inflated food prices too. All these factors led to soaring prices of energy, fertilizer, animal feed, food, some industrial metals (nickel, copper), neon gas (input for semiconductors). The immediate effects were worsened by commodity price speculation. The pass-through from these critical inputs to the prices of other goods & services was strong.

Against these exceptional and transitional factors, mainstream economists still try to point at expansionary fiscal and monetary policies during the pandemic, in particular in the context of the US, as the prime concern without a credible decomposition analysis of the causes of inflation (e.g., Furman 2021). More recently indicators of labour market tightness, and the high number of job openings and quits have received the attention of mainstream New Keynesian NAIRU interpretations both in the US and the UK (Domash and Summers, 2022; BoE, 2023). BoE Governor has been warning against a wage-price spiral.

To date there has been little evidence of wage-price spiral in the UK as discussed in section 2. While this may change in the coming months in the context of the recent wage disputes, policy makers so far have paid very little attention to the firms' price setting behaviour, which has driven a second wave of inflation due to increasing profit margins in the UK, as well as the US and the EU (Jung and Hayes, 2022; Konczal and Lusiani, 2022; Schnabel, 2022). This is not new, but rather the continuation of a secular increase in the mark-up rates and fall in the labour share (De Loecker and Eeckhout, 2018; Ugur et al., 2022).⁵ Firms have not only passed on the rising costs of inputs to their output prices but have increased their mark-up rates, i.e., increasing the prices at a faster rate than the increase in their input costs.

Konczal and Lusiani (2022) for the US present a detailed analysis of markups and profits, which increased in 2021 at the fastest annual pace since 1955 reaching their highest recorded level across many types and sizes of firms. Their findings suggest that market power is an explanatory driver of inflation.

ECB executive board member Schnabel (2022) presents evidence that the eurozone firms have been able to increase their unit profits across sectors; this trend is not limited to energy or basic

⁵Ugur et al. (2022) argue that the main determinant of falling share is not technological innovation per se but the extent of market power that allow successful innovators to extract rents.

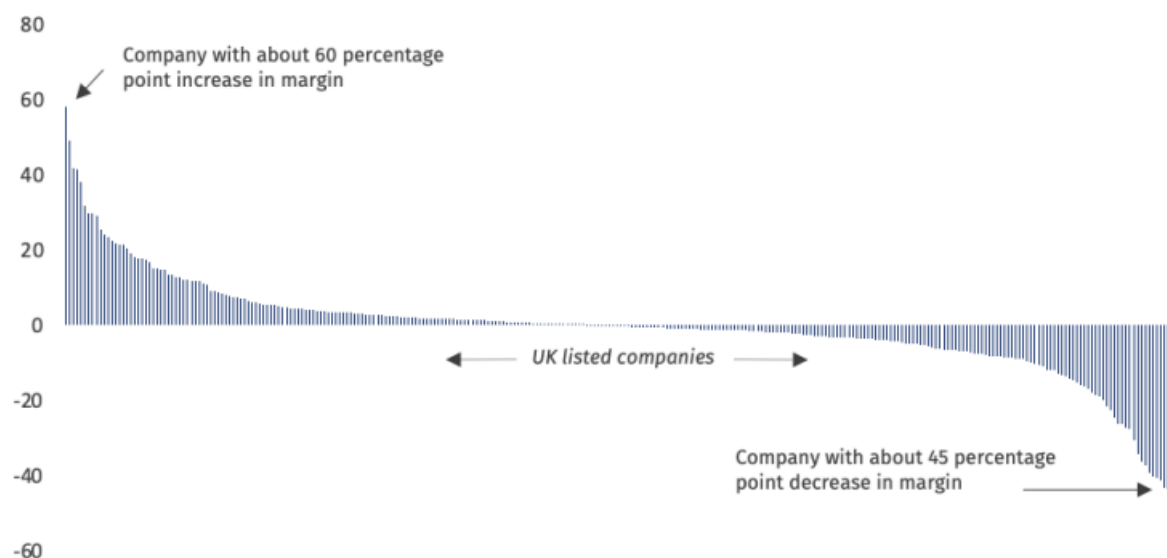
materials, and is particularly evident in those sectors most heavily exposed to global conditions, such as the industry and agricultural sector, with large, export-orientated firms probably benefitting the most.

In the UK, Jung and Hayes (2022) show that some companies increased their profit margins by up to about 60%-points in the fourth quarter of 2021 or first quarter of 2022⁶ compared to 2017-19 average based on data from non-financial listed firms in the UK (See Figure 5). Overall, about half of the companies could either preserve or increase their profit margins during 2021-2022Q1. This would indicate that it would be possible to increase wages without causing higher inflation if profit margins decrease in some industries or firms. Similar to the USA, the recent rise in the profit margins in the second phase of inflation is a continuation of an increasing trend in mark-up rates in the UK contributing to inflation, which became more visible with the surge in input costs and inflation (De Loecker, et al., 2022).

Another striking information shown in Figure 5 is that there is a substantial heterogeneity across firms in the UK with about half of the firms experiencing a decline in their profit margins. At the bottom of the firm distribution, SMEs are not able to pass high intermediate input or wage or borrowing costs to their customers who are themselves cutting back non-essential spending as their real incomes fall. The exposure of the companies to the rise in interest rates will depend on their level of debt. Company insolvencies and the number of listed companies issuing profit warnings have been increasing since the third quarter of 2022. We return to this issue in section 4 below.

⁶ Only a small number reported quarterly data for 2022 at the time of the analysis.

Figure 5. %-point change in profit margin compared to 2017-19 average, non-financial listed firms, UK, most recent reporting as of June 2022



Source: Jung and Hayes, 2022, IPPR/Common Wealth

A decomposition of the relative contribution of these different phases and factors, in particular a granular analysis of the contribution of changes in mark-ups to inflation requires updated firm level data for both listed and unlisted companies for the entire 2022 and is the topic of our future research. Given the inter-firm heterogeneity, it is not possible to arrive at quick conclusions about the effects of profiteering on inflation, from a decomposition analysis of the aggregate GDP deflator or even sectoral price deflators, and much less so if the sectoral decomposition is limited to fairly heterogenous aggregates such as goods and services.

4. The fiscal and monetary policy response in the UK

This section presents the policy responses to the cost of living crisis by three successive conservative governments in the UK during 2021-22 and the BoE, assessing their limitations along four dimensions: 1. failing to address the actual underlying causes of inflation; 2. lack of coordination between monetary and fiscal policy; 3. the rush back to austerity; 4. conflicting targets in terms of inflation vs. macroeconomic and financial stability.

4.1 Failure to address the actual underlying causes of inflation

First, the monetary policy response by the BoE, following the conventional wisdom of mainstream central banking, failed to address the root causes of inflation, driven by increasing imported input costs and mark-ups rather than demand or wage-price spiral. On the contrary, focusing narrowly on the wage-inflation expectation spiral, in an interview in February 2022, BoE's governor Andrew Bailey said that while it would be "painful" for workers to accept that prices would rise faster than their wages, and he added that some "moderation of wage rises" was needed to prevent inflation becoming entrenched. "we do need to see a moderation of wage rises, now that's painful. I don't want to in any sense sugar that, it is painful. But we need to see that in order to get through this problem more quickly." He continued to warn of apocalyptic prices and implied that workers must pay for the crisis by moderating their wage demands.

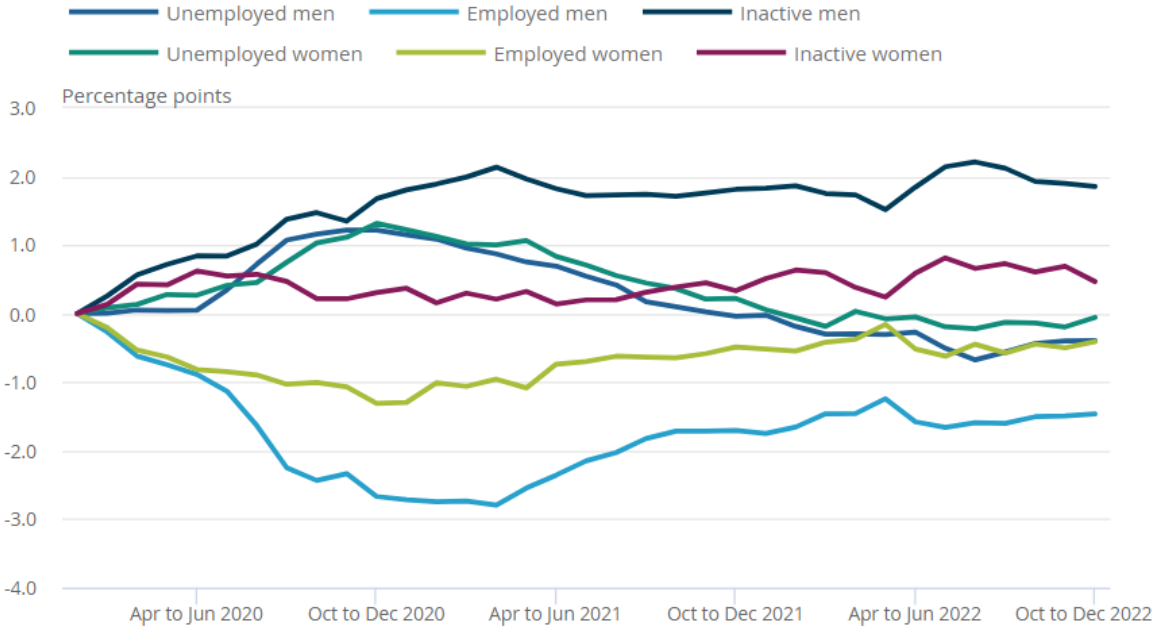
According to its own projections the current actions of the BoE to rely on increasing the interest rate to control inflation is expected to lead to a recession of -0.5% in 2023 and -0.25% in 2024 and growth is expected to remain well below pre-pandemic rates. The same projections assume that the USA, euro-area or emerging market GDP will all increase in 2023 and 2024.

The political economy of this could not be clearer, particularly after the long squeeze in wages since the Great Recession. Currently, the profit share of the employers and the wealth of the top 1% are increasing, while workers' share in national income is being squeezed by the spike in the cost of food, utility bills and rent. The current policies of the BoE to increase the interest rate does not tackle the rise in imported input costs or rise in mark-ups at the root of today's inflation and pretends that it is demand-driven. A recession is seen as an unavoidable outcome to make sure that the bargaining power of labour remains muted and the wage-price spiral does not escalate. This ultimately means that workers will pay for this crisis in the form of real wage cuts.

In this spirit, the BoE puts a lot of emphasis in its monetary policy reports (e.g. February 2023) on the tightness of the labour market, low unemployment, high economic inactivity, and workers shortages in justifying its rate setting decisions after 10 successive increases in the interest rate within 18 months until February 2023 bringing it to 4%. While the unemployment rate in the last quarter of 2022 at 3.7% is still lower than the pre-pandemic levels, it started to increase. Crucially, total hours worked decreased compared with the previous three-month period and remain below pre-pandemic levels. The economic inactivity rate at 21.4% is still higher than before the pandemic, mainly due to health conditions, unpaid care responsibilities particularly among

women, or unacceptable working conditions: the Great Resignation. But recently economic inactivity started to decrease, putting pressure on unemployment. Figure 6 below shows the cumulative change in the number of employed, unemployed and inactive from December 2019 to February 2020 up to October to December 2022.

Figure 6. Cumulative change from December 2019 to February 2020 up to October to December 2022



Source: ONS

The emphasis on the tightness of the labour market is a rather narrow mainstream New Keynesian NAIRU analysis, missing the broader range of policy tools beyond interest rates to address the root cause of the economic inactivity and labour shortages. The latter would require investing in the care economy -in both health and social care as well as childcare- and a radical reversal of the new migration policies in the post-Brexit UK. Some migrant workers from the EU who returned home during the lockdowns and have never returned, which add to labour shortages -an outcome partly related to the migration policies after Brexit. We return to investing in the care economy as part of the medium-term policies in section 5.

4.2. Lack of coordination between monetary and fiscal policy

In September 2022, a new government by the Conservative Party, replacing the previous Conservative Party government, announced a new revised budget.⁷ The main changes included an increase in planned borrowing due to regressive tax cuts for the high income groups, informed by supply side and trickle-down economics. It also can be summarised as a right wing version of fiscal policy based on some of the principles of the Modern Monetary Theory with a trust that growth generates the tax revenues to fund spending and financial markets would agree to fund increased public sector borrowing requirement.

Markets' reaction to the mini-budget was clear that this will not stimulate the economy, and a blind trust in simplistic low tax supply side economics will not solve stagflation or long-standing problems in the UK.

This shift in fiscal policy stance coincided with the opposite stance in monetary policy, teaching a perfect lesson on the consequences of lack of coordination between monetary and fiscal policy. The September 2022 “mini-budget” leading to an increase in government borrowing, coincided with the announcement of quantitative tightening “QT” by the BoE. The day before the mini-budget, the BoE committed to actively selling off government debt by shrinking its quantitative easing (QE) gilt portfolio by £80bn over the next year, including, in contrast to other central banks, outright sales of bonds before they matured. This meant both the BoE and the government were selling huge quantities of government debt in the markets. The detrimental lack of coordination between fiscal and monetary policy institutions triggered a financial crisis in parts of the pensions sector, which no policy maker had foreseen.

UK defined benefit pension funds had been engaging in liability driven investment (LDI) -so-called “hedging” activities which involved borrowing from banks to invest in high return assets using government bonds as collateral. The Pensions Regulator estimate that 60% of pension schemes make use of LDI. This practice was encouraged by the Pensions Regulator and appeared profitable when interest rates were 0 but became unsustainable as yields surged higher. In

⁷ The Conservative Party's internal conflicts led to the election of a new party leader by the party members, who then became the new prime minister (without a new general election). The new Prime Minister, Lizz Truss and her Chancellor announced revisions to the existing budget, which has been dubbed as the “mini-budget.”

September 2022 expectations of further increases in interest rates due to both QT and higher government borrowing had unexpected consequences for the UK pension funds engaged in LDI: the fall in the value of bonds triggered margin calls by the banks ask for new collateral from the pension funds. In turn, pension funds had to sell government bonds to meet the margin calls. The asset fire sales amplified market volatility, creating a dangerous feedback loop.

Eventually, the BoE had to pause QT and buy large quantities of gilts to prevent a financial crisis in the pension funds. The new government's "mini-budget" was abandoned in three weeks, and a third party leader and Prime Minister was appointed by the Conservative Party.

4.3. The rush back to austerity

The "mini-budget" is now replaced by a return to austerity policies by the Conservative Party government. Austerity, including real cuts to public sector wages of nurses, teachers, and civil servants, and a reduction in public debt/GDP are said to be essential to prevent inflation and plug a "fiscal hole."

This second age of austerity, following the big wave of cuts by the 2010-15 Conservative-Liberal Democrat coalition government following the Great Recession will not only be detrimental in a country with already weak social and physical infrastructure, but will be self-defeating on its own terms, as it will lead to further negative effects on national income, thereby lead to a fall in tax revenues despite some increase in the tax rates. Even the ultimate impact on public debt sustainability is ambiguous.⁸

The new Conservative Government has driven the wrong lessons from the collapse of the previous Conservative Prime Minister Truss's "mini budget". Steer and Stubbington (2022) in the Financial Times reports that even the asset managers say that austerity isn't going to solve many of the UK's problems.

The resistance to increase in public sector pay in health, education, and civil service after decades of below inflation pay rise with the discourse that the best way to fight the cost of living crisis is to halve inflation clarifies the political economy and class bias in these policies. Nurses', teachers', or civil servants pay rise would not directly feed into wage-price spiral, as they do not lead to rise

⁸ See Calvert Jump and Michell (2022) on the arbitrariness of the government targets and definition of the "fiscal hole".

in the input costs of private companies. Increased economic activity and tax rates could fund this spending. One political economy question becomes who should pay for these tax increases. The second question is what the signal effect of public sector pay rise would mean for the private sector wage negotiations, and thereby the profit margins of the private firms. Hence, insisting in further real pay cuts in the public sector is a political decision about the government's class position in terms of the distribution of income. One note about the hypocrisy of this position is also in place here: public sector workers have suffered more than a decade long real pay loss following the austerity wave during the 2010-15 Conservative-Liberal Democrat coalition government. Most of them worked under very difficult and risky conditions during the pandemic and were praised as the "key workers" daily by the policy makers and the public alike.

4.4. Conflicting targets of the central bank in terms of inflation vs. macroeconomic and financial stability

The events of September 2022 makes the problem of conflicting targets of the central bank in terms of inflation vs. macroeconomic and financial stability all too visible. We have already discussed this problem above in section 4.2 with respect to financial complexity, lack of oversight and vulnerability of the non-bank financial institutions to increases in the interest rate on government bonds in the context of the pension funds with LDI. In this section, we will look at potential financial fragility in the context of indebted households and firms.

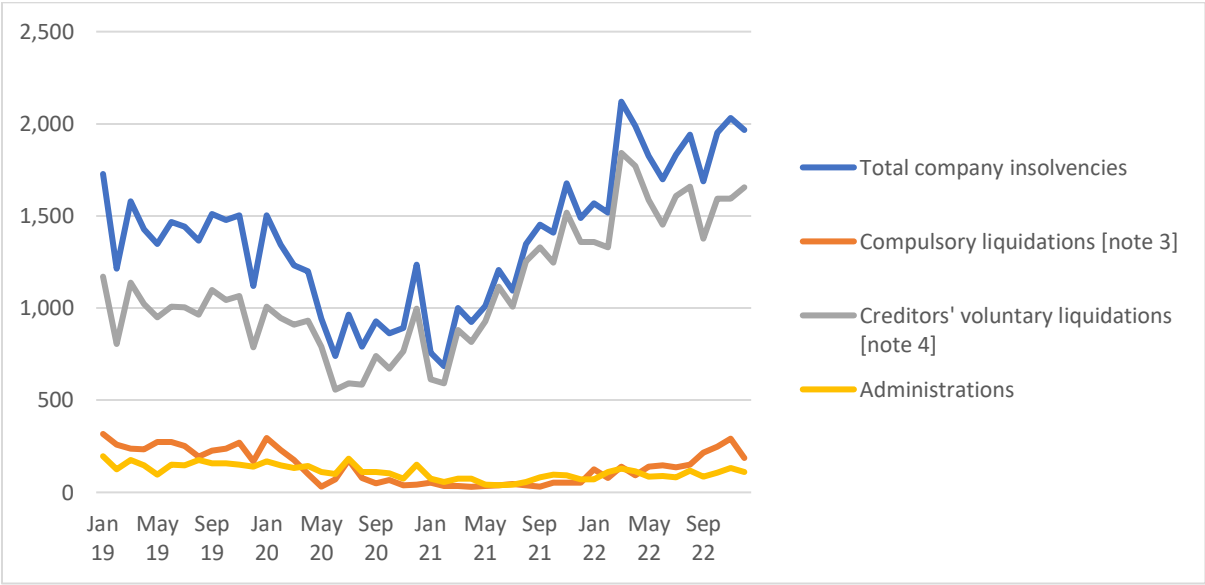
The increases in the interest rates, cuts in public spending and the recession will deepen the crisis for indebted working class households as well as indebted firms at the bottom of the distribution of profit margins. The crisis for indebted households and firms is yet to unravel even when inflation starts to decline in the second half of 2023. The use of interest rate as the tool to fight a surge in inflation fuelled by imported input costs turn a transitional problem into permanent distributional scars for indebted households and companies.

The increase in the interest rates led to higher mortgage and other debt payments by the households, who have already been struggling to make ends meet due to real wage cuts and rising food prices and utility bills. Noonan (2023) reports that more than 750,000 households are at risk of defaulting on their mortgage payments in the next two years according to the Financial Conduct Authority, because their mortgage costs will be more than 30% of their income. About 200,000 households had already fallen behind on their home loans by mid-2022.

The increase in the interest rates, fall in mortgages and slowdown in activity is feeding into a fall in the house prices. Mortgage approvals have fallen to their lowest level since January 2009. The Office of Budget Responsibility (2022) forecast that house prices will fall by 9% between January 2023 and the third quarter of 2024. While a correction in house prices might be welcome, this happening in a recessionary climate rather than due to a rise in housing investment, is expected to lead further deterioration in business as well as consumer expectations and investment. There is also an increase in sales by the buy-to-let landlords who cannot cover the mortgage payments, which then intensifies the crisis in the rental market.

On the side of the companies, on top of supply chain pressures, rising input costs, high energy prices and rents, higher interest rates increase the pressure, particularly on already indebted companies. The total number of company insolvencies registered in 2022 reached at 22,123, which has been the highest since 2009 and increased 57.4% compared to 2021 (see Figure 7). Companies in construction, retail and hospitality sectors have seen higher numbers of insolvencies. There are concerns that more companies will fail when the government’s energy support package is scaled back in April 2023. Personal insolvencies also reached the highest numbers for three years in 2022.

Figure 7 Corporate insolvencies, January 2019-December 2022



Source: The Insolvency Service

5. What are the economic policy alternatives?

The final section outlines economic policy alternatives to economic orthodoxy in addressing the root causes of the cost of living crisis, distinguishing between the short run urgent measures and medium run policies in the context of intersecting multiple crises.

5.1 *The short-run*

In the short-run, two sets of urgent measures are required:

i) First, we need policies to urgently reverse the squeeze in wages and low incomes. The policy tools to achieve this include increasing the minimum wage to £15/hour in the UK; increasing the public sector pay above inflation; tying the benefits to the increase in inflation; and rebuilding the trade unions' power for collective bargaining agreements to ensure adequate pay rise in the whole economy. Mindful of the risk that these measures may increase company insolvencies, in particular at the bottom of the distribution of SMEs, reactivation of fiscal support for short time work to avoid transitional shocks is essential.

ii) Second, extreme nature of the cost of living crisis requires price controls, in particular in energy prices, rents, and essential food items. New Economics Foundation (2022) proposed a package for guaranteeing basic energy needs for households, while avoiding subsidising fossil fuel consumption above a certain threshold. In terms of international context, France who acted early in November-December 2021 directly limiting electricity price increases to 4% and froze domestic gas prices with energy subsidies to businesses and households (White and Arnold, 2023), enjoyed the lowest inflation in the eurozone with 7.0% as of January 2023. The measures, which included discounts at the pump and cuts to electricity taxes, cost the government just over €34bn in 2022.

Another major component of essential spending for low income households which increased substantially is rent. The Conservative Government in the UK limited the increase in the social (housing) rents by 7% in November 2022 for the next year, but a genuine policy of rent controls require rent controls in the private housing market too. Both in the context of energy prices and rents, these policies need to be accompanied by a ban of disconnections or compulsory instalment of pre-paid meters for utilities and a ban on evictions. The latter was implemented during the pandemic.

A third category where price controls could help is essential food items. White and Arnold (2023) argue that France with a fiercely competitive supermarket sector had a lower food inflation because

of the limits on the rise in profit margins in the retail sector. In the UK where competition has not sufficed to limit the food price inflation, some coordination to curb the rise in mark-up rates or subsidies could go a long way avoiding the worst poverty effects of cost of living crisis.

Overall, anti-trust scrutiny and windfall taxes targeting the increase in the mark-up rates as well as banning speculation in commodity markets are other short-run policy tools to tackle the rise in inflation.

5.2 The medium-run

In the medium run (1-5 years during the first term of a new government), the multiple crises require a paradigm shift towards a needs-based approach to macroeconomic policy, in particular fiscal policy, addressing the deficits in the care and green economy, avoiding competition between urgent social and ecological requirements. Medium-run policies also need to address the issues of shortages and bottlenecks that are at the background of the need for price controls or may result from price controls.

Addressing the cost of living and energy crises, as well as reversing the ecological crisis requires a massive and urgent mobilization of substantial amounts of public investment in the green economy, i.e., renewable energy, public transport, housing, energy efficiency, sustainable organic plant-based agriculture, forestry, recycling, and repair. The long-standing deficits in the care economy are no less urgent, and are now behind the labour shortages, and the public provision of high quality universal free basic services in social care, health, childcare, and education is key to tackling both the care deficit and inequalities by creating decent purple care jobs while providing the much-needed services. The scale and the urgency of the spending needs to address both deficits in the green and care economy and the public good character of these services requires a large public spending programme, which cannot be substituted by private investment based on profit motive. There has never been a better moment to make the case for creating permanent public sector jobs with decent wages to build a caring and sustainable society based on a green, purple, red new deal.

The spending needs of a just transition to a caring and zero-carbon economy, especially because of the scale of required investment, may lead to further supply-side bottlenecks and increases in prices of critical inputs, e.g. critical minerals. This might mean that price controls and planning of

investment may remain important policy tools beyond the short-run policies to tackle the cost of living crisis.

5.3 How to fund a green, purple, red new deal?

The social and ecological needs, and the urgency of an effective response to the multiple crises of inequalities, care and climate change requires the use of all tools of policy.

Public spending even without any increases in the tax rates, is partially self-financing, thanks to the strong multiplier effects (Onaran, Oyvat, Fotopoulou, 2022; 2019; Onaran and Oyvat, 2022). However, increase in economic activity and thereby tax revenues without a change in tax rates will finance only half of the public spending in the UK according to our estimations (Onaran, Oyvat, Fotopoulou, 2022; 2019).

Public borrowing to fund the deficit can be justified given the effects on productivity and sustainability, or the expected damage to the ecology, society, and economy, if investment needs are not delivered on time.

Monetary policy should accommodate fiscal policy for public investment in the care and the green economy. The BoE's mandate should include a dual target of full/high employment and an inflation target high enough to be consistent with the former, moving within a band, with a higher weight for employment (Onaran, 2022). There is a major problem with the current mandate of the BoE targeting narrowly the inflation rate at a level as low as possible (2%): This only helps the rentier who make profits by speculation and lending, because their real return, i.e., the real interest rate is the nominal interest rate minus the rate inflation rate. Hence inflation being as low as possible is good for the rentier, while high unemployment and/or bad working conditions associated with the stagnationist effects of this low inflation target are bad for workers.⁹

National and regional investment banks working in cooperation with the government and central bank are also crucial for funding large scale public infrastructure projects.

⁹ Pollin and Bouazza (2022) show that higher inflation rates within a reasonable broad range are consistent with stronger GDP growth across the world. There are other concerns related to the level of the inflation target: Blanchard (2022) recently repeated his call for a higher inflation target, with a slight downward adjustment to 3% from his 2010 proposal for a 4% target. He argues that the zero lower bound was more binding than anticipated, and a higher inflation target would allow higher average nominal interest rates and would allow more room for monetary policy to operate in case of a recession.

However, eventually the large scale of spending needs requires also an increase in the degree of progressivity of taxation of both income and wealth. A progressive scheme of wealth taxation, aiming especially at the top 1% of the wealthiest households, rather than a limited one-off windfall tax targeting only one sector or increasing tax rates merely on dividends & capital gains, is particularly important after the Great Recession, QE and the pandemic which has increased wealth inequality. Wealth is more unequally distributed than income in aggregate and in terms of gender gaps. Wealth grows exponentially; returns are higher the higher wealth is; composition is skewed towards financial and business wealth on top the distribution. Progressive taxation of wealth is essential to prevent excessive wealth concentration. Wealth taxation also helps to control wealth-demand-driven inflation. According to our macro-econometric modelling for the UK, contrary to common wisdom, progressive wealth taxes, and the consequent decline in wealth inequality is good for private investment, because it tames speculation, financialisation, market concentration, and barriers to entry (Onaran, Oyvat, Fotopoulou, 2019). Thereby, wealth taxation have very strong positive impact on output, employment of women and men and the budget balance in the UK.

Tippet, Wildauer, Onaran (2021) proposes a progressive scheme starting with a high threshold targeting the top 1% wealthiest households, including all assets to limit avoidance, exemptions, and reliefs. The advantage of this is that only a small number of households (about 260 thousand) are to be valued and is easier to monitor. The proposal starts with a marginal rate of 1% for the top 1% (households with net wealth > £3.4 million), a marginal rate of 5% for the top 0.5% (above £5.7 million), and a marginal rate of 10% for the top 0.1% (above £18.2 million). It is estimated that this scheme can generate £70-130 billion a year, i.e. 9-16% of total tax revenues taken by the UK (after administration costs and 15-50% tax avoidance/evasion is accounted for). To put things in historical context, the average effective tax rate on wealth currently is less than 1% of wealth, while it was about 2% in 1970.

The coordination of fiscal and monetary policies with the labour market policies eases the funding pressures as higher wages lead to higher tax revenues (Onaran et al., 2019). Strong, well-coordinated trade unions, equal pay legislation, increased job security, permanent contracts, higher minimum wages, and an improved and equitable parental leave are good for an equality-led sustainable development. Labour market regulation for a shorter working week can also promote

a rise in gender equality in paid and unpaid work and income, while facilitating a green transition and higher productivity and moderate inflationary pressures (Onaran and Calvert Jump, 2022).

At this crucial juncture of food, energy and ecological crises international policy coordination is vital, especially for the emerging economies. Firstly, the effects of public spending are stronger and negative effects on the current account balance are moderated, if policies are implemented simultaneously in all the countries (Onaran and Galanis, 2014, Obst, Onaran, Nikolaidi, 2016). Secondly, cancellation or restructuring of parts of the debt of the low and middle income countries needs to be part of the international agenda. Thirdly, transfer of technology to support mass not-for-profit global production of key public goods from vaccines and medication to solar panels, turbines, or batteries for storing renewable energy is the only way to tackle global crises such as the pandemic or climate change.

Finally, the multiple crisis opens space to rethink not just the role of fiscal policy but also public ownership in the care and green economy and finance, national coordination in combination with collective, municipal, and cooperative ownership and democratic participatory planned decision making.

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