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Price and Prejudice: A Note on the Return of Inflation and Ideology

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A Note on the Return of Inflation and Ideology[1]

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Abstract:

The current debate on the causes of inflation is dominated by a particular view of what caused the inflationary acceleration in the 1970s, the so-called Great Inflation. In this view inflation is always and everywhere a demand phenomenon and requires contractionary monetary policy to be kept under control. The alternative view put forward by many heterodox authors emphasize what might be termed the oligopolistic view of inflation. In this paper we trace the limitations of both views for the center and the periphery.

Key Words: Center-periphery, conflict inflation, corporate power, excess demand, supply-side shocks

JEL Codes: E12, E31, E52, O11

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[1] We thought that the title was original, but Franklin Serrano noted that a previous paper had the same title. We decided to keep the title nonetheless, and acknowledge the work of Simonazzi and Vianello (2005).

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The two-decade period ranging from 1960 to 1980 witnessed the emergence of a reasonable consensus about the set of hypotheses that could explain a process of continuing increase in the prices of goods and services, at least in a hypothetical situation. The causes of inflation were traced to excess demand for a given supply, increases in the costs associated with bringing goods and services to markets, and heightened distributive conflict that led to wage-price spirals. In other words, too much demand, supply constraints and/or workers and corporations disagreeing over their respective relative income shares provided the foundations for the then existing models of inflation.[3]

Although, these alternative theoretical explanations of inflation were relatively well established by the 1970s, there was significant disagreement about the causes of inflation in the real world. Inflation pressures which had been very moderate in the developed world in the 1950s and the 1960s began to be source of public concern in the 1970s. The inflation rate began to trend upwards in 1967 for the United States and in 1970 for the European Union reaching double digits in both cases by 1974.

Milton Friedman and Monetarists, in general, blamed the government and the excesses of the Keynesian Welfare State for the inflation acceleration of the 1970s, and believed that austerity and monetary restraint, which would cause higher unemployment, were necessary for stabilization.[4] James Tobin and other Old Keynesians emphasized the oil shocks and wage resistance as the culprits for high inflation, and argued for incomes policies to soften the effects of inflation. Heterodox authors, tended to side with the Neoclassical Synthesis Keynesians in seeing inflation essentially as the result of cost-push factors and fundamentally associated with conflicting income claims.[5] The general opinion aptly expressed by Parkin (2008 (1987)) was that there was a variety of models of inflation with clear theoretical results but that there was no solid basis for the rejection of any of the models. As he put it (Ibid.: 6444): "Uncertainty surrounds both the issue of the impulse that generate inflation… and the issue of the propagation mechanisms that translate those impulses into movements in output and the price level."

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[3] The surveys on inflation of that era (Bronfenbrenner and Holzman, 1963; Johnson, 1963; Laidler and Parkin, 1975; Parkin and Swoboda, 1977; Frisch, 1983) generally distinguish between excess demand, cost-push and the socio-political struggle for relative income shares approaches to the analysis of the causes of inflation. The Monetarist view based on a portfolio disequilibrium created by excess real cash balances and the Phillips Curve explanation which says that inflation should accelerate when total demand from the private and public sectors persistently outstrips the capacity of an economy to produce (Bernanke, 2022: 5) fall in the category of excess demand explanations.

[4] Friedman (1979) said that: "Unemployment seems to be an unavoidable side effect of curing inflation." Inflation was clearly demand driven. More recently Blanchard at al. (2022) adopt a similar view: "Fighting inflation will require a decrease in vacancies and an increase in unemployment. There is no magical tool." Tobin (1974) argued precisely the opposite, saying that: "the wage-price-wage spiral is extremely resistant to unemployment, recession and economic slack." For Tobin the conventional Monetarist remedies would cause more harm than inflation itself.

[5] Rowthorn (1977) provides one the earliest full analyses of conflict inflation.

The Great Moderation, characterized by increasing stability in prices lasting from around 1980s to the recent inflation acceleration, and the ideological victory of Monetarism in the 1970s, led to a certain theoretical complacency, and a view of inflation as being fundamentally related to excess demand, a positive output gap, and the notion that central banks could manage the inflation expectations and target it at around 2 percent in advanced economies. The long period of price stability has been seen, by the mainstream, as resulting mainly from the good practices of central banks which included a clear mandate to maintain price stability as the hierarchical goal of monetary policy, political and operational (instrument) independence, in particular the adoption of inflation targeting, and the required credibility and persistence "to counter inflation psychology and anchor inflation expectations at a low level" (Bernanke, 2022: 43).

In addition, structural reforms, and the spread of the market friendly policies of the Washington Consensus led to responsible fiscal policies, and these coupled with independent and inflation conscious central banks explained, in this view, the relatively low levels of inflation. The Great Moderation was not seen as being confined to the most developed countries, but as extending, albeit later, to the developing world. From the 1990s onward, the developing world also experienced less volatile inflation (Ćorić, 2011). The reality underpinning the Great Moderation are more complex. Most likely structural causes including falling commodity prices and reduced power of labor unions due to the recessions of the 1980s, including the debt crisis in the developing world, and the 1990s, the rise and expansion of globalization and the large increase in the supply of low-wage workers from China, East Asia and Eastern Europe into global markets.[6]

With the acceleration of inflation in the post-pandemic recovery, the debate seemed to be limited to whether the inflationary spike would be short-lived or persistent and become imbedded into inflationary expectations. While some Keynesian authors like Paul Krugman initially believed that inflation was caused by cost-push factors including by the sharp rises in energy and foodstuff prices as a result of the Ukraine war, and that it would quickly subside, the debate shifted rapidly and a new consensus according to which inflation was, in part the result of over stimulation of demand during the pandemic coupled with supply side shocks that lowered the potential level of output which provides the main theoretical justification for raising interest rates.[7] Thus, even when most authors accept the notion that snags in the supply chain played a

[6] See Bootle (1996), Pain et al. (2008), Perry and Cline (2016), Pivetti (2013), Skidelsky (2018) and Lavoie (2022). In the mainstream Bernanke (2022) points to the increase in the productivity and the decline in the natural rate of unemployment as potential causes, besides from monetary policy, that can explain the decline in inflation in the United States. Blinder and Yellen (2001) argue that other factors were at work including the appreciation of the dollar and the fall in oil prices.

[7] Krugman (2022) admitted he was incorrect, and that labor markets were tighter than he thought, and that Lawrence Summers, who has been a hawk on inflation, was correct. Summers (2022) argued recently that: "The debate over U.S. monetary policy is in a new phase. There is no longer any question that the Fed allowed itself to

role in the acceleration of inflation, the main cause is to be seen on the excess demand side with the economy beyond its potential output level.[8]

The challenge to conventional wisdom, and its emphasis on demand, has come from left of center authors, like Robert Reich, that suggest inflation is caused by greedy corporations that have increased their profit margins during a crisis. This has brought back the old debate about the relationship between administered prices and inflation, and the proposition that inflation is directly related to highly concentrated market structures, or what might be termed oligopolistic inflation.

In other words, there is an ideological divide between those that blame inflation in an incompetent government and central bank reaction to the pandemic versus those that suggest that the real culprits are greedy corporations rising their mark up above their costs.[9] This has deviated the debate from the more important question, which is related to the question of whether the inflationary acceleration originated in temporary supply side disruptions caused by the pandemic or resulted from excess demand in an economy close to full employment, an issue that has significant policy consequences. In particular, the notion that the economy is close to its capacity limit is problematic, and that should be the main argument against contractionary monetary policy in the United States and other advanced economies.

Another important problem is that, while supply side factors are central for inflationary pressures, and while it is true that in advanced economies higher interest rates might not have a significant impact in the control of prices, the same is not true in peripheral countries. Central banks in peripheral countries reacted more promptly and with greater intensity to the rise in inflation than did developed central banks. The rise in interest rates in peripheral economies was aimed to a great extent at reducing the impact of depreciating national currencies on inflation and to reduce the possibility of capital outflows. If the risk in the center has been associated with an overreaction of central banks, and excessively contractionary monetary policy, in the periphery the risks are associated with a mild reaction and the possible inflationary impacts of depreciating currencies.

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fall way behind the curve in the second half of 2021 and early 2022, calling its credibility into question." In his view, labor markets remain tight, even if there is a risk of a recession.

[8] The focus placed on excess demand also characterized the inflation views of some heterodox groups, including some Modern Money Theory (MMT) authors, like Randall Wray, that give demand-pull inflation a limited role in the explanation of the recent inflationary bout. See Wray (2022).

[9] In a recent paper Reis (2022) argues that there are four tentative hypotheses that explain the rise in inflation: misdiagnosis of the nature of supply shocks, failure of anchor inflation expectations, lack of credibility and the decline in the natural rate of interest. All of these can be traced to a single common factor: "… monetary policy became used to a state of affairs in the past decade and took too long to shift its stance."

The rest of the paper is divided in three sections, discussing the limitations of demand-pull and oligopolistic inflation in the center in the following one, an analysis of inflationary factors in some peripheral countries, particularly Latin American ones, and a brief conclusion.

Beyond Corporate Power and Government Excesses

The dominant view in the profession, and among policy makers is that inflation is caused by excess demand, related, in turn, to fiscal expansion during the pandemic coupled with supply side shocks that have a long-lasting effect on the potential level of output. The main argument against this view, sometimes exposed by government officials in the U.S. is that corporations have taken advantage of supply-side problems during the pandemic to obtain unjustifiable extra gains in an already unequal society. It is clear that over the past forty years of neoliberal ascendancy deregulation has allowed corporations to amass excessive power.[10] And it is also the case that there is significant evidence that profit margins have increased during the recent inflationary acceleration. Similarly, the financial sector has made significant profits during and after the pandemic.

Bivens (2022) has documented that corporate profits have increased faster than unit labor costs, and that this suggests that: "the already-excessive power of corporations has been channeled into raising prices rather than the more traditional form it has taken in recent decades: suppressing wages." As it can be seen in Table 1, profits did increase significantly more in the recent period of inflationary acceleration. This has been interpreted by left of center authors like Robert Reich as suggesting that inflation results from corporate power, and their ability to profit from the crisis caused by the pandemic. However, it is clear that this does not imply that profits caused inflation, and is more likely that the reverse is true, that is, that higher prices, with relatively stagnant labor costs have caused the increase in corporate profits. That is the case in most commodity markets, in particular energy and food ones that have been central in the recent inflationary acceleration.

Energy prices are markets in which firms are price takers not price makers, to use an old dichotomy. Also, firms in oligopolistic markets, faced with higher prices of energy, a basic that is an input of all other goods and services, tend to pass, at least partially, the increase in overhead costs to their prices. Firms can certainly increase their markups in oligopolistic markets according to their desired profits. However, these desires have to be compatible with their market position, and if they exceed the price that would trigger the entry of new competitors, they might lose

[10] Kwon et al. (2020) provide an ample literature review on the case of the United States documenting the increase in industry concentration since the 1980s using census data. Using IRS data Kwon et al. argue that the rise in concentration began much earlier but there is no doubt as Nolan (2012) argues that globalization (which was accompanied by deregulation) tremendously increased the concentration of industry including that of the financial sector, as it gave rise, to the global systemically important banks.

market share. In that case, as well understood in the old classical notion of competition – that implies free entry, as opposed to marginalist notion that requires price taking behavior – new producers would expand output and eventually bring prices down again.

Table 1 Contributions to growth in unit prices

	2020 Q2–2021 Q4	1979–2019 average
Corporate profits	53.9%	11.4%
Nonlabor input costs	38.3%	26.8%
Unit labor costs	7.9%	61.8%

Source: Bivens (2022)

Notwithstanding, Reich (2022) has recently suggested that: "Corporations are using those increasing costs – of materials, components and labor – as *excuses* to increase their prices even higher, resulting in bigger profits" (Reich, 2022). In the same vein, Jayati Ghosh has argued that: "There is a direct link to the inflation causing so much havoc across the world, especially among already-poor populations – driven much more by profiteering by large companies and financial speculation than by supply shortages" (Ghosh, 2022: 9). It is clear also in Table 1 that the prices of nonlabor inputs have gone up, and those are the likely culprits, other than the increases of commodity prices set in international markets, for the acceleration in inflation. These were mostly associated with the shutdown of key suppliers, in China and other developing countries, for electronic components that went into the production of innumerous consumers goods, and disrupted a supply chain system that maintained low levels of inventories as a result of the widespread adoption of just in time replenishment strategies over the last four decades.

This discussion about the role of corporations has brought back the old debate about the relationship between administered prices and inflation, and the proposition that inflation is directly related to more concentrated market structures.[11] The fact that prices under oligopolistic conditions are higher than under competitive conditions has led some people to associate the continuous rises in price-levels, inflation, with the existence of imperfectly competitive markets. It is clearly the case that oligopolies do account for higher prices, and that they do have an exorbitant amount of power, but it is not the case that this can explain the continuous rise in prices. That would require a change in the competitive conditions, something that is not clearly taken place in the last two years. In the study by the Economic Policy Institute (EPI), Bivens (2022)

[11] On the old debate revolving around the findings of the Kefauver Commission, see Stigler (1962) and Blair (1964). The argument was that during the postwar period inflation could be associated to the oligopolistic power of large corporations. For a discussion of the relation of price determination, market structures and inflation along the lines of our analysis see Sylos-Labini (1979).

also recognizes that: “It is unlikely that either the extent of corporate greed or even the power of corporations generally has increased during the past two years.” This argument would suggest that there is not a clear and direct relation between market structure and inflationary regimes, and of course, higher inflation can occur both with fairly competitive or oligopolistic market structures. The Gilded Age Era, for example was one characterized by the rise of cartels and deflationary pressures, while the more recent period, often seen as a second Gilded Age with increasing market concentration, has been, until recently, characterized by the so-called Great Moderation.

The level effect that oligopolies have has been confused with the effect on the rate of change in prices. That does not imply that policies to mitigate the inequities associated with corporate power should not be implemented, of course, but policy initiatives like price controls are unlikely to work in the short run.[12] It is unlikely that those measures can counter the effects of the increase of commodity prices, when those take place like in the post-pandemic period, when the price of Brent Crude Oil went up by approximately 350 percent in international markets as shown in Figure 1. Note that the changes in the Consumer Price Index (CPI; left axis) in the U.S. follow closely the international price of oil (right axis), which is an exogenous variable, determined in international markets. While the pass-through effect of oil prices to the CPI is relatively small, the relationship seems to be persistent over time to the naked eye.

In places where there are national companies that control oil production and distribution, or where there is a large bureaucratic government apparatus to control prices, the utilization of prices controls or direct subsidies to reduce costs might be an adequate instrument for price stabilization. Also, reduction of taxes on essential goods like medications and foodstuff make sense.[13] But given the recent large increases on essential energy and foodstuff prices in the midst of war and the pandemic, and the lack of a bureaucratic apparatus to deal with it, these measures seem impractical.[14] Besides, the sheer size of the possible changes in commodity prices would dwarf any reasonable bureaucratic response. It is also important to note that given the current conditions, associated with a relatively mild winter in the Northern Hemisphere, and the agreement that has allowed the shipment of Ukrainian grain production through the Black Sea,

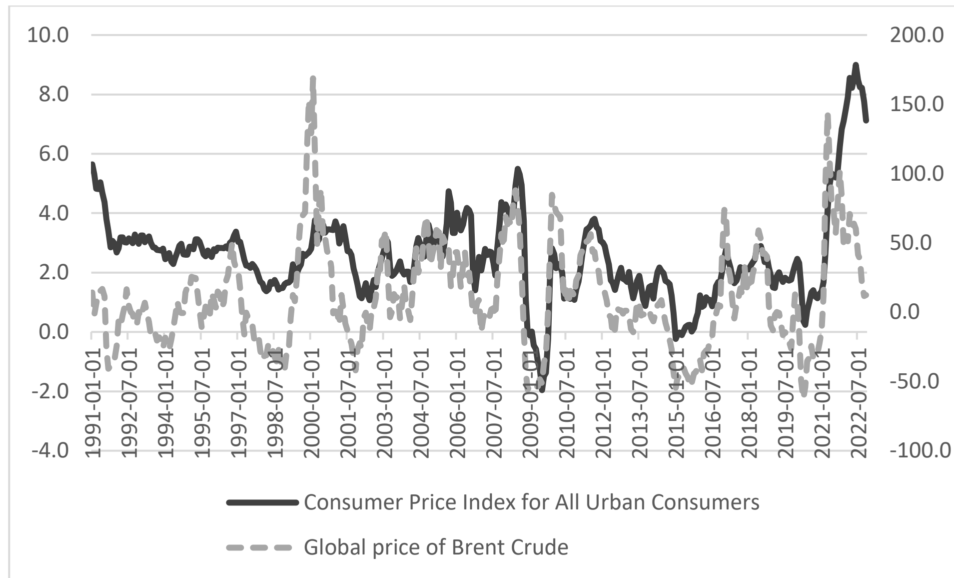
[12] Both Reich (2022), and Isabella Weber (2021) have argued for the introduction of price controls. While we are favorable in general terms with the proposition that price controls have been useful, and steps to control prices of basic goods should be introduced, we tend to be skeptical about the political feasibility of their introduction in the U.S. in time to have a relevant effect on the current inflationary period.

[13] Spain has been able to reduce inflation and to register one digit inflation rate in the Euro Zone thanks to these types of measures. See Soto (2022).

[14] Hugh Rockoff, in a book on price controls, suggested that they were useful during World War II in particular because “during the high tide of price controls, they were backed up by a vigorous enforcement effort and three important supplementary measures – wage controls, the seizure of noncomplying industries, and rationing both of resources and of final products" (Rockoff, 1984: 108). These conditions seem unlikely in the U.S. at the present moment.

the price of oil, and natural gas, and some key grain commodities, like wheat, that spiked up in 2021, have started to come down, with a visible effect on inflation.

Figure 1: Global price of Brent Crude, and Consumer Price Index in the U.S. (% change)



Source: FRED

While most authors accept the notion that supply chain disruptions played a role in the acceleration of inflation, the main cause is to be seen on the demand side, and an economy growing beyond its potential. This is true even among some heterodox groups that fiscal spending has been misdirected.[15] Note that Post Keynesians were in general doubtful about the possibility of demand-pull inflation, other than in very rare circumstances like war. Sylos-Labini (1979: 5) says that:

> "Since in industrial production full capacity is reached only in boom periods and in a limited number of industries, as a rule an expansion of demand does not affect industrial prices. In an open economy, the expansion of demand does not necessarily affect prices even in industries in which full capacity is reached; such an expansion tends, rather, to speed up imports. All things considered, at least to a first approximation, the determinants of industrial wholesale prices are the cost elements, with demand left on one side. This proposition is similar to the Keynesian proposition that changes in demand normally affect the level of activity, but not price."

[15] For example, Randall Wray, one of the main authors of MMT, argues that higher taxes on those that have higher propensity to spend are necessary to control inflation. He is cited in a Wall Street Journal piece that says: "Mr. Wray points out, it wasn't when trillions in benefit checks landed in bank accounts last year that inflation went up; prices went up when the recipients went out and spent the money. 'Money doesn't cause inflation,' Mr. Wray argues, a view that infuriates monetarist economists. 'Spending causes inflation'" (Mackintosh, 2021).

The only circumstance in which demand-pull would be with a very strong boom bringing the economy close to full employment. There is little doubt that this has been a relatively strong and fast recovery, particularly by recent standards. Available data for the United States shows that employment levels returned to pre-crisis levels in a little less than two and half years, in contrast to the more than six years in the previous recovery (Figure 2). And this is clearly related to the relatively large fiscal packages implemented as part of the strategy to deal with the effects of the pandemic recession in 2020 and 2021, including the last package that was directed towards the expansion of infrastructure.

Figure 2 Employment Recovery in the U.S.

Source: FRED

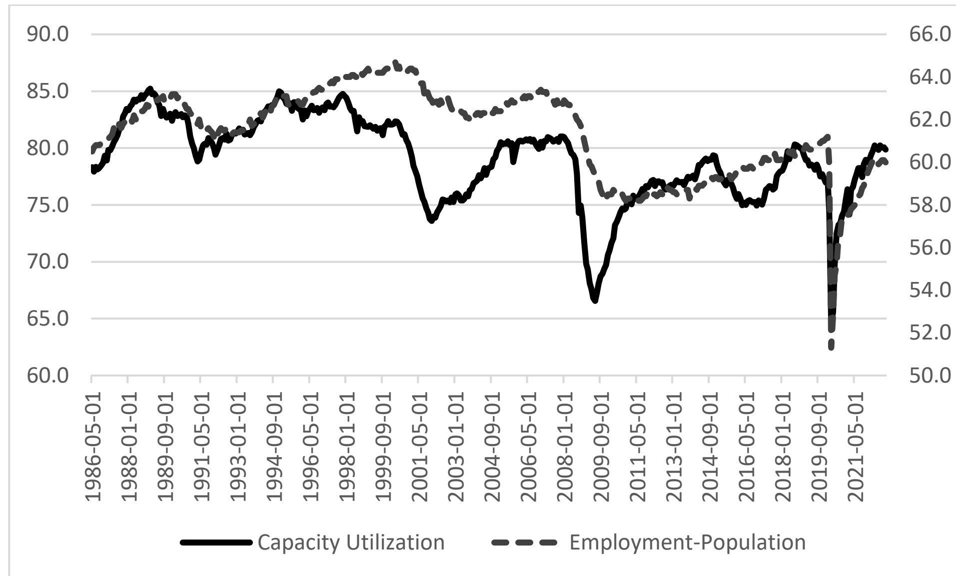
However, the recovery has brought the economy back to a pre-crisis situation which was not particularly strong to begin with. The employment-to-population ratio remains at historically low levels, as does, for the most part, capacity utilization in the case of the United States, as shown in Figure 3. Capacity utilization in the Euro Zone shows a similar trend. The point is that the recovery brought the economy back to a place that was not particularly good, and that cannot be seen as close to full capacity or full employment in most advanced economies.

In the United States both the capacity utilization of the economy and the employment to population ratio present a downward trend in the last thirty years or so. There is a reasonable debate about whether the new normal capacity utilization is lower, or whether it is the actual level that is low as a result of changes in the policy regimes, that explain also lower rates of growth.[16] More clearly the employment-population ratio shows that the currently low levels of unemployment are not particularly representative of a tight labor market, with many

[16] For a suitable discussion of the evidence see Gahn (2020) and Haluska (2022). In our view those that think that the lower levels of capacity utilization are not a new normal position are probably correct.

discouraged workers. There are many interpretations within the mainstream for the relatively lower rates of output and productivity growth in the U.S. over the last four decades, including a revival of the secular stagnation thesis by Summers (2014), which often suggest that the problems are on the supply side of the economy, and that expansionary demand would not have an effect on the potential capacity of the economy.

Figure 3: Measures of economic slack



Source: FRED

It is clear that the Fed policy stance is based on a notion that normal capacity utilization is down, and that the labor market is tight. But it is based on an argument that is harder to defend, in our view. The notion is that the recent shocks associated with the pandemic have had a negative impact on potential or normal output, not just on the short-term output and employment level. For example, Brainard (2022) argued that: "…the drawn-out sequence of shocks to the supply of labor, commodities and key intermediate inputs… blurred the lines about what constitutes a temporary versus a persistent shock to potential output. Even when each individual shock fades over time and behaves over time like a temporary shock on its own, a drawn-out sequence of adverse supply shocks that has the cumulative effect of constraining potential output for an extended period is likely to call for monetary policy tightening to restore the balance between demand and supply. In addition, a protracted series of supply shocks associated with an extended period of high inflation – as with the pandemic and the war – risks pushing the inflation expectations of households and businesses above levels consistent with the central bank's long-run inflation objective."

A fall in normal capacity utilization would require, from our point of view, an expectation of persistently lower growth of autonomous, non-capacity generating demand. If anything, the pandemic, and the rise of the hegemonic disputes with China, has generated a sense that public

investment will have to play a larger role in the economy, and in the U.S. not only a fiscal package directed at infrastructure spending passed both houses of congress, but also a bill to promote the domestic production and reshoring of electronic chips, indicating a more explicit concern with industrial policy, in general, and with the supply constraints that resulted from the pandemic. If anything, the rapid decline and recovery of the rate of unemployment, as a result of the pandemic, and the surge and decline of prices – with the CPI indicating deflation in December – suggests that this is just a short-term shock, without significant time to affect persistently the decisions about the normal level of capacity utilization.

The evidence for the existence of some slack in the labor market can be complemented by the weakness of trade unions, their lack of bargaining power and the relative stagnation of real wages during the last forty years, which is the main explanation of the so-called Great Moderation. If the labor market is not close to full employment, then there is space for more expansionary policies to bring down unemployment further without significant inflationary pressures, and perhaps bring the level of capacity utilization and the employment-population ratio up, with levels of unemployment remaining low. In this view, the policies to constrain demand are a clear mistake, at least in the United States, and seem to be geared towards weakening the bargaining position of workers, which might be seen in some quarters, as being intensified in the last decade or so since the Global Financial Crisis of 2008-9. Considerations about the possible trajectory of inflation require a discussion of the often-forgotten, in the current debate, cause of inflation, namely, conflicting income claims.

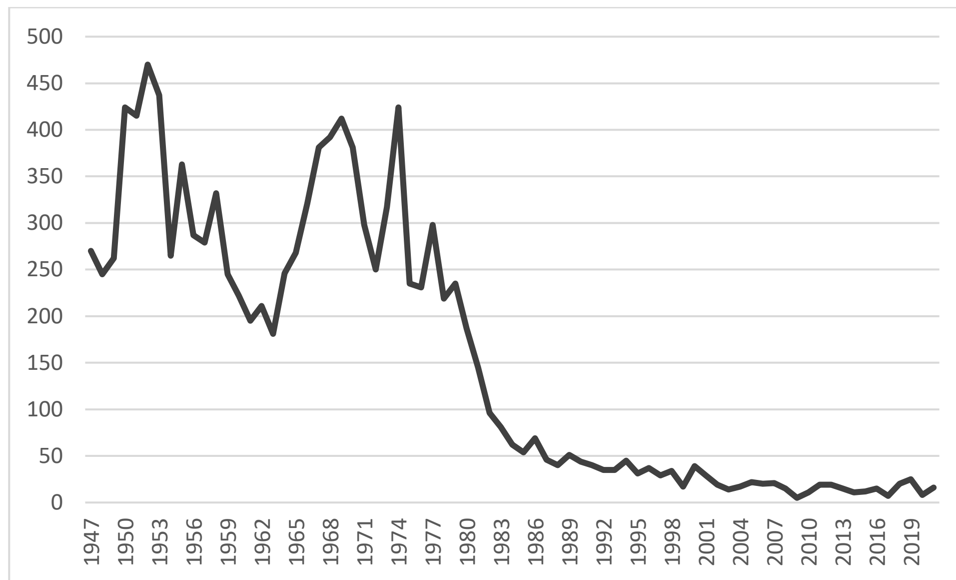
Conflict Inflation in the Center and the Periphery

Supply shocks increasing the costs of production, and under more limited conditions excess demand, when the economy is at full capacity, might be relevant for starting inflationary processes, but not for sustaining an inflationary process over time. In order for a continuous inflationary process to persist there is a need for significant distributive conflict.[17] As argued by the structural approach to inflation, developed in the late 1950s in Latin America, an explanation of an inflationary process requires distinguishing between inflationary pressures which are the initial causes of inflationary processes, the transmission mechanisms and the propagation mechanisms which maintain the inflationary inertia or provide an accelerating force to this process. In turn, inflationary pressures can be classified into basic, circumstantial and

[17] Arguably the importance of distributive conflict for inflationary processes was first discussed by Joan Robinson in her review of a classic book about the German hyperinflation (Robinson, 1938). The relevance of shocks and propagation mechanisms was highlighted by Latin American Structuralists in the 1950s (Vernengo, 2006). The structural approach to inflation was developed by Noyola (1956) and Sunkel (1958). In his seminal contribution, Noyola (1956) cites the work of Michal Kalecki and Henri Aujac. It is also likely that Nicholas Kaldor, who was at the Economic Commission for Latin America (ECLA, then now ECLAC with the addition of the Caribbean) in 1955, contributed to Noyola's analysis (Arndt, 1987: 126).

accumulative pressures. Basic pressures refer to structural inflexibilities within an economic system. Circumstantial pressures refer to exogenous events (i.e., supply shocks) while cumulative pressures are endogenous to inflation. The endogeneity of inflation allows the incorporation of inflation feedback towards other variables while giving a dynamic character to the structural approach. The propagation mechanism *par excellence* is the distributive conflict between the different social classes of the economy (Sunkel, 1958: 575). This view is, broadly speaking, consistent with the Post Keynesian approach to inflation, that emphasizes conflicting income claims.[18]

Figure 4: Annual work stoppages involving 1,000 or more workers in the U.S.



Source: BLS

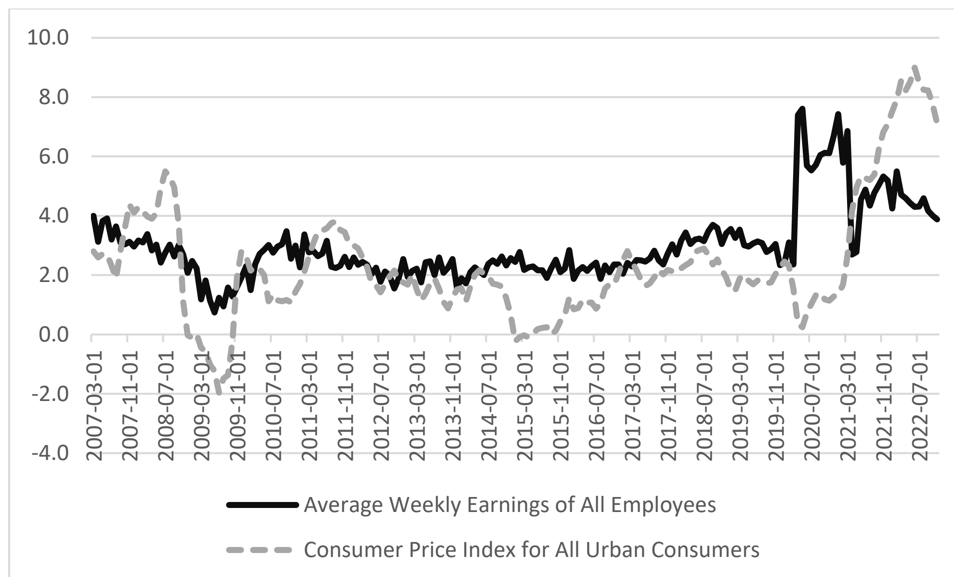
Conflict inflation has been for the most part neglected in recent discussions. In part because it has vanished from the mainstream toolbox. However, another reason, and perhaps more important, is the fact that the bargaining power of workers has been eroded by forty years of anti-labor policies and legislation, which has translated in significantly less strikes, even if they increased significantly in the last few years. In the U.S. there has been a significant decline in the number of strikes since the 1980s (Figure 4), that has gone hand in hand with the decline of union membership. Even with a small spike in both stoppages and union membership during the post-pandemic period, in particular the well-publicized unionization of some Amazon warehouses, and

[18] For a formalization of the Post Keynesian approach that emphasizes inertia and distributive conflict see (Lavoie, 2022). According to the Post Keynesian approach the aspiration gap between workers and firms, which depends on their respective bargaining power, also captures cost-push factors such as variations in the exchange rate, imported inflation, commodity prices, prices of inputs, productivity growth, or other factors such changes in interest rates or financial costs. The structural approach explicitly separates between cost-push factors and the conflict between social classes, that is seen as a propagation mechanism.

Starbucks coffee shops, the relative weakness of the working class is by historical standards at a high point.

This is reflected in the fact that from the 1980s onwards real wages have stagnated while labor productivity increased at a relatively rapid rate. Available evidence for 24 countries of the OECD for the period 1995-2013 show that the rate of productivity growth surpassed that of wages in 62 percent of cases considered (OECD, 2018). The basis for price stability in the pre-1970s era was the implicit accord by which wages increased with productivity, and in the post-1980s era the basis for the Great Moderation has been the stagnation of wages. There is little evidence to suggest that this will change significantly in the near future. Average hourly earnings (i.e., wages) have grown faster at the beginning of the pandemic, but it does not seem to be a sustained process (Figure 5). It is worth noticing that wages of non-supervisory workers are also falling behind inflation.

Figure 5: Prices and wages in the U.S.



Source: FRED

Real wages, and its relation with productivity, are the key variables to analyze the distributive conflict. Note that firms always try to pass increases of costs, including wages, to prices, and even in oligopolistic markets they cannot indiscriminately increase their markups beyond the limit or ceiling price that would trigger the entry of new competitors.[19] If in the

[19] As noted by Sylos-Labini (1979: 5): "The market power of the oligopolistic firms does not necessarily yield above-normal profits; it can mean above – normal wages, given the historic conditions of the labor market." If the increases in wages are above productivity, the increases in prices will be below the rise in costs, and vice versa when productivity growth is ahead of rising labor costs. Further, increases in labor costs at home that are larger than in competing countries cannot be fully passed to prices. Sylos-Labini noted that in the 1970s: "it seems that when rise American firms taken together succeed in shifting nearly all of their higher costs onto prices, while the Italian firms cannot such complete cost shifts" (Ibid.: 12). Profits certainly can go up, but in the 1970s they went down, according

Golden Age of Capitalism wage increases went hand in hand with increases in productivity, since the 1980s, real wages have stagnated, mainly due to the weakness of the working class, but also to the relative weakness of the oil producing countries. The 1970s not only was a period in which unions could resist pressures to reduce real wages, but oil producing countries organized a cartel – the Organization of Petroleum Producing Countries – that allowed them to coordinate and push for higher prices of oil, in circumstances in which the U.S. was relatively dependent on external energy sources, in ways that the more recent domestic energy boom have rendered irrelevant. In other words, the distributional and geopolitical circumstances were very different in the 1970s.

Given the historical significance of distributional conflicts and geopolitical factors in explaining persistent inflation, it would be reasonable to assume that the current inflationary impulse is not self-sustaining and depends critically on the persistence of external shocks. While it is possible that the war in the Ukraine, on the one hand, and the rearrangements of the supply chain, in particular in an increasingly conflictive relation between the U.S. and China, on the other, might cause disruptions, and higher prices of commodities and other supply side snags may persist, it is unlikely that these can precipitate a persistent increase in wages above productivity levels or lead to higher energy prices as a result of greater bargaining power of the major oil producers, although there is a significant degree of uncertainty regarding these issues.

The evidence points to a fall in price in the two most important explanatory components of the recent inflationary rise: energy and foodstuff. Oil prices declined from US$ 115.3 dollars a barrel at the beginning of June 2022 to 75.1 dollars a barrel at the beginning of January 2023. For its part the evolution of the Food and Agriculture Organization (FAO) Food Price Index shows a continuous decline from April 2022 to December 2023 (158.4 and 132.4) respectively.

Not surprisingly the inflationary pressures seem to have eased in the last few months, casting doubts on the notion that this required a strong response from central banks. If one looks at the annualized rate of inflation, it is clear that it has slowed down considerably in the U.S., the compounded annual rate of change was a decrease of 0.1 percent, hence deflation, in December 2022. In fact, from June to November the annualized inflation was 2.5 percent, whereas for the previous five months the equivalent rate was 11.8 percent (Weisbrot, 2022). That does not mean that supply chain problems, and possible spikes in commodity prices would not cause again some inflationary pressures. But in advanced economies, the monetary contraction is clearly an overkill.

to Sylos-Labini, and "decline of the share of profits in several capitalist countries can be attributed primarily to the persistent increase of direct costs in labor, raw materials, and energy" (Ibid.: 17). This contradicts views according to which: "Companies with enough market power can also unilaterally raise prices in a quest for greater and greater profits" (Kelton, 2020: 46).

Given the diagnostic that inflation is essentially driven by supply side factors, and that wage resistance has not been strong, it is clear that higher interest rates are not an adequate policy to deal with it. Also, at least in the U.S., it is unlikely that price controls can be used in the short run in an effective way, as noted before, and the political energy might have to be directed at other more relevant problems, if inflation does remain subdued as it has been for almost half a year. The current risk is not one of accelerating inflation but one of lukewarm output growth, or even a recession, with moderate and possibly falling inflation. This is not the case in many peripheral countries in which the role of exchange rates and exchange rate pass-through, implies considerably higher inflation, with the added danger that slow growth in the advanced economies, might reinforce domestic problems and lead to slower growth. Stagflation in some parts of the periphery is a serious possibility.

In particular, countries with low levels of international reserves, and relatively low domestic interest rates differentials, adjusted for country risk, with international interest rates, and relatively high levels of currency depreciation and capital outflows have experienced high inflation. In Argentina, and Turkiye, for example, inflation is approaching a hundred percent. In these countries, higher interest rates to preclude depreciation, and maintain a positive differential, adjusted to risk, with respect to the U.S. rate might be necessary for keeping inflation under control. Note that, while wage resistance is relatively low in advanced economies, the effects of depreciation on domestic prices, which are much larger in peripheral countries than in the U.S., where its effects on prices are marginal, lead to an unavoidable need to readjust nominal wages. Massive depreciations reduce wages drastically, at times below what would be the minimum required to satisfy basic needs.[20]

There is a resistance about raising rates in peripheral countries, and that has been defended by many heterodox economists. In many cases, the reasons are simply associated to the notion that higher interest rates would have detrimental effects on domestic spending, in conventional fashion. At other times, it is argued that higher interest rates and an appreciated exchange rate would reduce export revenues and reduce the rate of economic growth, a proposition normally associated with New Developmentalist authors. Similar views have been defended by MMT authors that have defended low interest rates and flexible exchange rate as a solution for the external problem.[21] The inflationary and contractionary effects of such a program

[20] Sylos-Labini (1979) provides again a relevant explanation. He notes: "The decline in profit margins can be remedied by a of the monetary unit, which raises the 'ceiling' set by the price of competing imports. In a country that imports substantial raw materials and has strong unions, however, the profit improvement is short-lived, for any additional increase in prices is soon followed by wage claims – especially if there is a mechanism of indexation…. Profitability can always be restored if the devaluation is repeated; but this may cause an acceleration of the inflationary process and generate a redistribution of income in the same class of incomes (for example, between of black market labor), exacerbating social tensions" (Ibid.: 19). In other words, exchange-rate/wage spirals might follow.

[21] For example, Warren Mosler argued that: "Argentina's problem is primarily of a fiscal nature… The specific measures he proposed were threefold: the adoption of floating exchange rates, a permanent 0% interest rate policy,

are difficult to exaggerate. It is exactly the persistent depreciation and low interest rates that have fueled the inflationary spiral in Argentina. A depreciated exchange rate reduces the real wage, since imported goods enter in the consumption basket of workers, and this leads to significant wage resistance, and foreign-exchange/wage spirals. A depreciation also increases the costs of imported goods for domestic corporations, and intensifies the distributive conflict. It is in the periphery, where the exchange rate is central for explaining inflationary pressures, that the distributive conflict is still relevant to understand inflation.

In other words, many countries in the periphery may need higher rates of interest, and a managed exchange rate that avoids significant depreciation in order to maintain price stability. In the cases in which there are large external reserves there is no reason not to pursue this policy together with expansionary fiscal policies, and subsidized credit policies to maintain growth and, together with a mix of industrial incentives, to promote the diversification of exports, reducing the dependence on foreign currency.[22]

While in the U.S. and other advanced economies it is unlikely that distributive conflict would lead to accelerating inflation as it did in the 1970s, and the second coming of Volcker and the rapid increase in interest rates – incorrectly seen as the way out of an inflationary crisis that was not caused by excess demand – would most likely be reversed after the economy slows down, in the developing economies the situation is more varied and complex. Higher interest rates might be needed to maintain international reserves, preclude capital flight, and avoid significant depreciation of the exchange-rate, which might trigger inflationary acceleration on levels not seen in a long while.[23]

Concluding remarks

The return of inflation as a central macroeconomic problem after almost forty years has taken place at a time in which the belief in the self-adjusting nature of the economy has been under questioning, if not by the economic profession, at least by society at large. The notion that the economy has a strong tendency to be close to full employment should be at the top of the

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and the implementation of job guarantees based on employment buffer stocks… Mosler's proposal is to adopt floating exchange rates so as not to have to defend a fixed exchange rate by means of foreign exchange reserves and for the Argentine economy to function exclusively through the national currency" (Garcia Hernández, 2022). The Argentine problem is external and associated to the lack of dollar reserves, and its foreign debt in dollars, not a fiscal problem in pesos.

[22] Bolivia, for example, that has maintained a stable exchange rate, maintained a fixed peg at 6.9 bolivianos per dollar, with some nominal appreciation since the first election of Evo Morales in 2006. In the same period the economy grew at an average rate of 3.9 percent, which is at least above the regional rate, and faster than most advanced economies.

[23] Note that in some developing countries this inflationary crisis is not the worst since the 1970s, as in advanced economies, exactly because of the effects of volatile exchange rates and financial deregulation since the 1980s. See Table 2 in the appendix.

ideas to be debunked. A second one to be discredited should be the notion that inflation is a monetary phenomenon. If the economy is only rarely at full employment, it should be clear that inflation seldom is caused by excess demand. Surprisingly, most economists would agree that the economy is close to full employment in the U.S. and that inflation is essentially caused by the overreaction of government and excessive spending and monetary expansion during the pandemic. The conventional narrative about the so-called Great Inflation of the 1970s is, however, incredibly persistent and prevalent. In fact, the very term Great Inflation is supposed to suggest that this was a crisis of the same proportion as the Great Depression, and to some extent justified the neoliberal turn in economic policies around the globe.

The persistence of contractionary demand, mostly monetary, policy as the main tool to contain inflation seems to respond more to the prevailing prejudices and the ideological biases of the profession, than to the analysis of the real causes of inflation. It is not helpful that the main challenge to this consensus has been to blame corporations for increasing their profit margins, since this view also provides an incorrect explanation for the recent acceleration of inflation. The main culprit for the inflationary acceleration in the U.S. and most advanced economies is related to the supply side snags, and the shock to energy and food prices resulting from the pandemic and the war in the Ukraine.

The best policy, of course, would depend on what criteria is used to evaluate its costs, and what is seen as the main consequence of inflation. In the standard neoclassical approach, the cost of inflation is often measured in terms of welfare loss in which money is seen as a tax on the holdings of money. In our perspective, rooted in Classical or Structural-Keynesian perspective, the main effect of inflation is distributive, and its cost is the fall of real wages, or even more precisely of the wages of the groups at the bottom of the income distribution. Inflation has limited effects on growth even at relatively high levels, certainly above two-digit levels. In that case, the best policy would be to guarantee that wages are compensated for their losses. The artificial target of 2 percent, or even higher rates of 3 or 4 percent, as have been defended by mainstream authors, have no particular relevance, and their impact on distribution and growth is not significantly different.

In the periphery, it is clear that other forces play a role in the acceleration of inflation, in particular, in countries where inflation has reached three digits. In those cases, the role of the exchange rate and of distributive conflict, which is subdued in the center, is of significant importance. While in the center there is a danger in accepting an exaggerated estimation of the social evils of moderate inflation, in the periphery the risk is to exaggerate the evils of higher interest rates and more stable and appreciated exchange rates. The higher levels of inflation, not only have a significant distributive impact, but also might have a larger effect on relative prices and on accumulation. In that case, accumulation of reserves and a stable exchange rate, which are associated with the maintenance of a positive interest rate differential, should be used. In

both cases, ideology rather than analysis seems to play a role in the particular policy prescriptions.

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Table 2: Monthly annual record inflation between 2021-2022 and earlier year and month when the recorded inflation rate was higher (selected countries)

	Highest inflation rate since January 2021			Not recorded since		
Countries	Inflation rate	Month	Year	Inflation	Month	Year
Argentina	92.4	November	2022	102.4	October	1991
Brazil	12.13	April	2022	13.98	October	2022
China (People's Republic of)	2.8	September	2022	3.3	April	2020
India	6.96	May	2022	7.49	January	2020
Indonesia	5.95	September	2022	6.25	October	2015
Russia	16.69	March	2022	16.93	March	2015
Saudi Arabia	6.16	June	2022	6.3	June	2011
South Africa	8.05	July	2022	8.37	May	2009
Austria	11.04	October	2022	Highest on record since 1960		
Belgium	12.26	October	2022	12.5	June	1975
Canada	8.13	June	2022	8.24	February	1983
Chile	14.1	August	2022	15.1	September	1992
Colombia	12.5	December	2022	13.5	April	1999
Costa Rica	3.49	January	2022	3.53	February	2015
Czech Republic	17.97	September	2022	18.52	December	2022
Denmark	10.11	October	2022	10.14	November	1982
Estonia	24.79	August	2022	Highest on record since 1960		
Finland	9.14	November	2022	9.87	November	1983
France	6.2	October	2022	6.38	June	1985
Germany	10.39	October	2022	7.45	October	1981
Greece	12.1	June	2022	12.31	October	1993
Hungary	22.5	November	2022	22.86	August	1996
Iceland	9.93	July	2022	10.8	September	2009
Ireland	9.16	October	2022	9.68	July	1984
Israel	5.28	November	2022	5.43	October	2008
Italy	11.84	November	2022	11.87	April	1986
Latvia	22.17	September	2022	23.16	January	1996
Lithuania	24.12	September	2022	24.32	August	1996
Luxembourg	7.43	June	2022	7.69	June	1984
Mexico	8.78	June	2022	8.95	December	2000
Netherlands	14.53	September	2022	Highest on record since 1960		
Norway	7.51	October	2022	7.81	September	1987
Poland	17.9	November	2022	18.5	December	1998
Portugal	10.14	October	2022	10.31	May	1992
Slovak Republic	15.34	November	2022	15.38	June	2000
Slovenia	11.03	July	2022	11.39	August	1995
South Korea	6.34	November	2022	6.78	November	1998
Spain	10.77	July	2022	11.35	September	1984
Sweden	11.46	November	2022	13.08	February	1991
Switzerland	3.45	August	2022	3.63	August	1993
Turkiye	85.5	October	2022	90.55	June	1998
United Kingdom	9.6	October	2022	10.35	March	1982
United States	9.06	June	2022	9.59	November	1981

Source: OECD (2022) and FRED (2022)