



## Inflation and oil price shocks

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The conventional wisdom, especially among those who lived through the oil embargo of the 70s, is that [higher oil prices](#) will lead to high inflation. But an article by Stephen King, managing director of economics at HSBC, hypothesizes that this [may not be the case this time around](#).

According to King, the worst inflation scenario is that workers (who are presumably unionized) manage to get wage increases in the face of higher prices. Ultimately, this may induce companies to raise prices even higher. This turns out to be especially problematic for retirees, who are on a fixed income. King goes on to argue that since society has changed since the 70s, it's unlikely that such a shift in financial burden is likely to be acceptable.

Society has changed. Western populations have aged. Those people who managed to extract wage increases in the Seventies and early-Eighties are now in their 50s, 60s and 70s. This is the baby-boomer generation, the generation that, because of its numbers, has enjoyed an unusually large influence on political and economic choice.

This is the generation that, in the Seventies, was prepared to tolerate higher inflation but, by the Nineties, was pushing for independent central banks with inflation targets. Now that they have their pension nest eggs, the last thing the baby boomers want is a return of inflation.

King also points out that the workers are less likely to be effective in demanding wage increases now, since there are fewer unions, and factories can always be moved to other countries.

Now, with the collapse of communism in central and Eastern Europe, and with a more open relationship with China and India, capital has become mobile. If workers misbehave, capital goes elsewhere. Workers are, therefore, resigned to the fact that higher energy prices will not be offset by bigger wage increases.

The result, according to King, is that everyone suffers equally—or no one really suffers at all. I'm not sure how to interpret his last paragraph.

Of course, this means that workers suffer as a result of higher oil prices. But that's life. So long as inflation remains low, the arbitrary creation of winners and losers in the light of an oil price shock should be avoided.

In any case, I have a feeling that higher prices due to higher energy cost certainly isn't going to affect us all equally—my guess is that it won't do anything to lower the [ever-growing disparity](#) between the rich and poor in the US (and [elsewhere in the world](#)).



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