To: Interested Parties
Fr: Richard K.
Re: Inflation in the political economy
Dt: 11/29/21

Inflation: the neoliberal ticket to stay in the game

One headline blares "This Year's Thanksgiving Feast Will Wallop the Wallet." Iowa's octogenarian Senator Chuck Grassley tweets "Welcome 2 Pres Biden's America where inflation is costing households an extra $175 a month."

AltPresident Joe Manchin urges the Federal Reserve "to address threat of inflation: don't overheat the economy." He writes in the *Wall Street Journal* that he won't support $3.5 trillion in the Build Back Better plan because "An overheating economy has imposed a costly 'inflation tax' on every middle- and working-class American."

Obama's neoliberal economic team agrees, blaming inflation on too much government spending, with Jason Furman, who headed Obama's Council of Economic Advisors saying, "The original sin was an oversized American Rescue Plan. It contributed to both higher output but also higher prices."

Neoliberalism is on its heels. President Biden is championing the view that we grow the economy by growing the middle-class, with robust government spending aimed at raising wages, investing in human as well as physical infrastructure, lowering costs for essentials like health care and child care, taxing corporations and the wealthy. Very mainstream *New York Times* economics reporter Neil Irwin writes that the Biden approach has become "mainstream among economists."

But as the *Time* reports, "With an American public that had gone nearly 40 years without seeing — or worrying — about inflation, the issue provides an opening for the opposition." That opposition is not just Republicans seeking an electoral advantage. It is the long-powerful purveyors and beneficiaries of neoliberal economics who see inflation as their bulwark against being pushed into the economic wilderness and being forced to give up some of their wealth. And because inflation is a visible and felt stress for the everyday Americans who are victims of 40 years of those forces, their strategy may work.

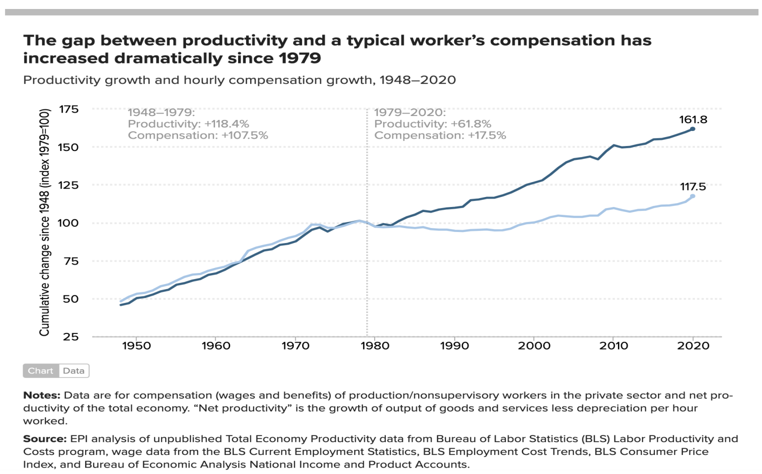
This memo is on the political economy of inflation today. It is divided into three sections:

1. Economic theory: what is the role of inflation in an inclusive economy that drives broad-based economic growth
2. Inflation today: what is behind inflation today and how that relates to our economic theory.
3. What to do and say: what are the appropriate policy and related political responses.

Theory: Inflation's role in an inclusive economy

Our economics simplified is that the more we fully include people in the economy, the more that individuals are well compensated and able to contribute to their full potential, the more we drive economic prosperity. We then point out that for the past 40 years economic growth has been distributed unfairly, with the incomes of most people being held down while the incomes of the most wealthy went up a lot. The reason is that from the post-war through 1979 economic growth was fairly evenly distributed between labor and capital. But starting in 1980, capital grabbed a much larger share of economic growth while labor's share decreased.

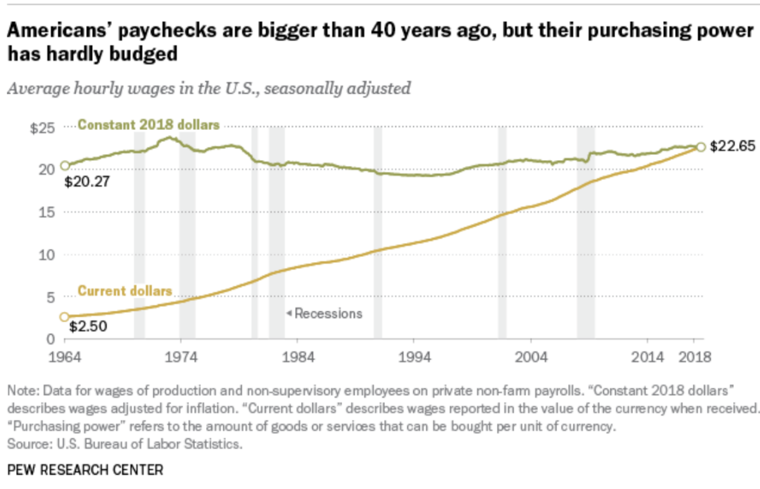
We see this in the chart from EPI that shows real compensation for non-supervisory workers going up at almost as much as productivity through 1979 but lagged behind since then. From 1979 through 2020 real compensation (wages and benefits) went up by 18% while productivity increased by 62%.



As EPI explains, instead of that increased productivity ending up in the paychecks of 80% of working people, it went to the 20% of the most highly paid workers and into higher profits paid to shareholders and other owners of capital.

Or in much more concrete terms, as a RAND study found, the typical working person would be making $42,000 more a year, $92,000 a year instead of $50,000, if economic growth in the United States from 1975-2018 had been shared equally, instead of dramatically shifted to those with the highest incomes. Or, if the minimum wage had kept up with productivity it would have been more than $24 in 2020.

How does inflation figure into this story? For an equitable distribution of economic growth, as EPI economist Josh Bivens explains, wages should grow as rapidly as the sum of productivity growth and the Federal Reserve's inflation target. Instead, over the past forty years, wages grew with inflation only; real wages were flat for 80% of workers.[1]



The question now is how to make up for those stolen wage gains. The dilemma is that even if wages started to meet the goal of increasing with the sum of inflation and productivity it would leave in place the huge inequality generated by the decades of divergence of wages from productivity. But if, in an attempt to make up that lost ground, wages exceeded the sum of productivity and inflation the result would be too much inflation; price increases would start exceeding gains in cost of living and be particularly a burden for people who already spend all their income on the basics.

One solution would be for income of the 80% (or higher) to increase faster than productivity while at the same time holding down incomes below that target for the more wealthy. Average income would still rise with inflation and productivity. This is a predistribution avenue; driven by measures to both raise wages with productivity and force the owners of capital to reduce their share of productivity-driven income growth.

The other avenue is through redistribution: 1) assure that incomes of the 80% (or higher) rise with the sum of productivity and inflation; and 2) tax the excess gains of the owners of capital and use those funds to raise incomes and lower costs for the 80% of workers whose earnings have been suppressed.

What's Driving Inflation Now?

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[1] But if wage increases have kept up prices for most people, why do people feel like it's much harder to live a middle-class life? Data from the Council of Economic Advisors and OMB reveals two key reasons: 1) the price of what are basics for a middle-class lifestyle today have gone up faster than median family income, with higher education, childcare, nursing homes and prescription drug costs exceeding income growth and rent, health care, and gasoline barely keeping up; 2) lower and middle income families spend a higher proportion of their income on these basics. Another reason so many people feel squeezed is inequality itself: we live in a society where all that income going to the wealthy is very visible and culturally dominant. The awareness that people who are held up as cultural norms are doing much better financially accentuates the feeling in most people that they are not as worthy. Inequality undermines social cohesion and resentments from inequality fuel right-wing populism.

Not real wage growth, although there are sectors where wages are going up quickly, notably the hospitality industry. But overall, compensation is down, labor costs are flat while profits are up.

What ***is*** going on? To start, while inflation, is measured by the Personal Consumption Index is running at higher levels than for 30 years, those measurements are exaggerated by at least two points because they are measured against pandemic price decreases. Still, even accounting for pandemic deflation, we are still seeing higher inflation than in a good while.

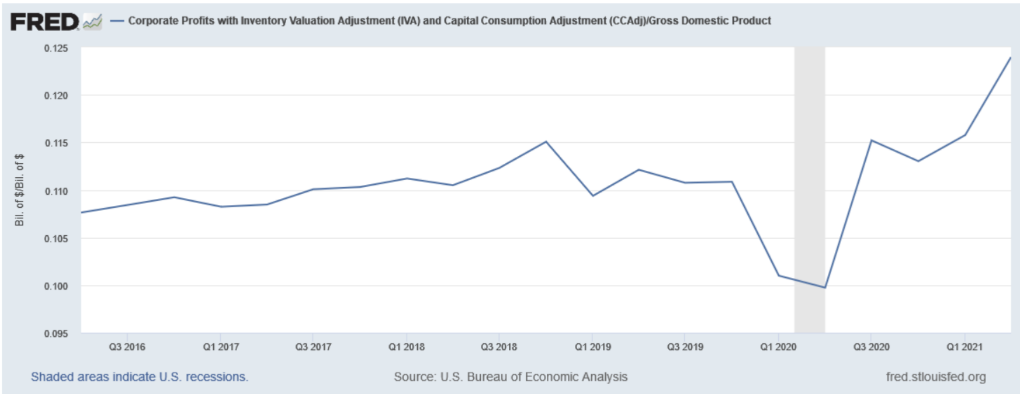
To be sure, inflation in the wake of the pandemic is a global phenomenon, as *The Wall Street Journal* described in an October article headlined "Inflation Surges Worldwide as Covid-19 Lockdowns End and Supply Chains Can't Cope." Price rises began to accelerate world-wide in March, taking inflation rates higher than most central bankers had expected. By August, the annual rate of inflation in the Group of 20 largest economies—which account for about four-fifths of the world's output—had risen to a decade high. The Bundesbank predicts German inflation, already higher than in decades, will reach 6% this year.

As much as neoliberals and Republicans want to lay the blame on Biden, it's hard to make that case for inflation in France and England. But like Biden, the leaders of those countries are seeing low approval numbers, as the combination of the lingering pandemic and higher prices take their toll. Nor can we blame Biden or economic stimulus for higher inflation in Brazil or South Africa.

Inflation in the U.S. is concentrated in a few industries, where supply bottlenecks are particularly acute. A Roosevelt Institute analysis highlighted that "energy, automobiles, and a handful of industries [airfare, hotel accommodations, and admission to events] directly affected by the pandemic account for all of the excess inflation this year." Overall, the biggest price increases are in goods, where real wages are flat. In many cases, businesses are using the supply crisis as a way to further hike prices and profits.

New York Times economics columnist Peter Coy makes the case simply: "Don't blame workers for inflation." Drawing from BLS data, Coy points out that real total compensation is down in 2021 from where it was in 2019 and 2020 and that strong growth in productivity is keeping down the labor cost of producing goods. Summarizing the key factors of compensation, inflation and productivity he is clear: "So we have worker pay not keeping up with inflation and worker pay not keeping up with workers' own productivity increases. That makes a solid case that workers are more sinned against than sinning when it comes to inflation."

He explains that: "The U.S. gross domestic product has bounced back to above its prepandemic peak, while the number of workers employed remains millions below the prepandemic level. That simply says that output per worker has grown. Which is great for employers. It means that they don't need to raise prices to cover higher labor costs."
Instead, they can raise prices to increase profits, which is what they are doing overall, as Dean Baker highlights with this data from the Bureau of Economic Analysis showing that corporate profits are at a recent record as a share of GDP:



A *Barron's* headline reads, "Higher Costs Could Dent Profits. Earnings Prove They're Helping." While the Wall Street Journal reports, "What Does Inflation Mean for American Businesses? For Some, Bigger Profits. Nearly two out of three of the biggest U.S. publicly traded companies reported fatter profit margins than they did before the pandemic; 'a very unprecedented environment.'"

Baker observes: "In other words, it hardly seems as though businesses are being forced by costs to push up prices. It instead looks like they are taking advantage of presumably temporary shortages to increase their profit margins."

Matt Stoller has pointed out two specific instances where we can see that long-established profiteering practices are driving up prices: monopoly and stock buybacks.

About half of today's prices increases in food are from beef prices, which are up 12%. Stoller's analysis shows that monopoly practices added $1.23 to a pound of beef since 2015. Cattle farmer and U.S. Senator Chuck Grassley told a House Agriculture Committee hearing in October, "The four major beef packing companies control 80% of the cattle industry. And they are what he called 'a chokepoint' for the entire sector. In other words, follow the money. In the beef industry, it's not Amazon, Apple, Google, and Facebook suppressing business, but 'the Big Four' - Tyson's, JBS, Cargill and National Beef, who control 85% of the market (and more in some regions)."

And then there are diapers. Stoller points to comments by Mike Hsu, the CEO of Kimberly Clark, to explain the real reasons diaper prices have gone up 14% this year. Hsu brags that sales grew 6% in the past year, in part due to the pandemic, while the company cut "returned $2.15 billion to shareholders through dividends and share repurchases."

In multiple sectors, when the pandemic hit last year, corporations cut back on their orders, worried that not doing so would drive down quarterly profits, resulting to a hit to their stock prices. This short-term focus exacerbated the supply-crisis and gave corporations the ability to raise prices. Meanwhile, as I write this on November 1, the Dow is at a record high.

Bob Kuttner also points out that long-term measures by corporations to lower costs, including just-in-time inventory and outsourcing products, has made the supply shortages much more acute, even as they have lowered labor costs and boosted profits. The trucking industry is scrambling to attract more drivers after years of driving down their compensation.

New York Times economic correspondent Peter S. Goodman summed up: "A dollar that a car company spends to warehouse computer chips as a hedge against supply chain troubles is a dollar that it cannot use on something else, including bonuses for executives or dividends for shareholders. Monopolistic tendencies also help explain shortages. Beef is scarce and prices are high, but this is largely because meatpackers have consolidated and eliminated capacity as a way to bolster prices and profitability. These sorts of choke points exist throughout the supply chain."

While wage increases are not the culprit for inflation for the economy as a whole, within any sector wages may be driving price increases. Here again that may be a correction of past sins rather than a problem. Coy quotes Oxford Economists, "Wage growth reflects a re-leveling of low wages rather than the onset of a spiraling price-wage inflation loop." Which is a good description of what is happening in the hospitality sector and a good summary of what we need to do overall: increase real wages as productivity rise while income for capital is held down.

What to do and What to Say

Yes, inflation may be global. And yes, it may be exaggerated by the comparison with the pandemic deflation. And yes, it may not be widespread across the economy. But what is visible to Americans is double-digit inflation in gas and chicken and beef. Moreover, as *The Times* Neil Irwin points out, while wages may be increasing rapidly for workers in some sectors, like the 11% annual jump in paychecks in leisure and hospitality, for most other workers the daily price shocks exceed any bump in pay.

In the political economy, it is always important to remember that people feel loss much more than they appreciate gain. Even if most people see wages rising higher than the last decade, and even if they have more money in the bank from stimulus checks, higher prices for basics and unaccustomed waiting times for orders stand out sharply, create insecurity and make it seem like the pandemic isn't over. The "political" part trumps the "economic" part.

We need policies to raise wages and lower costs and we need a story that moves people to shift their angst to anger at the economic and political forces that keep them from financial security.

What we Need to Do:

To drive broad-based prosperity, we must raise wages for the great majority of people at least as much as productivity increases, and preferably at a higher rate, to make up for 40 years of lost ground. In doing this while not triggering inflation that will result in real wages remaining flat or going down, we will need to both limit the income gains from productivity increases for those with the highest incomes and use the proceeds from taxes on higher incomes and wealth to raise income and lower costs for most people.

While the menu of policy solutions must include both predistribution and redistribution the foundational element is that of raising real incomes for the 80%; doing so is fundamental to everyday Americans having a better standard of living and is key to driving greater economic growth.

Policy options to increase real wages so that they keep up or exceed the growth of productivity include: raising the minimum wage; raising the overtime threshold; establish high wage standards tied to government spending; paid time off for sick days and family and medical leave; mandatory paid vacation; increasing union bargaining power; and organizing sectoral bargaining to drive wage increases among all employers in a sector. Of these, increasing union power has the most potential to also shift economic gain to workers from owners of capital. Additional measures to limit the economic share taken by capital include: breaking up monopolies; limiting stock buybacks; and limiting executive compensation.

Policy options to redistribute excess economic gains from the most wealthy are: 1) raise taxes on wealth and income; and raise taxes on corporations; 2) increase incomes of the 80% through tax credits, government paid family and medical leave; direct cash, and; 3) lower costs for basics with programs such as: subsidized child care and elder care; lower costs for health care; policies to increase the supply of housing and subsidize the cost of housing; lowering the cost of higher education. In short, the Biden BBB agenda.

President Biden's overall agenda would both predistribute and redistribute the gains of a growing economy. Biden made this point in his campaign kick-off speech and again in remarks he made in September in support of the BBB: "Are we going to continue with an economy where the overwhelming share of the benefits go to big corporations and the very wealthy? Or are we going to take this moment right now to set this country on a new path — one that invests in this nation; creates real, sustained economic growth; and that benefits everyone, including working people and middle-class folks?"

After pointing out that his plan taxes "big corporations and the super wealthy" to provide child tax credits and lower the cost of health care, child and elder care (and he could have added college), the President said: "All of this will mean thousands of dollars in savings for the average American family on some of the toughest and most important bills they have to pay every month. My Republican friends talk a lot about inflation, but if you want to talk about actually lowering the cost of living for people in this country, my plan does just that."
The President has also proposed predistribution measures, including a $15 minimum wage, strong union organizing rules and paid family and medical leave.

We also need to take short-term and long-term measures to deal with the supply chain crisis. President Biden has a task force aimed at dealing with immediate bottlenecks, such as the containers at the port of Los Angeles. He acted earlier to use government regulations to address blockades in PPE. Dealing with the long-term supply chain issues requires a number of strategies including breaking up monopolies and raising wages in supply-chain industries, which are characterized by low-wages.

In short, President Biden's economic agenda is aimed at reversing the economics of the past forty years that has killed real wage growth for the great majority of Americans and made it much more difficult to live the high standard of living that would be widely achievable if economic growth had been shared equitably rather than distributed almost entirely to the very wealthy.

What we Need to Say:

Today inflation, driven by corporate profiteering in the aftermath of the pandemic, is being used to undermine the Biden agenda and resurrect the policies that have created deep financial insecurity among a great many Americans. We need to aggressively paint a picture that the forces that got richer at the expense of everyday Americans are using inflation as an excuse to hold on to their wealth and power. They are profiteering from inflation and trying to stop President Biden from delivering on policies to raise wages and make life more affordable for everyday Americans.

Here is how we might tell this story in a narrative form:

Everyday Americans deserve to live a decent life but too many of us just make it paycheck to paycheck. For years, big corporations held down our wage and shipped our jobs overseas so that the US was totally unprepared for the pandemic – not enough things made here, wages too low to attract truck drivers or warehouse workers. Today, prices are not going up because of wage increases – every day we see that our wages are still not keeping up with the cost of living. Prices are going up because big corporations are using the pandemic as an excuse to hike prices and fatten their profits.

- Big corporations have held down our wages, cut our benefits and shipped our jobs overseas, while CEOs and the super-wealthy got even richer by profiteering off the work we do. By shifting manufacturing overseas and cutting wages to the workers who run the supply chain, these CEOs left the United States vulnerable to a pandemic.
- For years, the prices we pay for the basics of a good life – health care, prescriptions, food and gas, rent and mortgage, childcare and college – have gone up faster than our paychecks. For retirees, relying mostly on Social Security because corporations cut retirement benefits, it can be even tougher.
- Now those same big corporations are using supply bottlenecks caused by their greedy decisions before and during the pandemic to jack up prices and profits even more. They are pushing up prices at the supermarket, the gas pump, for just about everything so they can grab even bigger profits. The stock market is soaring, CEOs are laughing, while American families and small businesses are hurting.

  - The price of beef is up because four companies control meat packing; cattle farmers and families both end up on the short end.
  - The maker of Huggies hikes diaper prices by 14% while shoveling more than $2 billion in profits to top executives and stockholders.
  - Small businesses are hurting, unable to get goods, while the biggest businesses grab up everything that's available, raise prices and see their profits soar at our expense.

We need to make life more affordable for people. We do that by raising wages and lowering prices for the things we need to take care of ourselves and our families. And by taking on the big corporations. That's what President Biden and Democrats in Congress have begun to do.

- President Biden and Democrats in Congress passed legislation this year to put more money in our pockets and lower prices. They would have done even more but Republicans put politics and CEOs before working families and retirees.
- President Biden and Democrats in Congress, without a single Republican vote, delivered on $1,400 stimulus checks, monthly tax credits for families with children and lower health care premiums, and the cost of broadband. They are about to pass legislation that will cut the price of prescription drugs, lower the cost of childcare, caring for an elderly parent and the cost of heating and cooling our homes.
- And they pay for all this by making sure that big corporations no longer can avoid paying any taxes and putting a surcharge on incomes of more than $10 million.
- President Biden stepped in to clear up the huge container bottleneck at the Port of Los Angeles, is investigating profiteering by the oil industry and released 50 billion gallons from the strategic petroleum reserve to bring down gas prices before the holidays.

Now big corporations, CEOs and the politicians they pay for, are trying to shift the blame for prices going up from their profiteering from the pandemic to President Biden and working people. But we won't be fooled.

- We need more stimulus – higher wages and lower prices – so that the work we do delivers a decent life. When everyday Americans can care for and support their families that leads to small businesses, our communities and our nation doing better.