

Too many people draw lessons from the 1970s without studying its history

It is strange to read and hear unquestioning assertions that the high inflation of the mid 1970s was the result of Chancellor Barber's tax cuts. If you study the history you would conclude that the Barber period did indeed see an inflationary price bubble especially for property and financial assets, brought on by a change of money policy.

The Bank and Treasury in 1971 gave up on a complex system of quantitative controls on bank lending, substituting Competition and credit control as a policy. The deregulation would have been a good idea if the Bank had then used its retained powers to fix short term rates in a way which limited overall credit and money creation. Instead they went for a credit and money boom which powered the property and secondary banking bubble. In 1973 with clear overheating they abruptly changed policy just in time for the blow of the oil price OPEC surge to widen the inflation and add to the downturn their money policy lurch generated.

There are some similarities with today. Today the Bank has lurched from far too much money creation and low rates to money destruction and higher rates, just as in the 1970s the Bank and Treasury lurched from far too much private lending and low rates to too little. Then as now the asset inflation broadened out into a general inflation pushed hard by an external energy price shock. These external shocks pushed up the inflation rate but also took demand growth out of the domestic economy leading to recession in the 1970s. Today we will have a recession if we persevere with higher taxes and a severe monetary tightening at the same time as the real income hit from energy.