United Nations Association of Spain

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Inflation, recession and human rights

At the beginning of this year, the United Nations *World Economic Situation and Prospects 2022* (WESP)[1] report was published, forecasting a world GDP growth of 4% in 2022 and of 3.5% in 2023, comparatively lower than the 5.5% registered in 2021. However, the world today is immersed in high levels of inflation that may end up leading to a worsening of these prospects, with a consequent impact on human rights.

The law of supply and demand allows us to understand the origin of this phenomenon; that is, the reason behind the current sustained increase in prices. According to this economic rule, when supply falls or demand rises, prices tend to rise, and the other way around; for example, when there is a reduced supply of apartments for rent in Barcelona with constant demand, their price tends to rise, and the same happens if the demand for apartments increases while the supply remains unchanged. Applied to the case of general inflation, today there is both a low supply and a high demand for goods and services. On the one hand, supply has been essentially reduced by the preventive measures concerning the COVID-19 pandemic: globalization implies that each element of the production chain is manufactured in a different country, and the lockdowns and trade restrictions today still present hinder coordination in world production. On the other hand, demand has increased mainly due to economic measures in response to the pandemic: in the years 2020 and 2021, very important fiscal and monetary stimulus programs were passed (e.g., the ARP and AJO plans in the United States in March 2021, endowed with 4.5 trillion dollars[2]) to avoid economic collapses, but the effect of which on demand has been such that they have even overheated it, especially considering that these stimuli were financed through government budget deficits (higher expenditures than revenues) via money printing. As a result, the

[1] United Nations. Department of Economic and Social Affairs (2022). *World Economic Situation and Prospects 2022*. Retrieved from: https://www.un.org/development/desa/dpad/publication/world-economic-situation-and-prospects-2022/.

[2] Banco de México (2021). *Impacto de los Estímulos Fiscales de Estados Unidos*. Retrieved from: https://www.banxico.org.mx/publicaciones-y-prensa/informes-trimestrales/recuadros/%7BA52A0BD8-535D-A5D3-7638-0794D003660C%7D.pdf.

annual inflation rate in the United States picked up to 9.1% in June, while the eurozone's CPI registered a value of 8.9% in July[3].

On the supply side, the aforementioned supply chain problem looks set to resolve itself as the pandemic is left behind —with the elimination of lockdowns and trade restrictions—. However, on the demand side, the above levels have meant that central banks around the world are seeing their medium-term inflation target of 2% being detached from reality, without a natural solution being expected. Consequently, institutions such as the United States Federal Reserve and the European Central Bank (ECB) have responded by raising interest rates. What this monetary policy achieves is to make credit financing more difficult —since the interest offered by commercial banks is higher— and thus discourage consumption. If we go back to the law of supply and demand, we will see that if demand (consumption) falls, prices will also tend to fall: inflation would return to the 2% desired by central banks.

This is the logical sequence that explains the current macroeconomic situation, but it is essential to note how it may affect human rights and how we should, cautiously, act in the future.

At this point, we must remember the rise in interest rates. As I have already mentioned, financing is becoming more expensive, and as credit is less accessible, fewer goods and services will be bought on credit: real estate, vehicles and household appliances will be consumed to a lesser extent. Nevertheless, this does not end with a fall in demand, but supply is also restricted: if companies sell less, they will reduce their supply to the point of obtaining demand. Such a reduction, however, leads to a drop in company profits or even to an inability to cover their costs; therefore, companies will stop hiring or proceed with large layoffs. Accordingly, household incomes will be affected, making both demand and supply decrease even more[4]. It is thus a vicious circle: rise in prices, rise in interest rates, fall in demand (consumption on credit), fall in supply (goods and services on the market), fall in income, fall in demand (consumption on credit), etc. A spiral of deceleration, but ultimately wanted by central banks insofar as it will moderate prices.

Let us look at the magnitude of what was announced in the previous paragraph: the reduction of household incomes linked to the destruction of the productive fabric is a *sine qua non* to stabilize inflation; in other words, the solution to reverse the skyrocketing price levels is

[3] Expansión (2022). *IPC según los datos de cada país*. Retrieved from: https://datosmacro.expansion.com/ipc-paises.

[4] At the beginning of the article, I wrote that "when supply falls [...], prices tend to rise", but here prices will also fall. We must remember that they only rise if demand is constant or increases, but since in the present case demand decreases, prices will tend to fall.

through recession[5]. It is at this point that human rights affectation comes into play. In particular, empirical evidence[6] has shown how recessions such as those experienced in the wake of the crises of 1929, 1973, or 2008 are strongly intense in affecting life and health —with suicides, illnesses and difficulties in access to health care— (Art. 3 and Art. 25.1 of the Universal Declaration of Human Rights (UDHR)), equality —with income inequality— (Art. 23 UDHR), education —with difficulties in access to higher (basic) studies in developed (underdeveloped) countries— (Art. 26 UDHR) and, ultimately, dignity —with social exclusion— (Art. 1 UDHR).

Criticism of this impact on human rights, nonetheless, cannot be directed at the increase in interest rates, on the grounds that this was merely a logical response to the inflation generated by a black swan (the pandemic). Prior COVID-19 fiscal indiscipline of governments should be emphasized instead. To recapitulate, a rise in interest rates means that financing becomes more expensive, even though not only for citizens, but also for governments: the cost of financing public debt soars (e.g., at the beginning of the year, the Spanish ten-year government bond yield was 0.5%, whereas today it is close to 2.5%[7]). As if that were not enough, regarding the European Union, the ECB is expected to stop buying public debt —as persisting in doing it would stimulate

Source: United Nations.

[5] Technically, a recession is understood as the existence of a negative rate of change in the GDP for two consecutive quarters. Here it will be used in the sense of a decline in economic activity.

[6] Revista Española de Salud Pública (2014). *Long-term sequelae of the Economic Crisis and Inequalities in Health*. Retrieved from: https://scielo.isciii.es/scielo.php?script=sci_arttext&pid=S1135-57272014000200002.

[7] Expansión (2022). *Deuda de España: Obligaciones del Estado a 10 años*. Retrieved from: https://datosmacro.expansion.com/deuda/espana/tesoro/obligaciones-10-anios.

inflation even more—. In consequence, it is possible that the risk premium (the price premium paid for financing a riskier investment) of indebted European countries will increase significantly, meaning that financing will not only be more expensive given the rise in interest rates, but also due to a risk premium. In this regard, the crux of the matter is that new buyers of public debt will ask for additional —to a risk premium— guarantees to ensure that they are able to collect on debts; in other words, indebted countries will be forced to make adjustments to reduce spending (social cuts) or raise revenues (tax increases). On the contrary, in non-indebted countries the increase in the cost of financing will only come from the increase in interest rates, with no additional guarantees to be met and a hardly raisable risk premium, as they do not depend on the ECB buying their debt (since their finances are sound, it is easy for them to find other investors). It is therefore likely that the citizens of indebted States will see their human rights negatively affected to an order of magnitude higher than those residing in economically stable countries.

At the 2009 *United Nations Conference on the World Financial and Economic Crisis and Its Impact on Development*[8], it was stated that the 2008 crisis presented "an opportunity to achieve a strengthening of multilateralism". The same words apply to the current situation. When the recessionary times we are living and will live through come to an end and the economic boom of the second decade of the twenty-first century returns, a global and coordinated response to implement fiscal discipline will be appropriate. This will allow reducing public debt via government budget surpluses (higher revenues than expenditures) and make States more robust in the face of potential recessions or, what amounts to the same thing, make human rights more robust in the face of potential recessions.

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[8] Departamento de la Información Pública de las Naciones Unidas - DPI/2535B (2009). *Conferencia de las Naciones Unidas sobre la crisis financiera y económica mundial y sus efectos en el desarrollo*. Retrieved from: https://www.un.org/es/ga/econcrisissummit/docs/Anatomy_26May_SP.pdf.

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