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Price controls are the sorry result of government inflation errors

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You rush into your local Tesco after a long day only to find once again that the bread aisle is empty and there's not a single pint of milk in sight. A Soviet-style dystopia? Not quite. This could be our new normal soon, if the government gets its way.

Rishi Sunak is said to want to mimic the French government by using his pulpit to broker price caps with supermarkets on bread, milk and other basic food items to reduce living costs. Big chains signed up to the deal put forward by Bruno Le Maire, the French finance minister, in March to set prices "to the lowest possible level" as part of a government-branded "anti-inflation quarter".

Sunak's aides insist that such price caps will avoid the economic disruptions of mandated price controls in the 1970s, because they are "voluntary". Yet a government pressuring companies brings with it an implicit legislative threat. In France, the three-month agreement has been extended already and Le Maire has threatened tax rises on retailers if prices don't fall further. Behind the velvet glove is an iron fist.

The economics of such an approach is pretty grim. Government-backed food price caps have a history replete with failure. From grain price ceilings causing farmers to abandon work in ancient Rome to price caps exhausting food supplies in a besieged Antwerp in the 16th century, right through to Second World War price controls delivering extensive rationing and black markets, they cause legion economic distortions.

With retail profit margins of only 3 per cent and 3.8 per cent for Sainsbury's and Tesco, respectively, last year, the British Retail Consortium is right that our competitive retail market is not defined by customer rip-offs. Recall the shortages of rice and flour in leading chains during the early pandemic? That reflected supermarkets' unwillingness to risk their brands by raising prices substantially during an emergency. Only independent stores and online merchants had the goods available, at much higher prices.

If Tesco, Sainsbury's, Asda and others agree to sell certain essentials below market prices in today's inflationary conditions, we'd see such effects at a great scale. There'd be within-store shortages of covered products, with demand shifting to uncapped brands or corner shops, pushing up prices there. This isn't theory: Hungary capped prices of sugar, flour, sunflower oil, chicken breasts, pork legs and milk in 2022; by December, 56 per cent of Hungarians reported regularly encountering shortages of regulated items.

To avoid empty shelves, supermarkets might limit per-customer purchases (let's call them Rishi's Rations), or else promise caps on only their own-branded products where they can attempt cost controls. Given the slim margins, some supermarkets would push farmers and wholesalers to cut their prices, thereby reducing their incentive to produce or distribute food. Suppliers, as those in France have, then would demand that the government implements "spot checks" to ensure that supermarkets do not pass the profit buck to others.

The BRC says food production costs peaked late last year, meaning that future renegotiations of fixed-price contracts will lead to retail prices falling sharply soon anyway. As Julian Jessop, the economist, points out, government-backed price ceilings ironically may then keep prices above market rates. Formal negotiations might enable supermarkets to tacitly collude to recoup profits by keeping prices higher even as their costs fall.

Such damaging effects might be deemed acceptable if these price caps reduced inflation. But, as the 1970s showed, they will not and, with controls limited to a few products, they cannot. The Bank of England and government often talk, misleadingly, as if businesses determine inflation through their pricing decisions. This error facilitates far-fetched concepts such as "greedflation," which emboldens calls for these hare-brained price controls.

"Food prices inflation" has been at 19.1 per cent over the past 12 months, for example, notably higher than the overall 8.7 per cent consumer prices index. Government sources talk as if food prices are therefore "driving" inflation by lifting the overall price level. Yet this confuses cause with effect. Rapidly rising food prices are a consequence of overly inflationary monetary policy and the supply shocks from the Ukraine war that are filtering higher prices through supply chains.

Capping retail milk and bread prices will combat neither of these forces and so will not reduce inflation. Any direct consumer savings from lower-priced bread and milk purchases would leave affected customers with more money for other spending, driving up prices elsewhere. This is true whether price controls are mandated or, as Andrew Bailey, the Bank's governor, seemingly wants, if firms self-sacrifice on profits. The more prices get divorced from supply and demand, the worse the damage.

The reach for such anti-market policies is an underappreciated cost of macroeconomic mismanagement leading to high inflation. When inflation gets out of control, redistributing wealth arbitrarily, the public demands recourse. As Axel Leijonhufvud, the economist, explained in 1975, "there will be widespread and general complaining about rising prices . . . but that diffuse message is quite drowned in the rising babble of specific demands and concrete proposals . . . to compensate me, to regulate him, to control X's prices and to tax Y's 'excess profits' ".

Governments, meanwhile, find it irresistible to supply such policies. Given the highest post-Second World War tax burden today, there's no will to transparently tax and redistribute to aid those particularly burdened by high living costs. Talk of targeted price controls allows the Conservatives to signal to large numbers of voters that they care, while quietly shifting the responsibility and blame for inflation from the central bank and Treasury to individual supermarkets.

Ultimately, though, Britain's food retailers are disciplined in what they can charge both by competition and their customers' willingness to pay. Asking them to cap certain prices to control inflation is futile. Asking them to cap certain prices to provide charity is extremely inefficient. This price ceiling proposal represents a desperate, misguided attempt to hide inflation's symptoms from a government largely powerless to mitigate the scale of external shocks and the Bank's recent monetary errors.

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