

Profit Inflation and Markups Once Again

By Marc Lavoie

In its latest announcement of an interest rate hike, [the Bank of Canada said](#) that it “will be evaluating whether the evolution of excess demand, inflation expectations, wage growth, and corporate pricing behavior are consistent with achieving the inflation target.” The Bank of Canada thus joins the European Central Bank and several economists, both heterodox and mainstream, in worrying about the presence of profit inflation.

As my friend [Servaas Storm recalls in his paper](#), the purpose of [my blog](#) was to bring some clarity to the debate about profit inflation by noting that a rise in the profit share could be caused by an increase in the cost of intermediate goods (at the firm level) and by an increase in the cost of imported commodities (at the national account level), despite constant markups. My second point, which is not picked up by Servaas Storm, is that independently of the first point, a short-term increase in the rate of economic activity is likely to raise the profit share in national income, due to the presence of overhead labor, again with a constant markup. My main point, again as reported by Servaas Storm, was to argue that an increase in profits or in the profit share could not demonstrate that there was price gouging and that one had to look instead at the evolution of markups.

My blog contained no empirical evidence whatsoever, except for a reference indicating the existence of a historically negative relationship between the relative price of materials and the labor share. The blog was only 1450-word long and so my sentence, “in general, the rise in profits and the profit share can be explained without resorting to an explanation based on firms taking advantage of the situation and raising markup rates,” might be understood as an empirical claim that markups did not rise recently, despite the fact that I also added that “one can certainly acknowledge that some industries such as the oil industry have benefitted from higher profit margins,” since the prices of their products are determined by demand on world markets, and not by unit costs. By contrast, the article of Servaas Storm exceeds 5,500 words and provides some needed evidence about the evolution of markups, both for the USA and elsewhere – a welcome development.

Storm makes the interesting point, also made [by Nikiforos and Grothe](#), that the increase in the price of commodity inputs need not lead to a rise in the share of profit if firms are unable to sustain the level of their markups. This is likely to happen in particular if there is enough resistance by workers, as was the case in the 1970s. Obviously, labor and trade unions were more powerful then; I can attest to it, as I recall that in those years air travel was full of uncertainty, as one would never know for sure whether takeoff or luggage delivery would be cancelled by a strike. Hence, indeed, one could argue that constant markups in times of input cost inflation is a sign of strong corporate power. [Guillermo](#)

[Matamoros makes a similar point](#), arguing that the sharp increase in oil prices in the early 2000s did not generate the kind of inflation we now face.

This being conceded, my main interrogation is with regards to the empirical evidence concerning the evolution of markups for American private industries, as they are to be found in Storm's Table 1 and Figure 4, and extended to Figures 5, 6, and 7. What I find puzzling is that the starting period to measure the evolution of markups is the second quarter of 2020, when all hell broke loose. If one starts from the third quarter of 2020 and considers that the fourth quarter of 2022 might be an outlier, one could argue that there has been no increase to speak of in the calculated markup. Between these two time periods, the curve of Figure 4 is nearly flat. It seems rather unfair to start from the second quarter of 2020 to assess a change in corporate behavior.

If I can judge by the evolution of the Canadian economy, which I know best and which is probably not that much different from that of the US economy, the second quarter of 2020 is a bad quarter to start making comparisons. The industrial rate of capacity utilization was 71.2% in that quarter whereas it is now almost at 82% and standing around 80% in normal times. The table below shows the evolution of three variables starting instead from the fourth quarter of 2019, with 100 being the 2012 base year.

	2019Q4	2020Q1	2020Q2	2020Q3	2023Q1
Real GDP	116.4	113.2	98.0	108.7	118.7
Labour productivity	107.9	112.8	127.3	114.6	106.4
Labour share	101.0	103.2	109.9	103.9	101.8

Source: Statistics Canada, Indexes of business sector, Table 36-10-0206-01

We can see that real GDP has barely recovered its pre-pandemic level. Labor productivity, which exploded in the second quarter of 2020, is now back to where it was in 2019, a rather dismal state of affairs, as also noted [by Steve Pressman](#) and [Brett Fiebiger](#) for their respective countries. The labor share is now about equal to its level before the pandemic, while its value during the second quarter of 2020 was surprisingly high, as I claimed in my previous blog. Hence any measure of the increase in markups that starts in the second quarter of 2020 is, in my opinion, likely to be misleading. It seems to me that it would make more sense to compare the most recent quarters to the quarters preceding the pandemic, and not to the second quarter of 2020 which showed all kinds of anomalies that will haunt empirical work for years to come!

It may well be that a revised measure of markups will continue to show that they have risen. But even if this is the case, it could be the result of a change in the composition of output (towards more powerful corporations that have survived the pandemic) or in the composition of demand (towards more luxury goods with higher markups). Assuming that [Thomas Ferguson](#) and [Servaas Storm](#) are correct in claiming that the richest 10% of households “have powered the recovery of aggregate US consumption expenditure,” this line of reasoning can be extended by asserting that these rich households are likely to

have indulged in purchasing luxury goods that carry a higher profit margin than that of necessary goods. As anecdotal evidence of this, one only needs to look at the kind of cars that are now available in North America, with small cars being nowhere to be seen, while large luxury SUVs fill the parking lots of car dealers.

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