Profit hikes, not wages the key driver of inflation

Nick Beams
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Like its international counterparts, the European Central Bank (ECB) continually cites a "tight" labour market as a key reason for interest rate hikes in its so-called fight against inflation, the real aim of which is to suppress workers' wage demands as they seek to counter the fastest escalation in prices in four decades.

But it knows full well that profit gouging by major corporations is playing the main role in the inflationary spiral. This fact is not widely publicised lest it expose the real agenda of the central bank's program, but it is acknowledged in an ECB blog post, based on official data, at the end of last month.

Noting that domestic price pressures had increased strongly since the second half 2021—well before the Russian invasion of Ukraine, so often cited as a major cause—it said profits had increased by 9.4 percent in the fourth quarter of 2022 and "contributed more than half the domestic price pressures in that quarter."

Higher input prices for energy made it "easier for firms to increase their profit margins, because they make it harder to tell whether higher prices are caused by higher costs or higher margins" and the inflationary environment enabled corporations to recoup real income losses.

The ECB said analysis of developments since the start of the pandemic showed that "in the euro area as a whole unit profits have increased faster than unit labour costs since the start of 2022, in some cases since the end of 2019."

In what it called a sectoral analysis, the ECB found that profits had grown "much more than labour costs" in a range of industries including: the agricultural sector; energy and utilities; construction; manufacturing and "contact-intensive" services sectors.

In short, what can only termed profit gouging extended across the board. Its extent was indicated by a historical analysis.

According to the blog: "If we compare the relative contribution of unit profits and unit labour costs to domestic price pressures over a longer horizon we see that, most recently, the effect of profits on domestic price pressures has been exceptional from a historical perspective. While, on average, from 1999 to 2022 unit profits contributed around one-third to the GDP deflator (the gauge of inflation), over 2022 they contributed an average of two-thirds."

The blog concluded that the ECB would continue to monitor developments and take policy decisions to ensure that interest rates dampen demand, in other words slow the economy to suppress wage claims.

A recent article in the *New York Times* (NYT) also reported on the effect of profit gouging, particularly in food which comprises a major component of the cost-of-living pressures on lower income and working-class families.

It noted that while energy prices had started to fall back somewhat, food prices were continuing to rise. They were up by 15 percent in the year to March in the euro zone and increased by more than 10 percent in the US in the 12 months to February. This was in spite of the fact that in world commodity markets, which set the prices received by farmers, food prices have been falling since April last year.

According to Claus Vistesen, an economist at Pantheon Macroeconomics: "The only way to explain this in relation to what we've seen in some of the commodity indices for food is that margins are being expanded."

The profiteering has become so blatant it has attracted critical comment from members of the ECB's governing body with Fabio Panetta, a member of its executive board, warning of a "profit-price spiral."

Clearly concerned about the anger this will fuel in the working class, he said in a speech last month that "opportunistic behaviour by firms could also delay the fall in core inflation."

The NYT article pointed out that since March 2022, when it reached its peak, a United Nations index of food prices including cereals, meat, vegetable oils, and dairy products had fallen over the past year but "the prices paid for food in both the US and the European Union [EU] have kept rising."

It cited research by the ING Bank that the hike in profit margins by food suppliers went back to the start of the pandemic, with margins in the German agricultural sector (which excludes manufacturers of packaged food and retailers) rising by 63 percent between the end of 2019 and of 2022, almost entirely due to higher profits rather than higher wages.

In a note to clients, economists at the bank said: "The rise in price margins in the agricultural sector, the construction sector, and in the trade, transportation, and hospitality sector can be mainly explained by an increase in profits, and thus is not due to higher energy and commodity prices."

According to the EU's statistics agency, the share of the operating surplus accounted for by profits was 42 percent in the final quarter of 2022, the highest level since 2007, while the share of wages fell.

The NYT article cited comments by Bank of England chief economist Huw Pill which indicated the increased accumulation of profits could embed higher inflation.

"Persistent deviations of inflation from target, even if stemming from what are fundamentally a series of transitory inflationary shocks, might prompt changes in behaviour that generate more long-lasting inflationary dynamics," he said in a speech last week.

The findings for Europe and the US on the effect of profit margin increases lend support to an analysis by economists at the Australia Institute in February that a profit-price spiral was the main driver of inflation. It reported that "excess corporate profits," amounting to $160 billion, were responsible for 69 percent of additional inflation above the Reserve Bank of Australia's target range of around 2.5 percent.

Real wages in Australia fell by 4.5 percent in 2022, the largest decline on record and, on the basis of the RBA's own policy framework, back-to-back interest rate rises would have been unlikely "without excess profits," according to the study.

This claim is based on the position that the aim of the RBA and other central banks is inflation and the focus on wages is some kind of mistake because they are not the cause.

But the central bankers' program is not misguided. It is a conscious policy directed at the working class, seeking to make it pay for the deepening crisis of the global capitalist system, of which profit gouging by corporations is a component part.