

Is There a Trade-Off Between Global Inflation and the Great resignation in the USA?

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Abstract: The aim of this paper is to get a better insight into the relationship between global inflation and the „Great resignation” in the United States. Based on Post Keynesian conflict inflation theory, we argue that these two phenomena may be seen as the opposite power processes in which high inflation redistributes power from labor to corporate capital, whereas a very tight labor market strengthens workers' bargaining power. Given the dominant share of less powerful, low-income workers in the job-to-job flow as well as their disproportionately high exposure to the negative effects of inflation, we provide arguments in favor of a possible trade-off between global inflation and the Great resignation in the United States.

Keywords: Global Inflation, Great resignation, The United States, Trade-off, Post Keynesian Conflict Inflation Theory.

JEL: B52, E31, J64

Introduction

Following the COVID-19 recession, the U.S. economy is facing two, in the last 40 years, unprecedented economic hardships in terms of a record-high quit rate, known as the “Great resignation,” and a historically high inflation rate. This surprising coexistence of plentiful unfilled vacancies and unemployed workers on the one hand, and high inflation on the other hand raises many questions. If they are interrelated problems, what is driving them? And what are their

consequences for the economy as a whole, particularly on the labor market and income distribution? This paper is intended to shed more light on these questions by drawing on the Post Keynesian view of inflation and the labor market.

Stylized facts on global inflation and the Great resignation

As entry points to our analysis, we will identify stylized facts about inflation and unemployment in the United States. The reason for using stylized facts as an empirical basis for drawing conclusions is that most econometric techniques cannot be applied in our case due to the short time series of global inflation and the Great resignation in the United States. We will use stylized facts in accordance with Powell's (2021) recommendations. He argues that economists must practice reflexivity when considering stylized facts in order to mitigate their non-evolutionary and non-benign nature and ensure that they are grounded in instrumental reasoning. Given that stylized facts are assumed to be the result of social construction, they can simultaneously be positive and normative claims.

Global Inflation

Today, the U.S. economy is experiencing the greatest increase in inflation in the last four decades (Bennion et al. 2022). Moreover, since the beginning of 2021, the price surge in the United States has increasingly outpaced inflation in other advanced economies (Jordà et al. 2022; Furman 2022). The prices of many products, from gasoline to construction materials, have reached or come close to a record high. This general picture is similar when looking at inflation from the consumer and seller perspectives.

Figure 1 shows a time series of the commonly used inflation measures: the Consumer Price Index (CPI), the Producer Price Index (PPI), and the Import Price Index (MPI), which describe consumer, producer, and imported inflation, respectively. Using as a threshold the CPI

index of 5 percent or higher, it is possible to recognize the three periods of high inflation since 1983: 1989 Q2–1991 Q1, 2008 Q3, and 2021 Q3–2022 Q3. Throughout the period, all price indexes followed a similar trend, indicating that higher input and import prices caused a rise in consumer prices. It is worth noting that the changes in producer and imported inflation, on the one hand, and consumer inflation, on the other hand, differed in the sense of lower volatility of consumer prices.

Insert Figure 1 here.

What distinguishes the current U.S. inflation episode from previous ones is its origin in the unprecedented global economic disruption caused by the COVID-19 pandemic and the Ukraine war. First, lockdown and then strict COVID-19 restrictions, especially in China as a “world factory,” led to problems with global supply chains, generating bottlenecks in different industries, from transportation to semiconductor production. The war in Ukraine additionally disrupted international trade in energy, food, and commodities, resulting in worldwide turmoil in commodity and financial markets (Caldara et al. 2022). The net effects on the global economy are upward pressure on prices and, accordingly, downward pressure on economic activity.

Even though the domestic components of inflation, due to quantitative easing and enormous fiscal stimulus introduced in response to the pandemic (Jordà et al. 2022; Borrallo, Buesa, and Párraga 2021) or tightening of the labor market (Ball, Leigh, and Mishra 2022), should be taken into account in the diagnosis of the U.S. inflation pattern, the foreign components of inflation due to imported cost-push factors are of primary concern. The markets for key intermediate products (e.g., semiconductors) and vital commodities (natural gas, oil, titanium, or wheat) are global. Therefore, a change in price in one region will affect prices everywhere, especially in the United States, as the world's largest importer.

The presented stylized facts about inflation in the United States largely reflect the conventional Post Keynesian view on inflation. Post-Keynesians advocate an eclectic approach to inflationary phenomena, allowing for multiple causes of an increase in the general price level. In this vein, upward pressure on the price level should be attributed more to supply than to demand conditions. If we accept the assumption of money supply endogeneity, as an essential feature of Post Keynesian inflation theory (Arestis and Howells 1996; Davidson 1989; Moore 1979), the key importance in aggregate price formation lies in the price-setting behavior of enterprises, primarily corporate capital or megacorps in Eichner's sense (Eichner 1983; Lavoie and Rochon 2010). Faced with increasing input prices, corporate capital reacts by increasing the price it charges for goods and services to maintain its profit share. Given the leading role that corporate capital plays in mature capitalist economies, the net result is an increase in the general price level.

That higher commodity and import prices have been largely passed through to higher inflation in the United States is well grounded in the Post Keynesian theoretical and empirical literature (Block, Dockery, and Sapsford 2004; Kim 2020; Galbraith 1997; Powell 2021). Thus, James Galbraith (1997) points out that all US inflationary episodes since the 1950s have been driven by commodities, particularly oil, or import prices through devaluation. He argues that, despite compelling empirical evidence that supply-side factors are the primary contributors to US inflation, policymakers continue to base their options for reducing inflation on the concept of the "natural rate of unemployment," rather than the "non-inflation-accelerating rate of oil production" or the "non-inflation-accelerating rate of dollar devaluation." As a result of such a policy approach, a greater proportion of the costs associated with reducing inflation is borne by workers than by capital owners, indicating the redistributive effects of anti-inflationary policy (for more see: Amitrano and Vasconcelos 2019).

The Great resignation

Another ongoing problem facing the US economy is the historically tight labor market, i.e., the shortfall of workers relative to the number of available jobs. Despite a rebound in aggregate output, the COVID-19 recession has been accompanied by a sluggish recovery in the labor market. According to the U.S. Bureau of Labor Statistics (BLS), the vacancy to unemployment ratio has risen steadily since the peak of the recession in April 2020, standing at 2 in September 2022, indicating that 50 percent of job vacancies remained unfilled. This gap is 2.5 times larger than it was before the start of the pandemic and 4.5 times higher compared to its long-term average over the previous 20 years.

The coexistence of unfilled vacancies and scarce workers presumably reflects two things: a sharp increase in vacancies as a result of the strong demand recovery from the COVID-19 shock, and reduced labor force participation. The transmission mechanism of aggregate demand to job creation is expected and well elaborated in the literature. However, the second mechanism requires a further explanation. Reduced labor availability in relation to vacant positions is attributed to the interplay of different factors: COVID-19 health concerns, job mismatch, reduction in immigration, the negative impact of generous public income support on labor supply, and changing job preferences among workers (Duval et al. 2022; Domash and Summers 2022). Preliminary empirical evidence on this issue (Duval et al. 2022; Coibion, Gorodnichenko, and Weber 2020; Shibata and Pizzinelli 2022) suggests that shifting worker preferences have played the leading role, while the other factors had a modest effect.

The post-COVID period in the United States is characterized by a strong shift in work attitudes and behaviors. A key manifestation of this phenomenon, termed by psychologist Anthony Klotz as the “Great resignation,” is the increase in voluntary quits, either to change jobs or to leave the labor force. It seems that the pandemic prompted workers to start reconsidering

their priorities, career opportunities, and work-life balance, altering the labor supply. Recent research has shown that US workers cited low pay, no opportunities for advancement, feeling disrespected at work, and work exhaustion as the top reasons for voluntarily quitting jobs (Amanor-Boadu 2022; Gittleman 2022; Parker and Horowitz 2022).

A tighter labor market is typically accompanied by a higher quit rate. In situations where there are a lot of open positions, workers are able to find better jobs more quickly and face less risk of extended unemployment. This is clearly illustrated in Figure 2, which shows a strong historical co-movement between quit rates and the vacancy-to-unemployment ratio. Additionally, Figure 3 reveals that, since the third quarter of 2021, the relationship between quit rates and a tight labor market has significantly exceeded what we observed and what we could predict from the previous business cycles.

Insert Figures 2 and 3 here

What makes the current situation in the United States distinctive, out of its historical high, is that most of the employees who quit jobs are younger, less-educated, and low-paid workers who come from industries most adversely affected by the pandemic (Hobijn 2022). The sectors that contributed the most to the quit rate are accommodation and food services, retail trade, professional and business services, transportation, healthcare, and social assistance. At the same time, these industries have the fastest job and strong wage growth, reflecting the rebound in demand during the post-COVID period. This trend contradicts the widely held belief that workers with limited professional and spatial mobility, as well as those employed in sectors with rising wages, are less likely to quit their jobs.

The presented stylized facts on the US labor market could hardly fit into a neoclassical description of labor market with self-correcting characteristics. From a Post Keynesian

perspective, the market-clearing function that wages are supposed to play in the aggregate labor market performs well only in the absence of institutional constraints and income support policies. In the given context, it is possible to understand why strong wage growth during the post-COVID period was not accompanied by a reduction in the number of people who voluntarily left their jobs. Contrary to what is emphasized by neoclassical theory, wages are not the result of an optimizing process aimed at allocating labor to the most productive employment. Relative wages have very little in common with specific marginal products; rather, they reflect the social reproduction needs of firms to maintain hierarchies that have been sanctioned socially by force of custom (Seccareccia 2003). Such an ossified wage distribution by industries and occupations may be subject to change during crises, but only to the extent that the existing institutional framework permits.

Examining this issue from a microeconomic standpoint, labor market actors in the real world do not behave in ways that are consistent with neoclassical predictions, particularly those derived from the rational expectations model. Economic agents, in line with the Post Keynesian tradition, are regarded as boundedly rational decision makers faced with incomplete information and limited cognitive resources. Accordingly, they are not able to consider more than a small fraction of the relevant alternatives and to foresee what will happen if they choose those alternatives (Dunn 2001). The concept of “bounded rationality” is especially relevant in the workplace, which is first and foremost a social institution rather than just a site of income generation (King 2015). As a result, the worker's decision to change jobs should be viewed in a broader context, in which wage is an important but not always deciding factor.

Discussion

The stylized facts emerging from the above consideration indicate the interplay between global inflation and the Great resignation. Certainly, a tight labor market leads to wage inflation and,

hence, price inflation. If there are not enough workers to fill open jobs, corporate capital, as a wage setter, is forced to raise wages. However, corporate capital as a price setter is able to pass through rising labor costs to consumers, which is likely to have contributed to inflationary pressure. What is less obvious is that the causality between a tight labor market and inflation may run in reverse directions, suggesting a negative relationship between global inflation and the Great resignation.

The intuition behind the proposed trade-off between inflation and resignation is that inflation erodes workers' standards of living, which in turn reduces the employment-to-inactivity and employment-to-employment flows. In contrast to the effect of inflation on job-to-out of labor force mobility, according to which workers tend to remain employed when their real income is reduced, the negative relationship between inflation and job-to-job mobility requires further elaboration. At first glance, it seems that falling real wages increase workers' propensity to search and quit for better-paying jobs or renegotiate their wage with their current employer. However, there are two essential and interlinked factors that need to be added to this relationship. The first is the effect of anti-inflationary policies on effective demand and thereby job creation, and the second is the effect of inflation on workers' bargaining power. Since the effects of monetary policy tightening on the labor market are beyond the scope of this paper, we will focus on the bargaining issue.

From a Post Keynesian perspective, inflation can be explained as a conflict process that includes workers, corporate capital, and the government (Dutt 1992; Lavoie 1992; Rowthorn 1997). According to Dutt (1992), inflation results from competing claims on income made by workers and firms, claims that are influenced by their relative bargaining power. This bargaining power influences the income distribution and, as a result, the pattern of accumulation in the economy, which in turn influences how the bargaining power of various groups changes over

time. Accordingly, global inflation and the Great resignation can be seen as opposite power processes.

Inflation is associated with an increase in the pass-through or pricing power of corporate capital, whereas a tight labor market is associated with the strengthening of workers' bargaining power. Specifically, higher inflation increases the degree to which corporate capital passes through rising production costs directly to consumers, in the form of higher prices for goods and services, and indirectly to workers, in the form of lower real wages. On the opposite side, a tighter labor market indicates a greater number of available jobs and a lower unemployment rate, so workers have a higher bargaining power to obtain concessions from corporate capital. Taking into account the fact that the majority of voluntary quitters in the current US economic setting are less-educated and low-paid workers, as well as the fact that these workers are most affected by the redistributive effects of inflation, it is reasonable to argue that inflation might weaken the bargaining position of voluntary quitters, thereby contributing more to the slack than to the tight labor market.

Conclusions

The stylized facts presented in this paper suggest that the current economic situation in the United States hardly fits into a neoclassical description of the labor market and inflation. The observed composition of job-to-job mobility flows, dominated by less educated, low-paid workers employed in industries with rising wages, is not consistent with the predictions of neoclassical theory, especially with the rational expectations model. Also, there is suggestive evidence that the ongoing inflationary episode in the United States is primarily caused by soaring commodity prices and imported inflation rather than by wage inflation, making the conventional anti-inflationary policy based on the natural rate of unemployment concept questionable in terms of distributive fairness and an inclusive labor market recovery.

Taking these limitations into account, we argue that the Post Keynesian theory of conflict inflation provides a useful alternative framework for understanding the complex interplay between global inflation and the Great resignation. In this context, high inflation and a tight labor market might be seen as opposite power processes, implying a potential trade-off between inflation and work resignation. Such a view is backed by data indicating that the comparatively highest costs of inflation, as well as an anti-inflationary program, would be borne by the most vulnerable groups of workers, which in turn is likely to lead to a reduction in their job-to-job mobility as one of the defining characteristics of the Great resignation.

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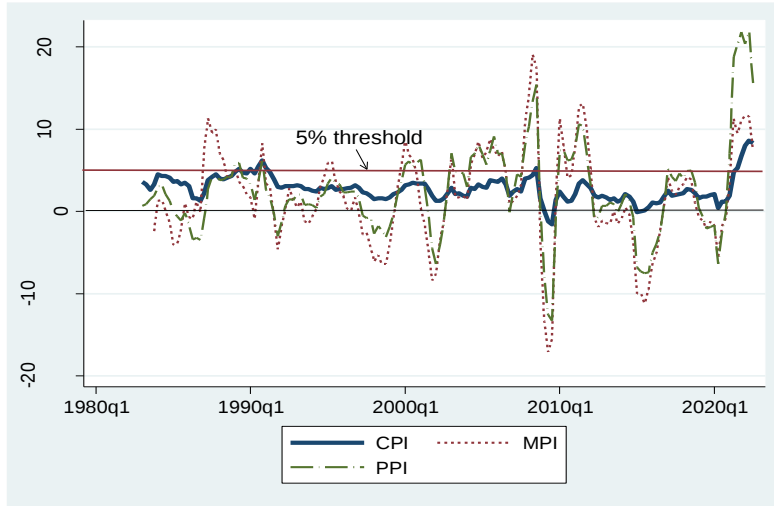
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Figure 1 Consumer, Producer and Imported inflation in the USA, 1983q1-2022q2, Percent Change to a Year Ago



Source: Illustrated by the authors based on the BLS data (2022).

Figure 2: Quit Rate and Labor Market Tightness, USA, 2000Q4-2022Q3.

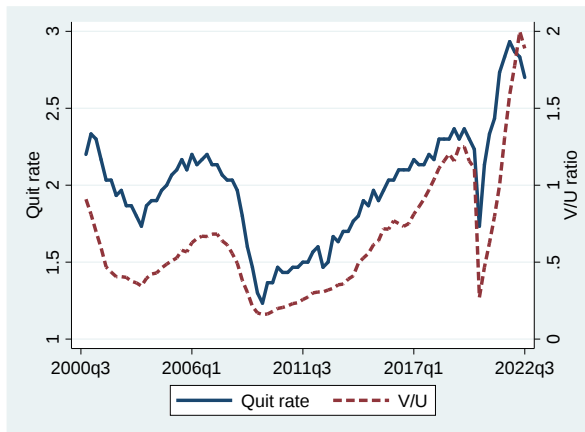
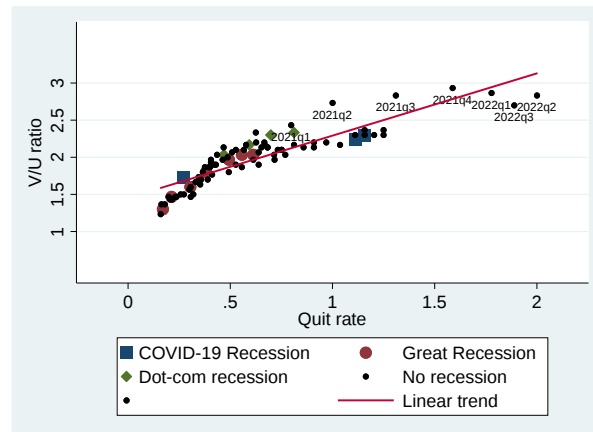


Figure 3: Relationship Between Quit Rate and Labor Market Tightness, USA, 2000Q4-2022Q3



Source: Author's calculations based on BLS data (2022).