Corporate Power and The Return of Inflation

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Abstract: The origin of the current inflation stemmed from the disruptions caused by the Covid-19 induced recession, the subsequent efforts to mitigate those disruptions, and the exercise of corporate power. First, the paper addresses the mainstream views of inflation, all of which ignore corporate power. Second, the paper considers the concept of administered prices developed by Gardiner Means. Third, the paper examines the empirical data, finding that the profit share of domestic income is at its highest since 1929. The fourth section considers the policy of countering inflation by raising interest rates, the threat of recession, and the reallocation of claims to the "functionless investor."

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The origin of the current inflation stemmed from the disruptions caused by the Covid-19 induced recession, the subsequent efforts to mitigate those disruptions, and the exercise of corporate power. Covid-19 disrupted supply chains and prompted governments to shutter businesses. Unemployment increased to over ten percent, prompting many workers to leave the labor force. The decrease in income, declining labor force, and rising unemployment impeded the ability of many Americans to buy food, pay rent, and meet obligations. Both supply-chain disruptions and higher nominal wages, enacted to attract workers, increased business costs, exacerbated by higher energy prices. The higher costs provided corporations an opportunity to exercise their power to increase markups, further increasing prices.

In May of 2022, inflation increased to 9.8%, the largest increase since 1981. The increase in government spending, supported by the Federal Reserve's (Fed) renewed purchases of US Treasury Securities and mortgaged-backed assets, represented an effort to protect human beings from the market forces instigated by the pandemic. From February 24, 2020 to June 8, 2020 the Fed's assets increased from $4.159 trillion to $7.169 trillion. In April of 2020, the Treasury provided people with cash payments, subsidized firms to maintain employment, and supplied funds to states to help them meet their obligations. The programs include the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), the Payment Protection Program, and various facilities created by the Fed (See Watkins 2021). The American Rescue Plan totaled $1.9 trillion, providing households $1400 per person, tax credits for children, and supplemental income for the unemployed. Despite the pandemic, estimates of the number of people below the poverty level barely changed, increasing from 37,548,000 to 37,933,000 . Hyman Minsky had warned that efforts to avert debt deflations could, in fact, precipitate inflation later.

> When lender of last resort refinancings and the massive government deficits abort debt deflations and sustain profits, they also sustain, with a lag, the ability to finance spending at higher prices. The inflationary impact of investment is augmented by the inflationary consequences of government intervention. The financial and profit repercussions of government interventions to prevent deep depressions override the limitations on inflation caused by the inelasticity of finance and by the uncertainty, with respect to validating profits, that constrain private investment. (1986, 270)

Increases in government deficits supplemented income, enabling people to spend at levels they could not have otherwise. Supply-chain disruptions represent an enforced sabotage, raising costs.

Higher costs, combined with increased spending, provided corporations the opportunity to increase profits, prompting business to increase prices.

The paper proceeds as follows. The first section reviews the mainstream hypotheses regarding inflation, namely, the quantity theory of money, the augmented-expectations hypothesis, and excessive demand. Notably, the mainstream hypotheses omit discussions of corporate power. The second section reviews the concept of administered inflation going back to Gardiner Means. The third section examines the empirical data indicating an increase in profits, attributable to corporate power. The fourth section critiques the usual prescription to cure inflation, namely, increase interest rates, adversely affecting debtors, small businesses, the working poor, and export-producing industries.

Mainstream Views of Inflation

The current inflation reminds us that the causes of inflation are situational, differing for different times. The situational nature of inflation reveals itself in the obsolescence of long-held theories. In the past, the mainstream view promulgated the quantity theory of money, attributing inflation to increases in the money supply. Instability in velocity over the past years, however, has undermined the presumed correlation between money-supply increases and increases in the price level, at least at modest levels of money supply increases.

The augmented-expectations hypothesis, proposed by Milton Friedman, incorporated the quantity theory of money as the cause of inflation. Friedman modified the traditional Phillips curve asserting that a certain level of unemployment is natural, attributing the tradeoff between unemployment and inflation to erroneous expectations. Efforts to reduce unemployment below its natural rate require higher inflation. Unemployment falls because inflation reduces real wages, leading businesses to hire more workers. Workers, suffering from money illusion, are unaware that increases in inflation have reduced their real wages. In the long run, workers, learning from their mistakes, form realistic expectations regarding inflation, demanding higher wages, causing unemployment to return to its "natural rate."

During the 1990s and 2000s, unemployment fell below the so-called natural rate without causing inflation, breaking the tradeoff between inflation and unemployment. The absence of a tradeoff suggests that the natural rate is a ruse, an enabling myth justifying ignoring the problem of unemployment by economists and policy makers. Further, attributing the tradeoff to erroneous expectations overemphasizes the power of workers to demand higher wages and ignores the power of corporations to raise prices.

A more recent explanation proposed by Lawrence Summers (2022) attributes the current inflation to excessive demand, the result of active fiscal policy. "Excessive stimulus driven by political considerations was a consequential policy error that would be tragically compounded if valid concerns about the economy overheating prevented Congress from making the types of necessary public investments that are the focus of President Biden's Jobs and Families Plans." No one, however, anticipated the quickness of the economic recovery. As the *Economic Report of the President* noted, "The U.S. economy ended 2021 3.1 percent larger in inflation-adjusted terms than its pracademic level, the fastest recovery among Group of Seven nations" (Council of Economic Advisers 2022, 51-53). Randall Wray and Yeva Nersisyan reject Summers' emphasis on demand. "We will argue that aggregate demand has played a relatively minor role in generating inflation pressure. Instead, most of the pressure has come on the supply side: supply chain disruptions, labor market disruptions, and corporations exercising pricing power." (2022, 3).

Administered Inflation: A Manifestation of Corporate Power

In the modern economy, power resides with the corporation. In Wallace Peterson's words, "the modern corporation remains the foremost example in our day of resort to organization as a means to escape [what John Kenneth Galbraith called] the "tyranny of the market"" (1989, 381). Corporations exercise power in a number of ways: economic sabotage; increasing sales through advertising, branding, and providing consumers credit; influencing the political process; and what Gardiner Means called administered prices.

Means developed the hypothesis of administered prices in the 1930s, defining administered price "as a price set for a period of time and a series of transactions" (1972, 292). As Gladys Foster emphasized, administered prices "must be clearly identified not as a market phenomenon but as a phenomenon of economic power" (1991, 156). Power is "the possibility of imposing one's will upon the behavior of other persons" (Weber 1954, 323). Power involves domination. If the competitive-equilibrium price represents the modern form of the "just price"--efficiency made synonymous with justice--the administered price represents the "unjust price," the price designated to exact more profit. "The power that bigness and organization confers upon the corporation is the power to administer prices, to set prices more or less independently of the conditions in the market in which it operates" (Peterson 1989, 384).

Means developed the hypothesis to help explain the Great Depression. Administered prices prevent the employment of the available resources. During recessions, production declines more than administered prices fall. Conversely, during booms prices rise slower than production expands. "An administered price was defined as a price set for a period of time and a series of transactions" (Means 1972, 292). Means also used the hypothesis to explain inflation despite the existence of unemployment.

Administered prices are more likely where industries are concentrated, raising the possibility of inflation. As Means noted, administrative inflation "can occur whether employment is full or less than full and can occur in a period of recession, in a period of stagnation, or in one of recovery. It can appears, as well, during a period when prices are also rising as a result of excessive demand" (Means 1975, 11). Means identified the period from 1953 to 1958 as an example of administrative inflation. Means continues:

> Administrative inflation appears to be endemic under the conditions of modern industry. It occurs in periods of full employment when there is no excess in aggregate demand. It occurs when there is excessive unemployment. And it even occurred in the recession of 1969-70 when administered prices rose, while those prices subject to market forces and the level of employment both dropped. (Means 1975, 12)

The concept of administered prices is a point of agreement between institutional and post-Keynesian economists. As Joan Robinson noted, "One of the most important insights of the Keynesian revolution was a proposition that now seem obvious, that the general level of prices in an industrial economy is determined by the general level of costs." With cost-push inflation of the 1970s in the background, Robinson asserted "that the main influence upon costs is to be found in the relation between money-wage rates and output per unit of employment" (Robinson 1979, xix).

The administered price can be stated as follows: administered Price = (1 + markup)*((Nominal Wages/Average Product of labor) + Resource Cost/Quantity + interest on corporate debt*fixed costs/Quantity). The increase in money wages, supply-chain disruptions imposing a form of economic sabotage, and higher resource costs offered businesses, with market power, an opportunity to increase markups. Given the current weakened power of labor relative to business a wage-price spiral seems unlikely, implying that the current inflation is not cost-push.

The rise in inflation to 9.8% in March of 2022 was unexpected. For the past number of years, corporate profits have been at an all-time high. Corporate profits fell in 2008-2009 during the Great Financial Crisis (GFC) only to recover. By 2013, corporate profits had recovered to their pre-GFC level, only to decline in the following years, achieving a relative low with the Covid-19 pandemic. Despite the increase in transportation costs, supply-chain issues, and labor shortages, corporate profits as a percentage of national income increased to their highest level since 1929.

The Empirical Data

Supply-chain disruption, rising energy prices, and the increase in nominal wages increased business costs. Corporations responded by passing those costs onto consumers. The higher costs, however, also offered corporations an opportunity to increase markups, more likely where industries are concentrated. Erdogan Bakir, Megan Hays, and Janet Knoedler (2021) found that the decline in labor's share stemmed from increased concentration, a view supported by David Autor et al (Autor et al. 2020).

Obtaining cost data for individual firms is difficult. Nevertheless, the Bureau of Economic Analysis provides data on profit per unit of real gross value added of nonfinancial corporations. As Figure 1 indicates, from 1947 to 1980 profit per unit varied between .06 in 1947 to .142 in 1978. Since 1980, profit per unit has increased, declining during the recessions of 2001 and 2008 only to rebound. From 2020 to 2021, profit per unit increased by 20%, from .494 in 2020 to .603 in 2021.

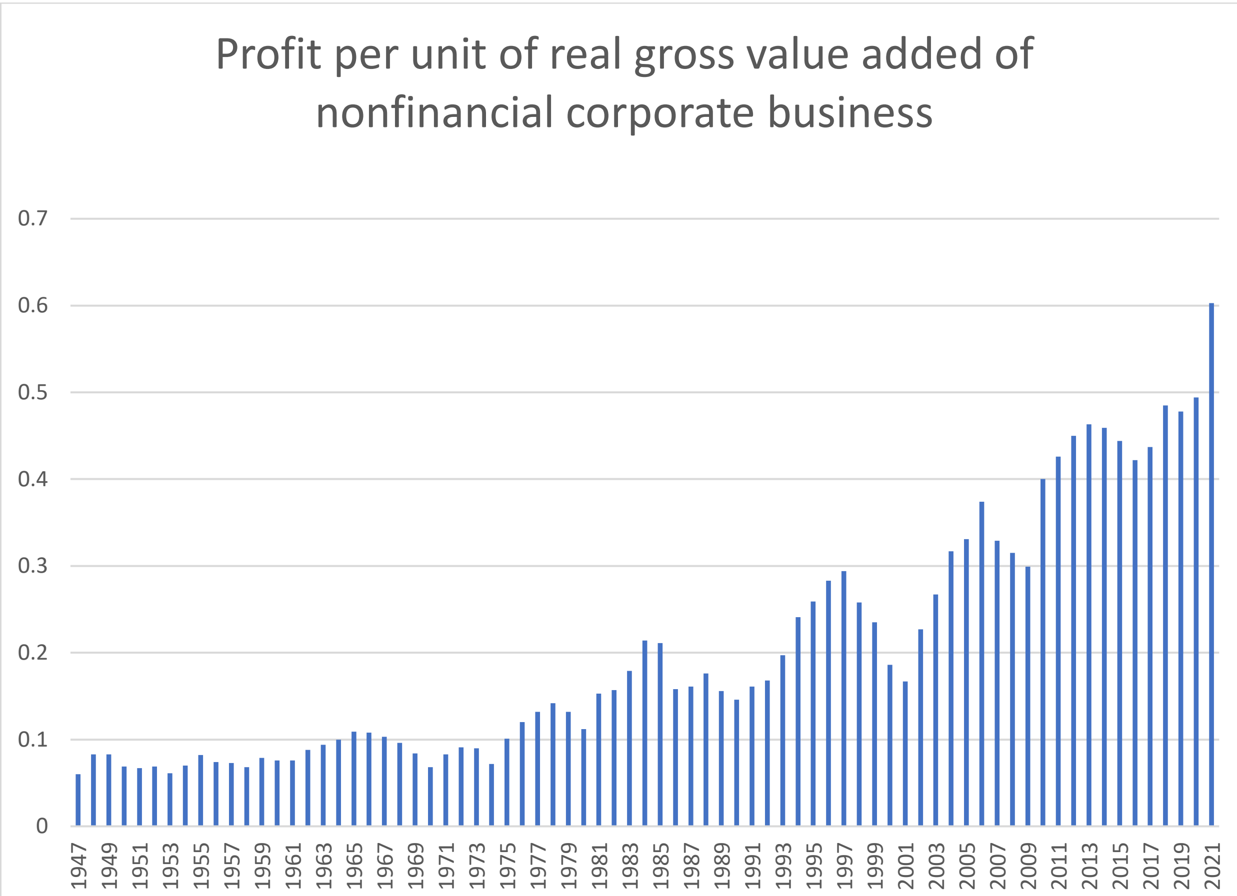

Figure 1: Profit per unit of real gross value added of nonfinancial corporate business

Source: Federal Reserve Economic Data

Increased profitability is reflected in the corporate share of national income. As Figure 2 indicates, the share of gross national income rebounded from its recent low in 2008, hovering around seven percent. In 2021, however, the share increased from 7.2% in 2020 to 8.4% in 2021. One must go back to 1929 to find the corporate share higher. Given the increases in productivity over the past 40 years, combined with stagnant wages, implies that that corporations have capture those increases, again reflected in the data.

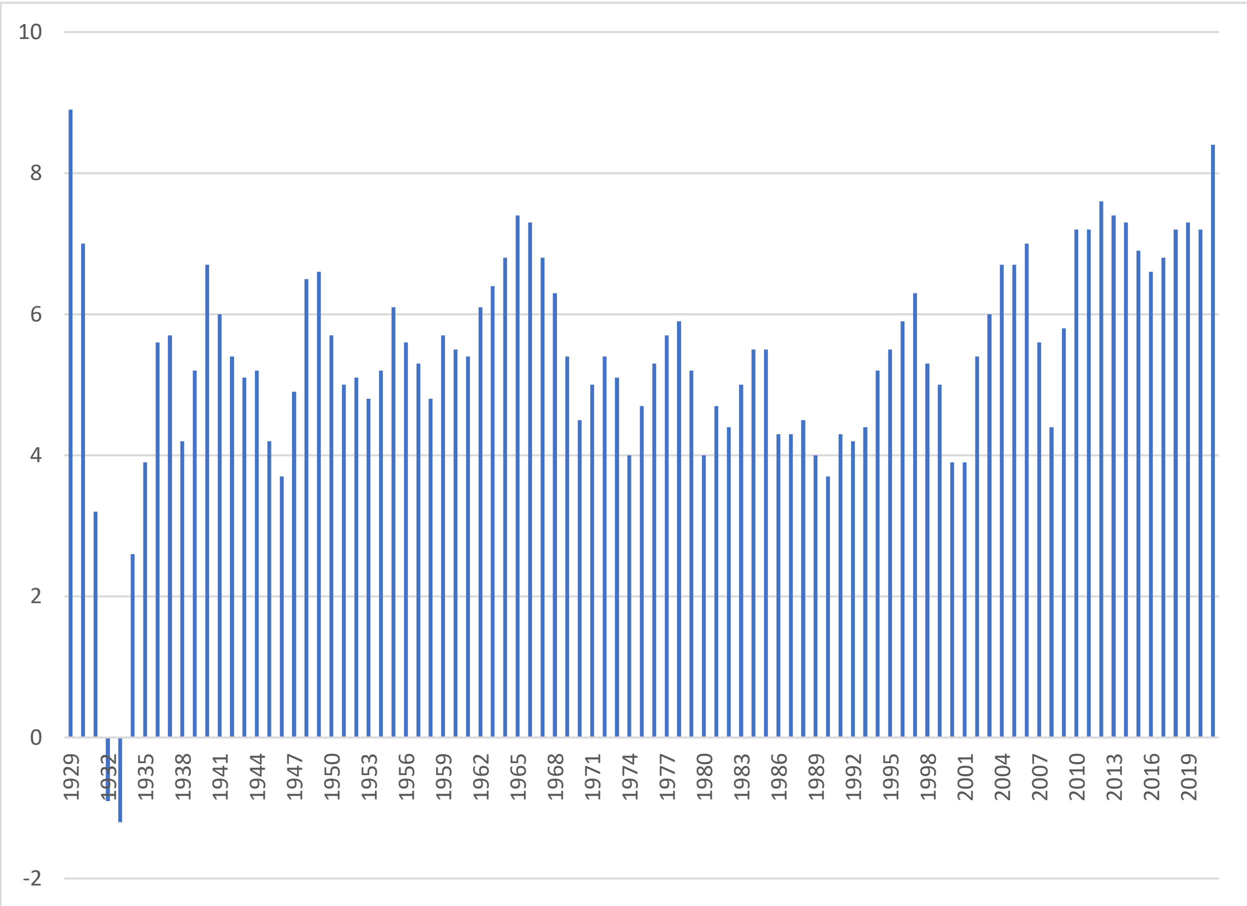

Figure 2: Shares of gross domestic income: Corporate profits after tax with inventory valuation and capital consumption adjustments, domestic industries.

Source: Federal Reserve Economic Data

As Figure 3 indicates, percent changes in productivity have outpaced the percent changes in real compensation. Notable exceptions are 2015 and particularly in 2020 when compensation outpaced productivity. Nevertheless, the decline in productivity in 2021 suggests that the increased profitability resulted from increased prices.

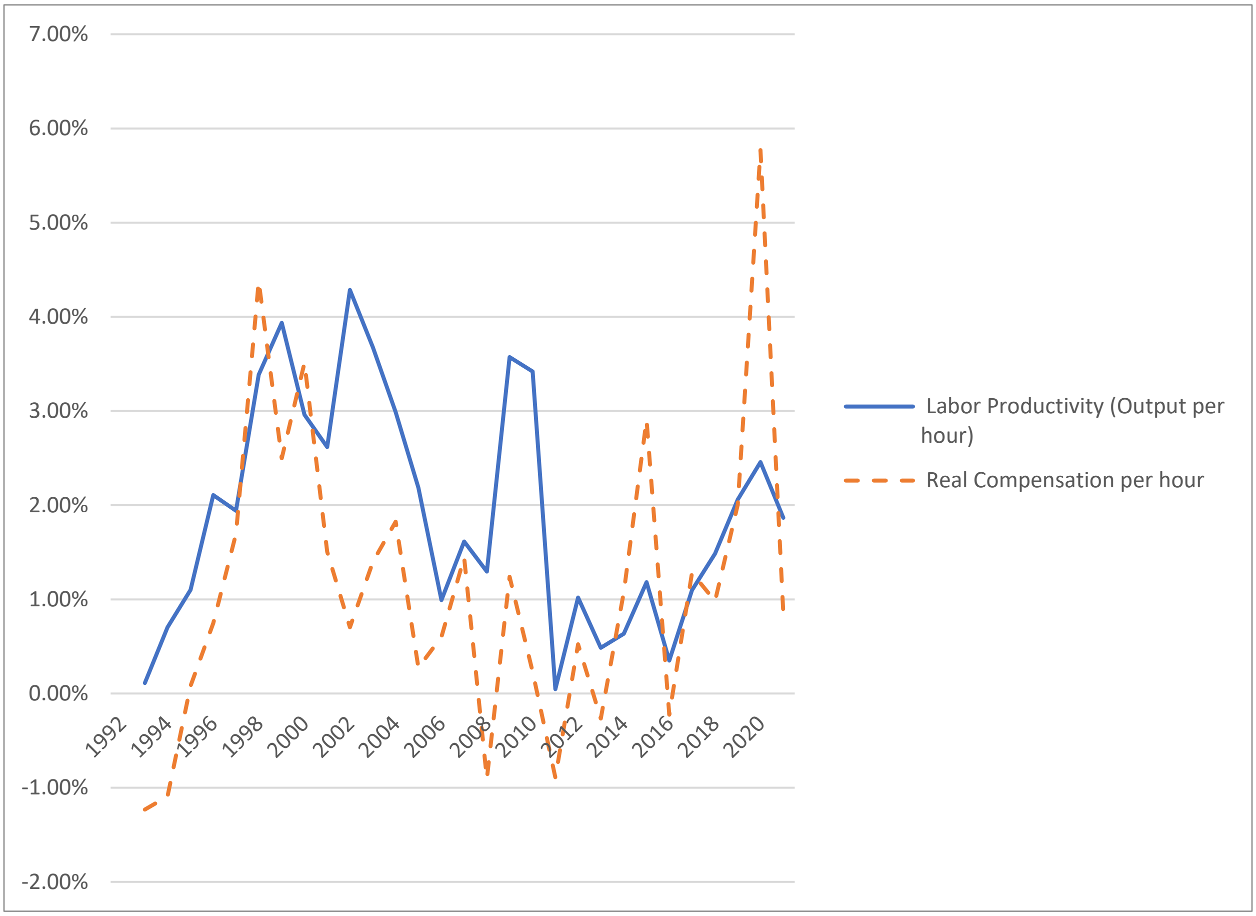

Figure 3: Percent Change in Labor Productivity and Real Compensation

Source: Federal Reserve Economic Data

Policies to Address Price-administered Inflation

To counter inflationary pressures the Fed typically increases the Federal Funds Rate, increasing interest rates generally. Since 2008 the Fed paid interest on reserve balances, giving the Fed another tool. The policy of increasing interest rates is consistent with the augmented-expectations model: increase unemployment to reduce inflation. As Minsky noted, raising interest rates helped precipitate the credit crunch of 1966, and the recessions of 1970, 1974-75, 1979-80, and 1982-83 (See Minsky 1986, 18). "Clearly, in the financial environment that has ruled since 1966, traditional monetary restraint efforts by the Federal Reserve lead to threatened financial breakdowns as well as unemployment and loss of output" (Minsky 1986, 18). Higher interest rates reduce investment and consumer spending, raising the danger of precipitating a recession. Higher interest payment increases financial fragility, increasing the possibility of financial crises.

Obviously, inflation harms those whose incomes rise less than the rate of inflation. Despite the recent wage increases, prices have increased faster, reducing real wages. Ideally, the policy response would address the underlying causes. As noted, those causes include the increase in fossil-fuel prices, the increase in money wages, increased costs owing to supply-chain issues, and increases in markups. Inflation Reduction Act subsidizes renewable energy sources, designed to mitigate energy-price increases. Higher costs associated with supply chain disruptions, although declining, will likely continue for two reasons. First, China's policy of imposing lockdowns in response to Covid outbreaks. And second, efforts to return manufacturing to the United States.

Insofar as inflation results from increasing administered prices, two policies present themselves. First, an incomes policy involves capping prices and wages. President Nixon imposed involuntary wage and price controls, with moderate success. President Carter flirted with wage and price controls, making them voluntary. An incomes policy, however, seems unworkable and politically unpopular. Second, taxing profits seems more workable. In 1971, Henry Wallich and Sidney Weintraub "proposed to levy a surcharge on the corporate profits tax for firms granting wage increases in excess of some guidepost figure" (1971, 2). Something similar could be enacted based on the profit per unit of real gross value added. Doubtless, some would argue that such a policy penalizes profitable firms. Moreover, vested interests would oppose raising taxes on corporations. Still, the current policy of penalizing the working poor to cure inflation seems unjust.

The argument in favor of using fiscal policy stems from averting the damage resulting from higher interest rates. First, as noted, raising interest rates increases unemployment, increases financial fragility, and reduces output. And second, raising interest rates increases interest income, transferring funds from debtors to creditors, from taxpayers to holders of U.S. government securities. Raising interest rates rewards the "functionless investor," justified by the argument that we must reallocate claims from corporations to creditors, offering debt holders "something for nothing." During the pandemic, increases in government deficits helped protect people. Corporations, wielding their power, benefited then and now from those efforts, manifesting itself in higher prices.

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