

The Underproduction Inflation – An Acute Challenge for the Post-Pandemic World

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The economic crisis caused by the COVID-19 pandemic has led to a high level of inflation. Solving the problem associated with this high inflation requires understanding its main causes. In particular, it is necessary to find out with what we are dealing – with a rise in demand, with a fall in supply or with some combination of these two (Sachs, 2021). Only by knowing the real cause of this inflation can we correctly determine the methods for its reduction (Rodrik, 2022).

In fact, we are dealing with a combination of rising demand and falling supply in which the latter plays the dominant role. Some of the rise in demand was driven by direct government cash transfers to socially needy citizens affected by the COVID-19 pandemic. Falling supply played a much greater role in increasing inflation. The reason for the fall in supply was the disruption in global supply chains caused by the lockdown of the functioning of certain sectors of the economy in order to limit the possibilities for the spread of the virus.

By mid-2021, there was a misconception that there were short-term supply-side bottlenecks (Stiglitz, 2021) but already in the fall of 2021, it became obvious that we were dealing with the actual collapse of the global production system (Coyle, 2021). The emergence of a new term, “Supply–Chainflation,” also testifies to the significance of the phenomenon of rising of inflation caused by the disruption in global supply chains (Pride, Reynolds, and Vovk, 2022).

Obviously, deglobalization as a result of the global lockdown of different sectors of economy is the cause of supply–chainflation (Marin, 2021).

Breaks in global supply chains disrupt global technological cycles of production, resulting in a reduction in the level of production. Therefore, supply–chainflation, by its very nature, is one of the causes of **underproduction inflation**.

Thus, the inflation resulted by the economic crisis of the COVID-19 pandemic is basically underproduction inflation. In this case, the question arises as to whether central banks have the ability to solve the problem of supply–chainflation. Obviously, the answer to this question is no, since central banks do not have tools to increase production by updating old or establishing new global supply chains. In other words, the *supply–chainflation problem is not instrumental*.

The essence of the main mistake of central banks is that they did not understand the economic causes of high inflation and considered it a macroeconomic problem (Galbraith, 2021). In reality, as noted, supply–chainflation is evident.

Perceiving inflation as a macroeconomic problem, central banks began raising interest rates in order to limit demand. But in doing so, they made loans more expensive which will further will production and, as a result, limit supply. Unfortunately, taking such an unjustified decision, the central banks showed some confusion (Roach, 2022).

The solution to the current problem of supply–chaininflation depends entirely on well-functioning global supply chains which should be built on the basis of a renewed globalization context in the post-pandemic period (Rogoff, 2021).

Based on the principle of economic efficiency, the creation of new global supply chains must take into account the risks associated not only with the COVID-19 pandemic, but also with the possible emergence of new global threats. It is not at all excluded that some production will be transferred to those countries and regions in which production costs will increase significantly. As a result, solving the problem of supply–chaininflation will lead to a new increase in inflation which economists call cost-push inflation.

The essence of cost-push inflation, as it is known, is as follows. Due to rising production costs, firms will be motivated to raise prices in order to maintain profits. If the markets do not accept these increased prices, then the firms will go out of business and, due to the reduction in production, the supply will also decrease which will eventually lead to higher prices. Therefore, cost-push inflation is another cause of underproduction inflation.

It turns out that by overcoming supply–chaininflation, we get cost-push inflation; i.e., one cause of underproduction inflation is being replaced by another.

Given the above, it is not surprising that the main economic topic of the post-pandemic world will be economic growth, expansion of supply and increase in productivity (Spence, 2022).

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