Distributional Conflict and Inflation:
Data, Theory, and Outcomes

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Outline

1. Review of stylized facts of post-COVID inflation.
2. Review of theories of conflict inflation.
3. Assessment of current balance of power and future evolution.

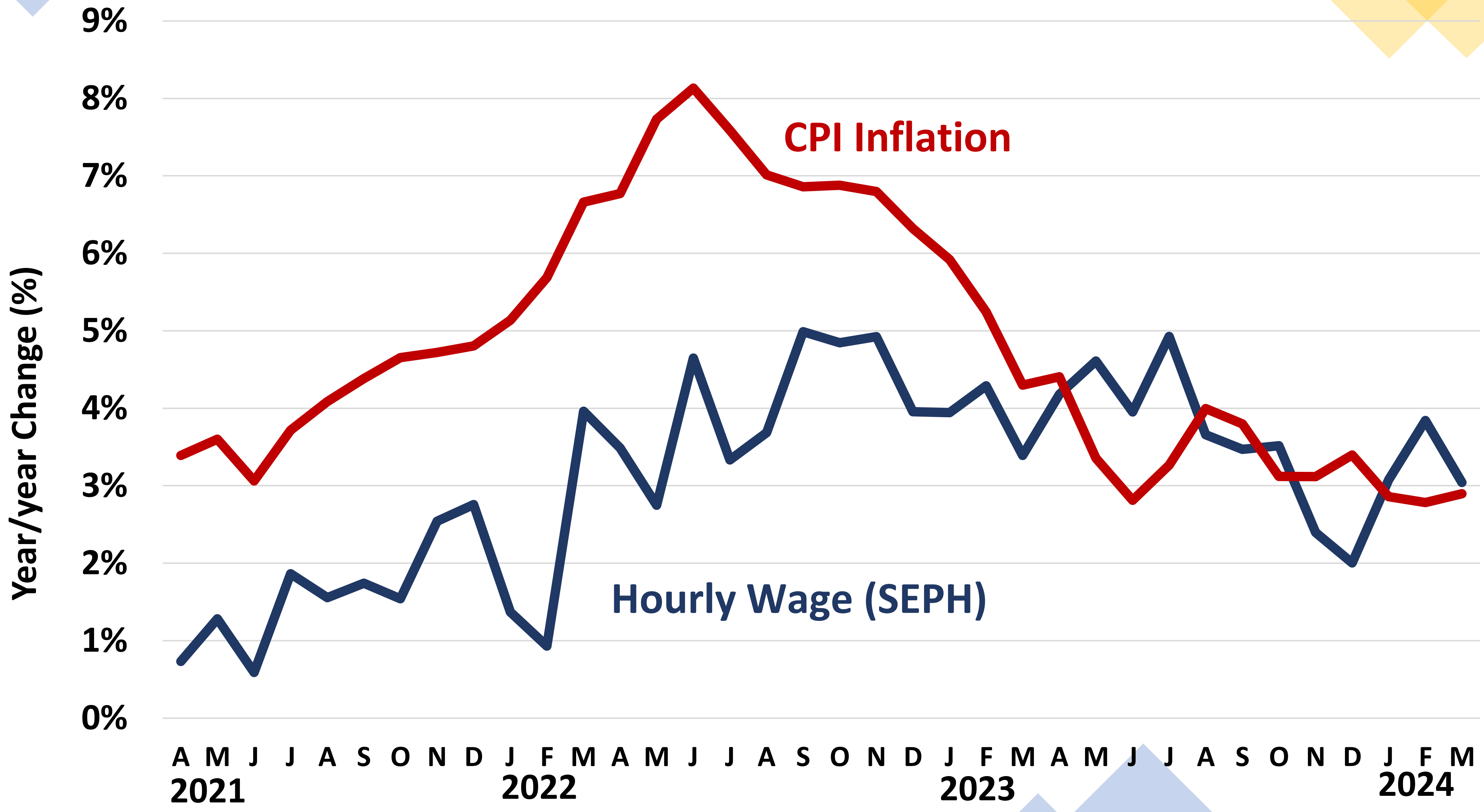
Understanding Post-COVID Inflation

- Output, supply chains, logistics all shocked by lockdowns.
- Government action income supports preserved purchasing power.
- Reduced supply plus stable demand is a recipe for inflation.
  - Alternative would have been worse.
  - Pent-up demand, composition shifts made it worse.
- Energy price shock (futures market speculation after Ukraine war).
- Companies took advantage of combination of supply disruptions, uncertainty, and consumer desperation to jack up prices.
- Most initial spurs to inflation gradually resolved.
- Central banks wouldn’t wait: aggressive interest rate tightening.

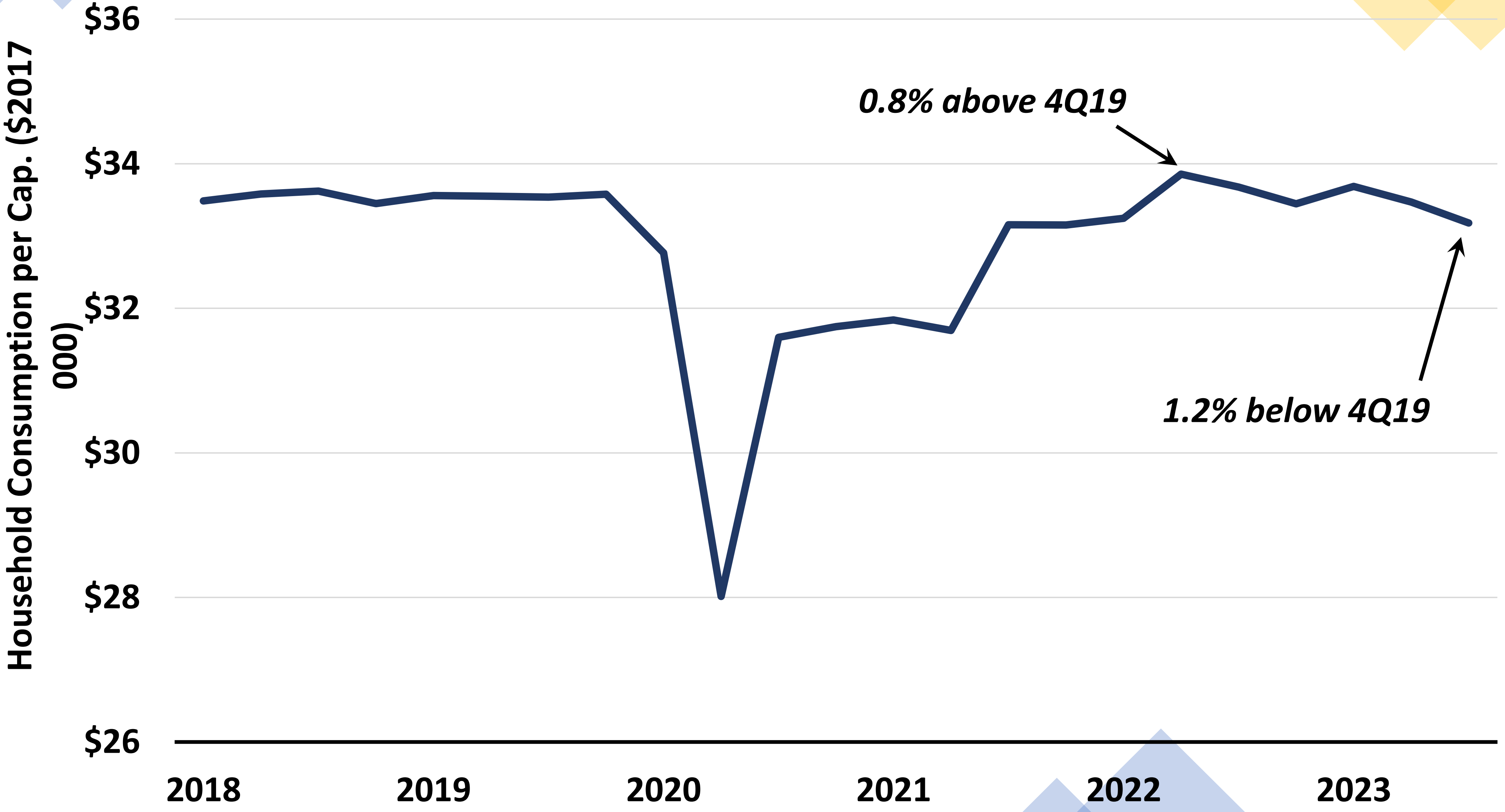
Inflation: Who's to Blame?

- Conventional view of inflation reflects lingering memories of the 1970s:
  - 'Wage-price spiral'
  - Excess demand / spending power
  - Need to claw back purchasing power, stabilize inflation 'expectations', break link between wages and prices.
- But the experience of post-COVID inflation was very different:
  - Problems on the supply side more than the demand side.
  - Different groups had different degrees of power to advance / protect their interests through the inflation.

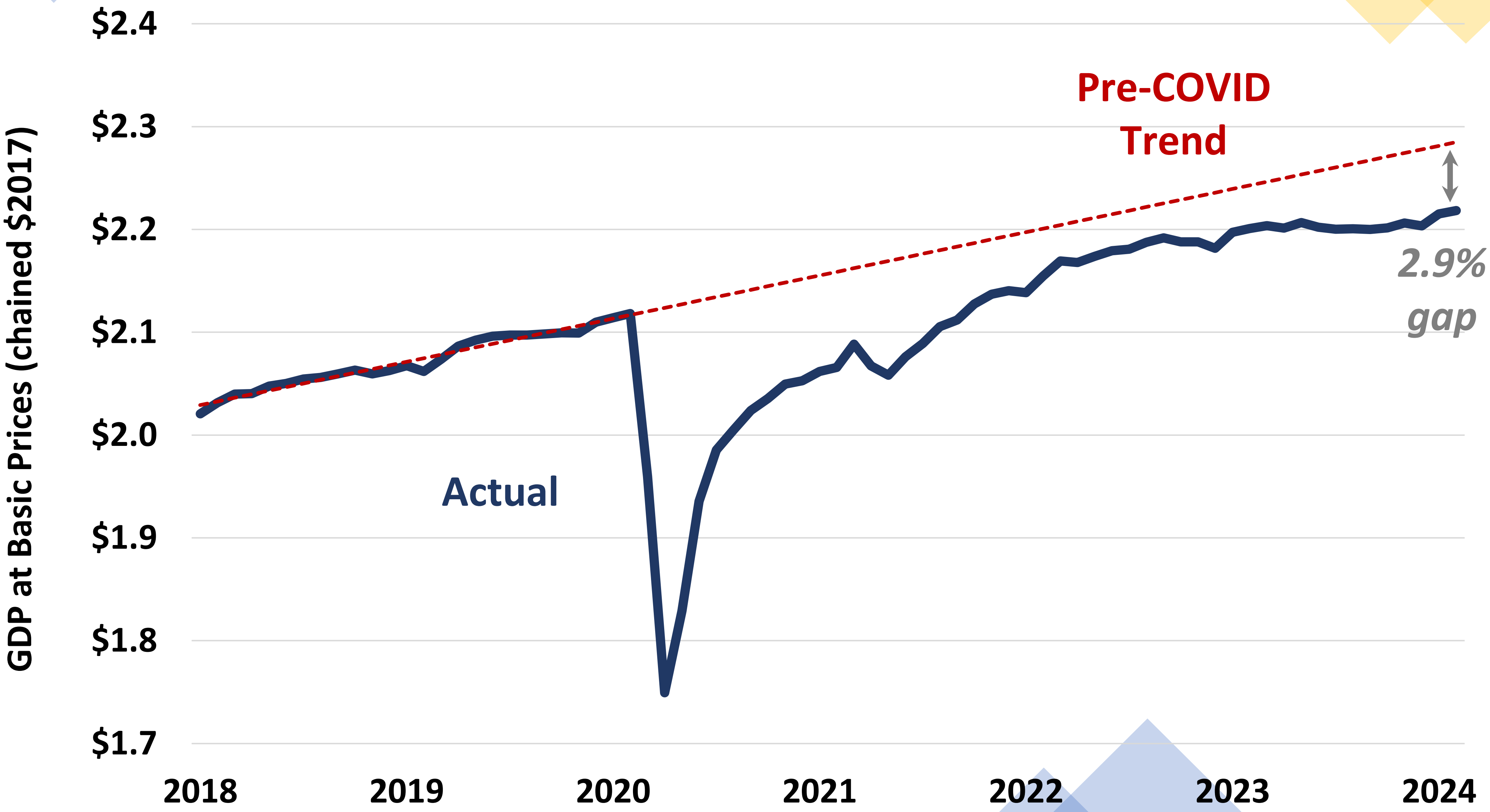
Wage-Price Spiral?



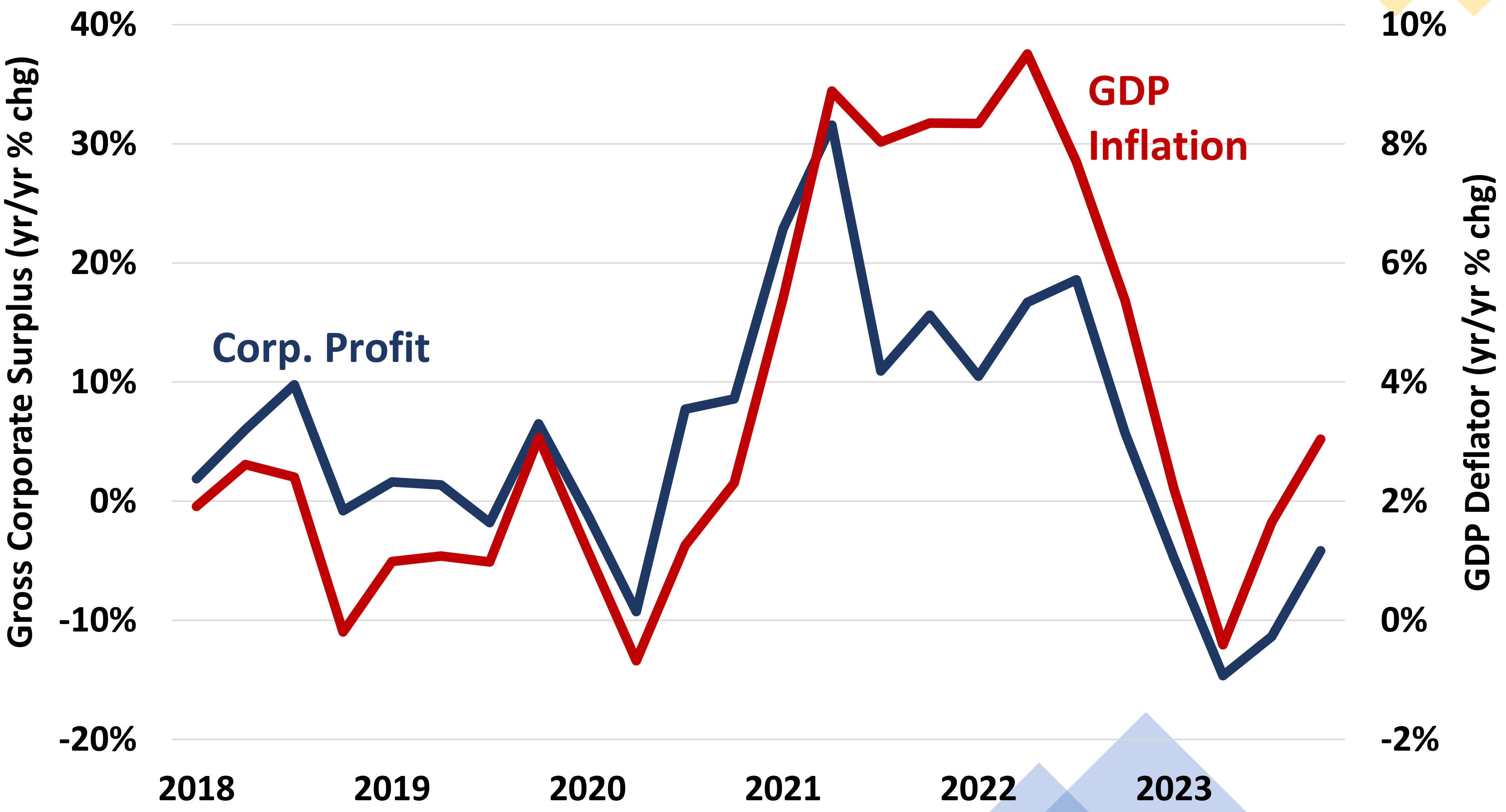
Excess Demand?



Inadequate Supply?



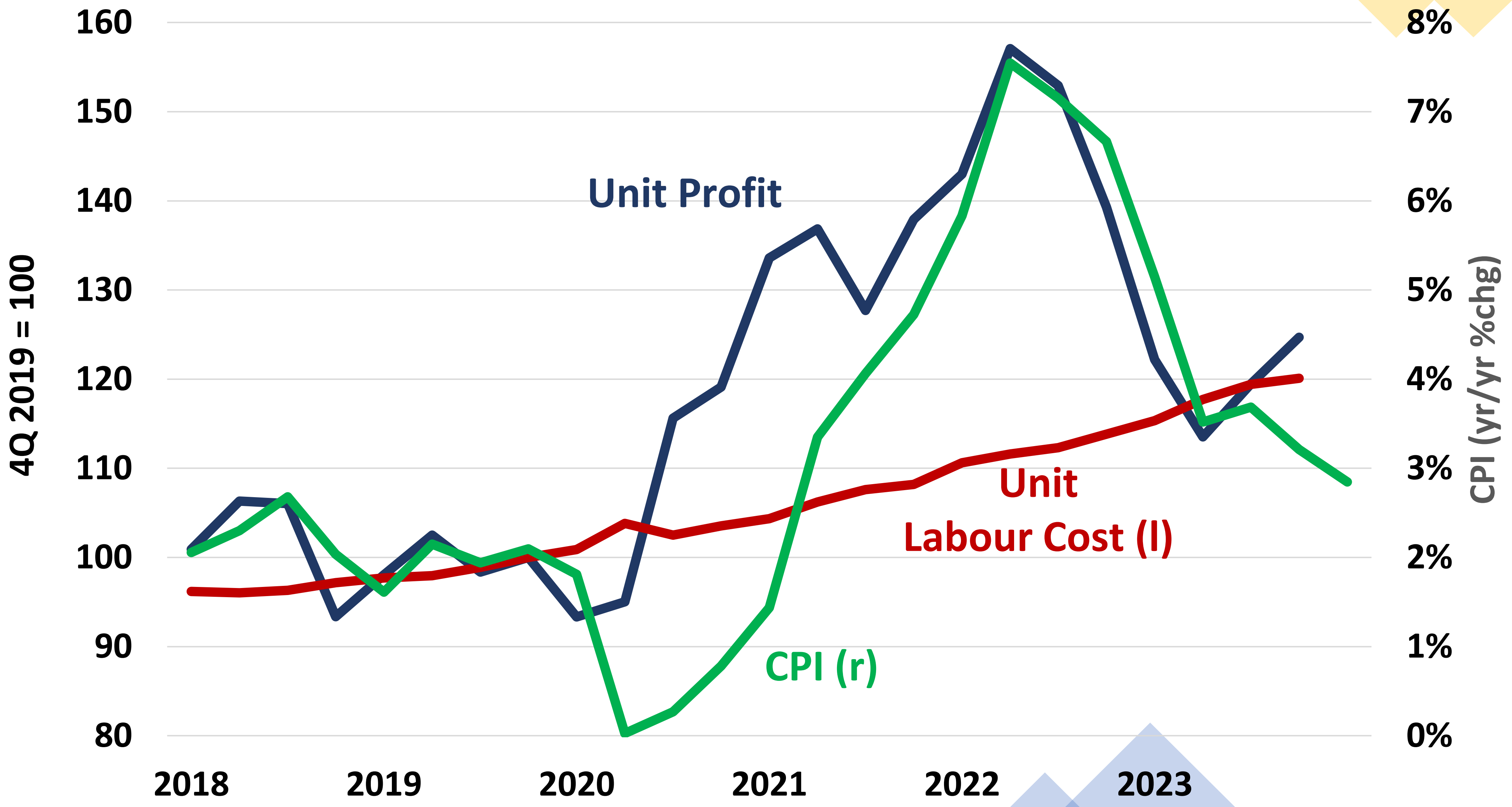
Profit-Taking?



A Strong Correlation

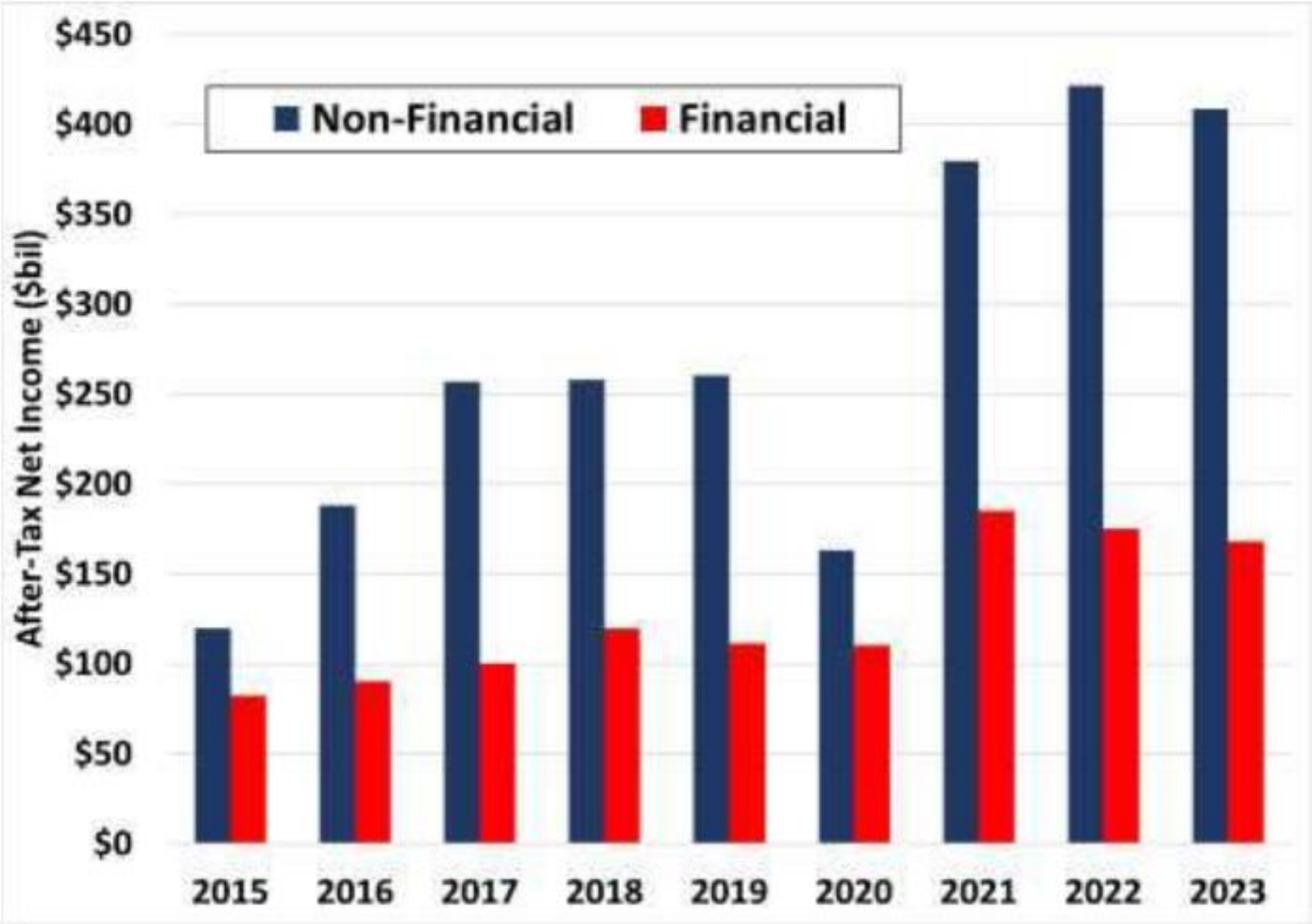
- Comparing GDP Inflation to Gross Corporate Surplus (yr/yr % change):
  - Correlation coefficient: .795
  - Slope: .237
  - R^2: .632

Unit Costs and Inflation



Profits Remain Historically High

Figure 2. Profits for Non-Financial and Financial Corporations, 2015-2023



Classic Theories of Conflict-Driven Inflation

- Long-standing theme in heterodox macroeconomics from 1970s and 1980s:
  - Robert E. Rowthorn, “Conflict, inflation and money,” *Cambridge Journal of Economics* 1(3), 1977, pp. 215-239
  - Sam Rosenberg and Thomas E. Weisskopf, “A Conflict Theory Approach to Inflation in the Postwar U.S. Economy,” *American Economic Review* 71(2), 1981, pp. 42-47.
- Inflation results when claims on income distribution exceed real production available to satisfy those claims.
- Fits well in heterodox framework, which allows for:
  - Independent role for corporate decisions and mark-ups.
  - Focus on conflictual nature of income distribution.

Revival of Conflict Models Post-COVID

- Blanchard acknowledged the elephant in the room.
- Evidence of rising profit margins / shares in most industrial countries.
- Exploration of differential impacts:
  - Across sectors.
  - Across countries (unique impact of energy costs in Europe)
- New contributions:
  - Isabella Weber and Evan Wasner, "Sellers' Inflation, Profits and Conflict: Why can Large Firms Hike Prices in an Emergency" (Amherst: University of Massachusetts Economics Working Paper), 2023.
  - Michalis Nikiforos and Simon Grothe, "Markups, Profit Shares, and Cost-Push-Profit-Led Inflation" (New York: Institute for New Economic Thinking), June 2023.
  - Marc Lavoie, "Profit Inflation and Markups Once Again," Institute for New Economic Thinking), June 2023.

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1/8. A point which is often lost in discussions of inflation and central bank policy. Inflation is fundamentally the outcome of the distributional conflict, between firms, workers, and taxpayers. It stops only when the various players are forced to accept the outcome.

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Weber’s Three Stages of Seller’s Inflation

Stage 1:
Initial Price Shock

Stage 2:
Uneven Pass-Through

Stage 3:
Catch-Up and Conflict

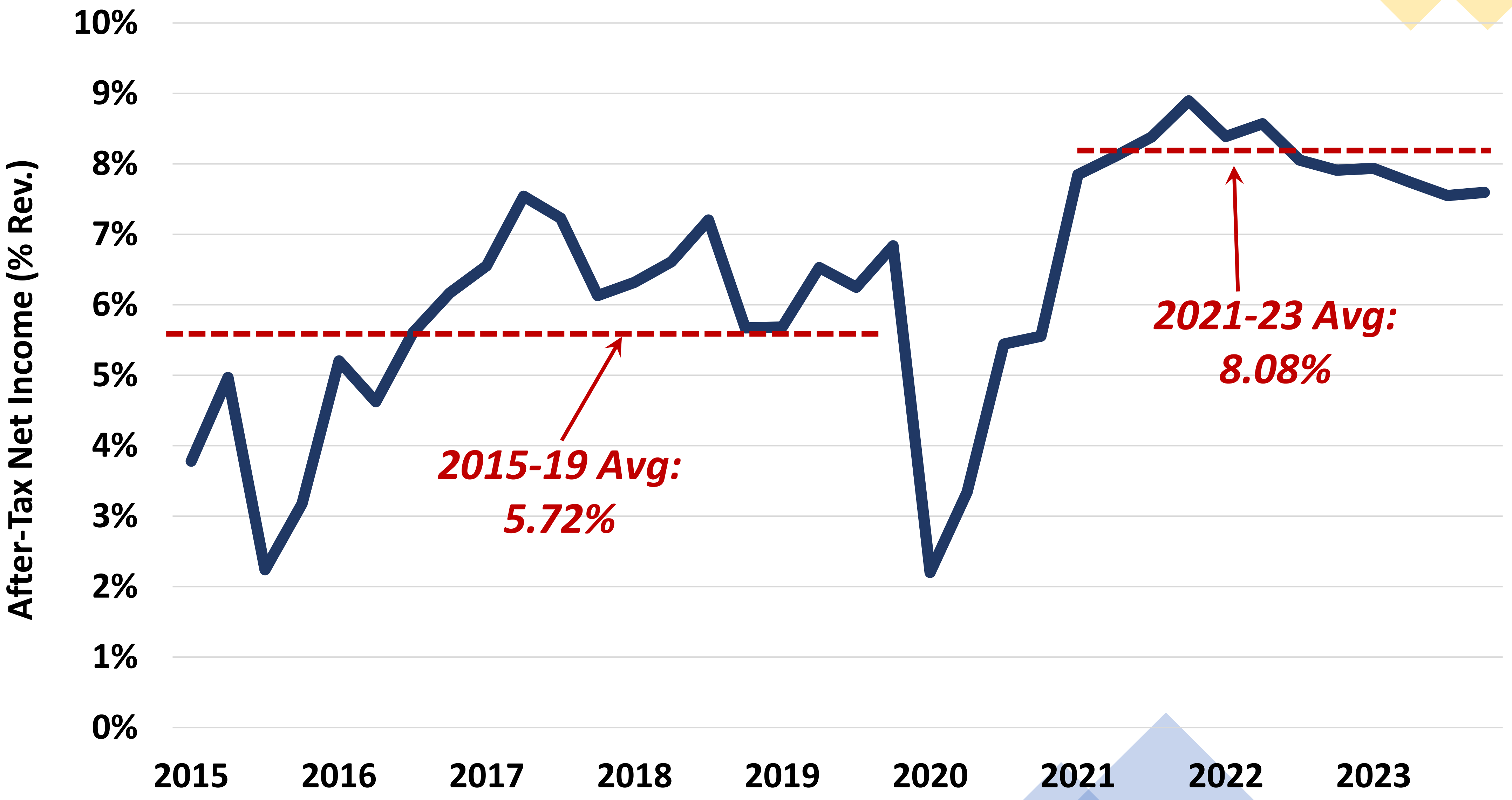
Table 1
Growth in Profit, 15 Super-Profitable Sectors

Sector	Change Annual Net Income Since 2019 ($b)	Rank	Change Annual Net Income Since 2019 (%)	Rank
Oil & Gas Extraction & Service	$38.0	1	1011%	1
Banks & Deposit Institutions	$17.3	2	60%	17
Misc. Financial Intermediation	$13.7	3	31%	24
Real Estate	$12.4	4	35%	23
Mining	$11.3	5	695%	2
Wood & Paper Products	$9.5	6	552%	3
Primary Metal Mfctrg.	$7.1	7	148%	7
Other Retail	$6.0	8	132%	11
Motor Vehicle Dealers	$5.4	9	210%	5
Insurance Companies	$4.8	10	111%	15
Petroleum Refining	$4.7	11	40%	22
Building Materials Wholesale	$4.2	12	117%	14
Machinery & Equipment Wholesale	$3.2	13	53%	19
Food & Beverage Retail	$2.8	14	120%	12
Food Manufacturing	$2.4	15	47%	21
Top 15 Sectors	**$142.9**		**89.2%**	

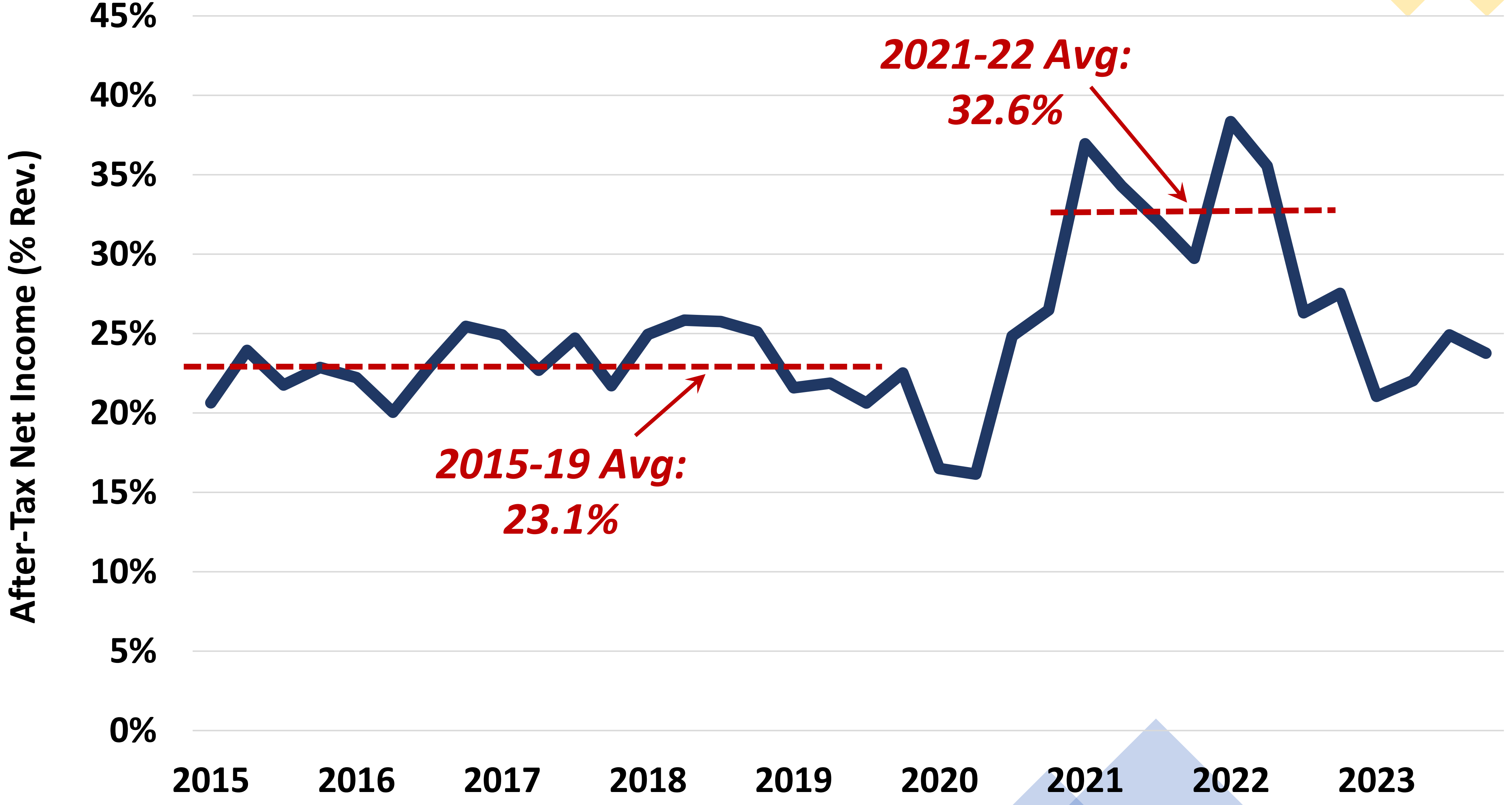
Profit-Led Inflation: Debunking the Myths

- Myth #1: Profit margins have been stable through the inflation.
  - Non-financial margins rose and have remained higher than before the pandemic.
- Myth #2: Profit margins / mark-ups must rise to prove profit-led inflation.
  - Given rising costs from outside the firm's business (upstream inputs, imports), maintaining a constant profit margin implies higher profit share and higher profit rate.
  - Even stable profit margins through a supply shock implies market power of the seller to shift all impacts to consumers. Except in special case of perfectly inelastic demand, this should not be possible in a competitive context.
  - Empirical evidence: aggregate profit margins and overall profit share increased during the acceleration of inflation.
  - Orthodox response: this could be evidence of "excess demand"… but why was corporate capital the only factor to capture higher incomes??

Non-Financial Profit Margins



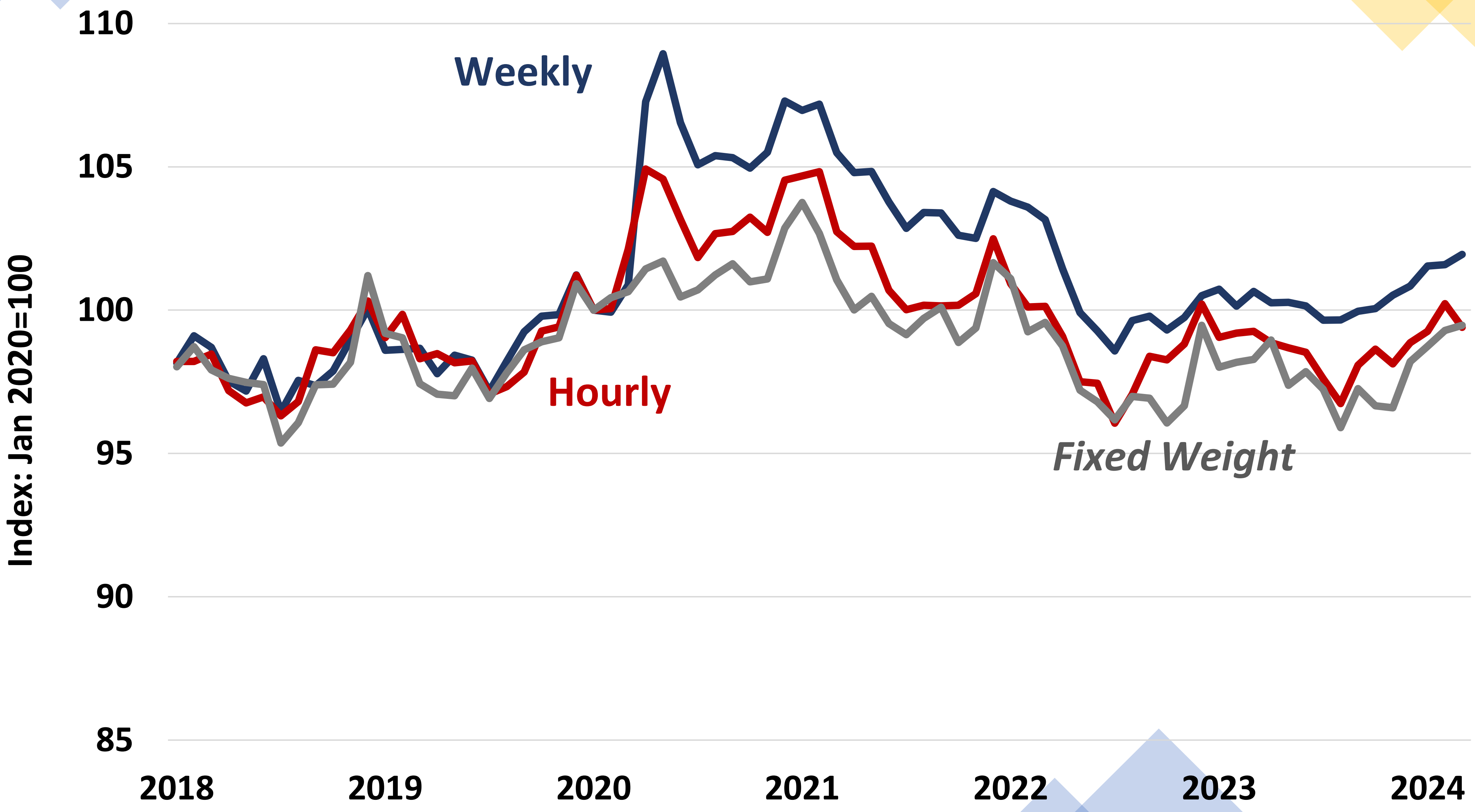
Financial Profit Margins



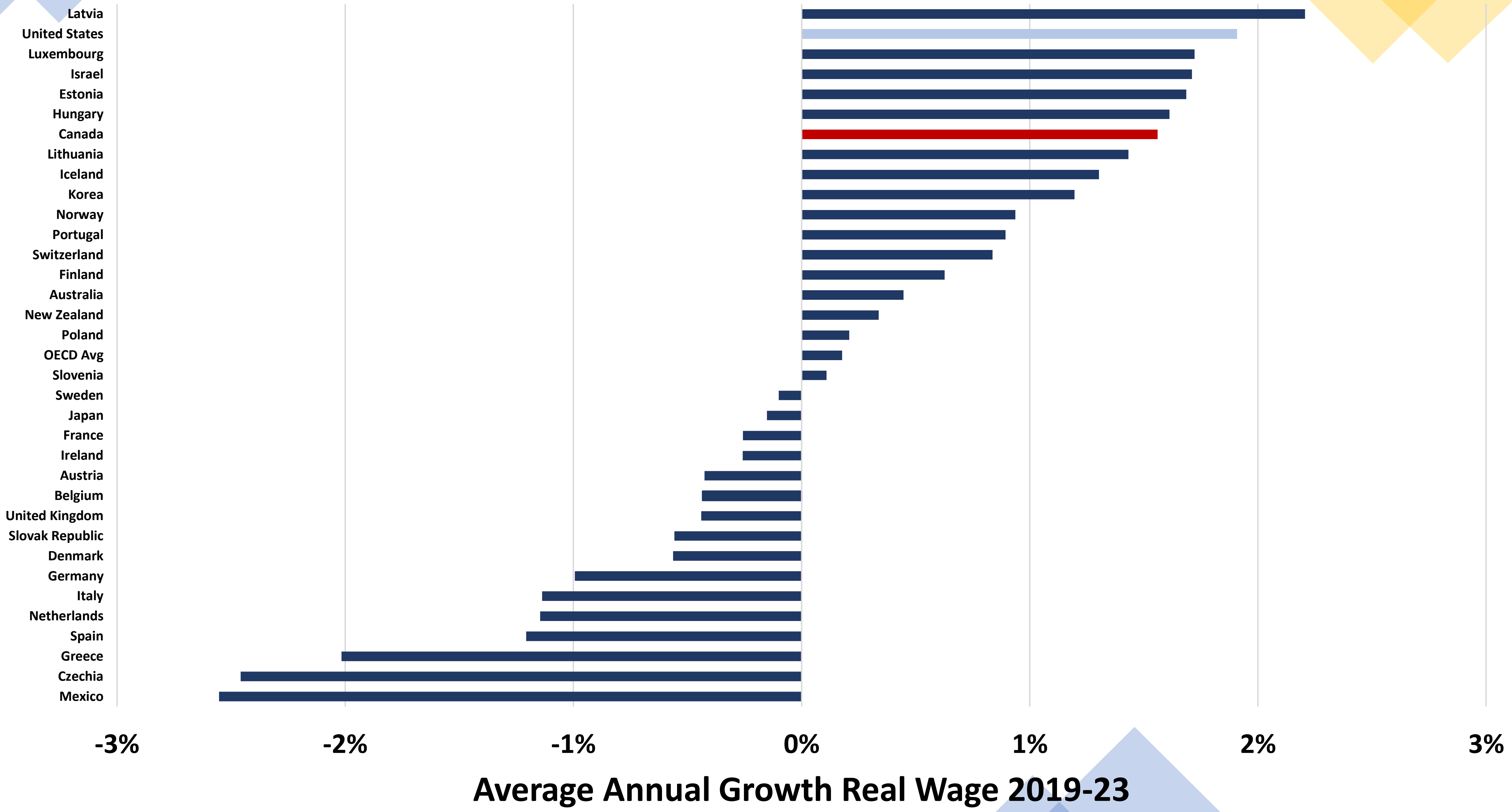
Distributional Conflict in Wake of COVID

- Canadian workers benefit from relatively strong labour market institutions:
  - Sustained union coverage.
  - Globally strong strike frequency.
  - Higher real minimum wages (in most provinces).
- Initially tight labour markets (high vacancies) reinforced that power.
- Real wages recovered quickly (though unevenly: public sector still down).
- Factor income shares of GDP mostly restored.
  - Productivity issues complicate unit cost comparisons.
- Monetary policy, immigration will undermine further real wage progress.

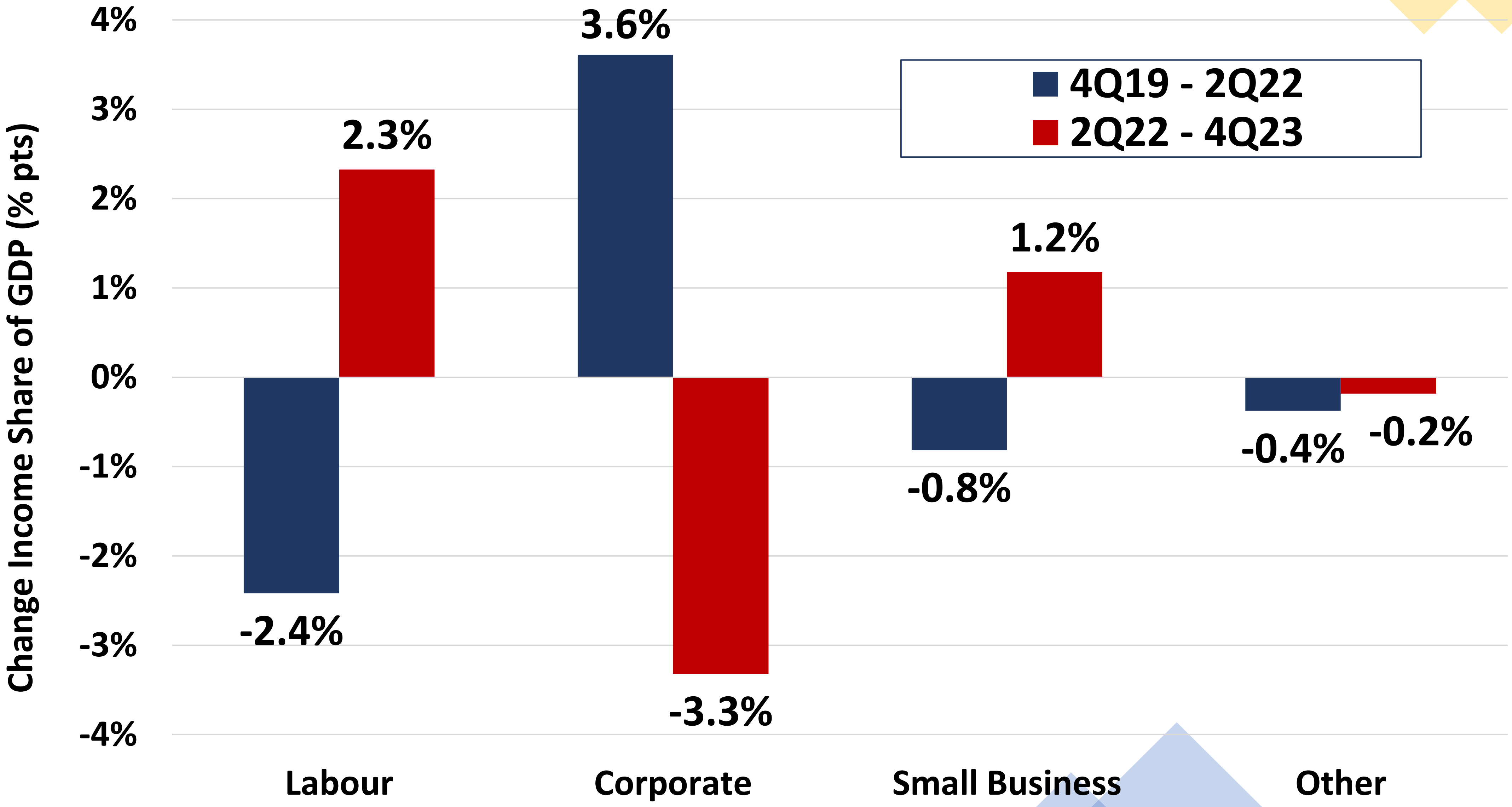
Real Wage Measures (SEPH)



OECD Real Wage Growth Comparisons



Restoration of Factor Shares



Conclusions

- Discretionary corporate pricing decisions led post-COVID inflation.
- Profit margins and shares increased significantly.
- Despite moderation, non-financial profit margins remain elevated.
- Canadian workers have capacity to defend their share, and they are doing that.
- Distributional shares have been largely restored.
- Evolution of future distributional conflict and inflation will be complex:
  - Monetary policy.
  - Macroeconomic performance / stagnation.
  - Productivity (important for unit costs & factor shares).
  - Business investment.

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Thank You!