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Profit-Price Spiral:
The Truth Behind Australia's Inflation

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23 February 2023

Introduction and Summary

Workers in Australia have suffered considerable economic losses as a result of accelerating inflation since the onset of the COVID pandemic. Reaching a year-over-year rate of 7.8% by end-2022, inflation has rapidly eroded the real purchasing power of workers' incomes; average wages are currently growing at less than half the pace of prices. Now, severe monetary tightening by the Reserve Bank of Australia (through higher interest rates) is imposing additional pain on millions of workers. Tens of billions of dollars of household disposable income are being diverted away from consumer spending, into extra interest payments made to banks and other lenders. Most ominously, signs of macroeconomic slowdown from higher interest rates portend job losses and even greater income losses in the month ahead.

The pain experienced by workers through this inflationary episode contrasts sharply with an unprecedented upsurge in business profitability at the same time. Additional profits resulted from businesses increasing prices for the goods and services they sell, above and beyond incremental expenses for their own purchases of inputs and supplies. This dramatic expansion of business profits (taking gross corporate profits to almost 30% of national GDP, the highest in history) has been mostly unremarked on by the RBA and other macroeconomic policy-makers. They have focused instead on the supposed risk of a 'wage-price' spiral. However, new empirical evidence confirms the dominant role of business profits in driving higher prices in Australia – not wages. This suggests the focus of monetary policy on wage restraint is misplaced and unfair.

Major findings of this analysis include:

- As of the September quarter of 2022 (most recent data available), Australian businesses had increased prices by a total of $160 billion per year over and above their higher

expenses for labour, taxes, and other inputs, and over and above new profits generated by growth in real economic output.

- Without the inclusion of those excess profits in final prices for Australian-made goods and services, inflation since the pandemic would have been much slower than was experienced in practice: an annual average of 2.7% per year, barely half of the 5.2% annual average actually recorded since end-2019.
- That pace of inflation would have fallen within the RBA's target inflation band (equal to its 2.5% target plus-or-minus 0.5%). Even within the RBA's own policy rule, therefore, current painful interest rate hikes would be unnecessary.
- A second scenario considered below allows for modest nominal inflation in unit profit margins, consistent with the RBA's 2.5% target – once again, above and beyond the costs of other inputs (including labour and taxes) and the growth of profits due to expanded real output. Even in this scenario, inflation would have averaged just 3.3% since the pandemic, only slightly above the target band, and current harsh interest rate changes would again have been unnecessary.
- Analysis of the income flows associated with excess inflation since end-2019 confirm the dominance of corporate profits in the acceleration of inflation since the pandemic. Excess corporate profits account for 69% of additional inflation beyond the RBA's target. Rising unit labour costs account for just 18% of that inflation.
- The distributional dimensions of post-COVID inflation (falling real wages, falling labour share of GDP, and record corporate profits) are completely opposite from the experience of the 1970s (when real wages rose, the labour share of GDP increased, and corporate profit margins fell). This historical comparison confirms that fears of a 1970s-style 'wage price spiral' are not justified. Instead, inflation in Australia since the pandemic clearly reflects a profit-price dynamic.

Distributional Trends During the COVID-19 Pandemic

An initial perspective on the distributional impacts of recent inflation in Australia can be attained analysing changes in income shares in the period since the COVID-19 pandemic began in early 2020. ABS national accounts data disaggregate factor income flows in the economy into several major components:

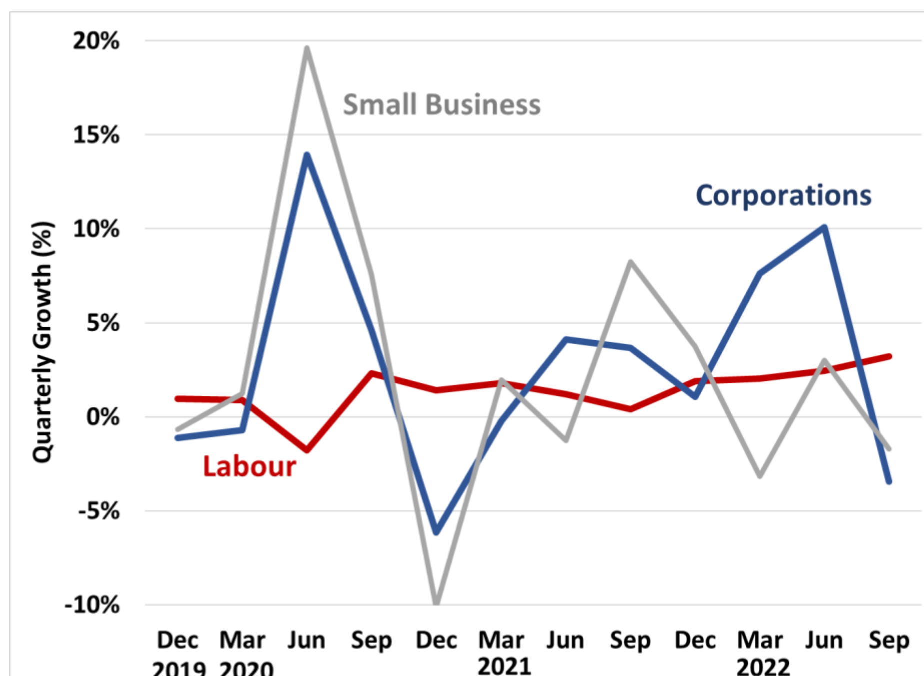
- Labour compensation (including superannuation contributions by employers)
- Gross corporate surplus (after basic operating costs, before deducting depreciation and income tax)
- Gross profits of unincorporated small businesses (called mixed income)
- Indirect taxes less subsidies (reflecting the impact of the GST on production costs, net of subsidies paid by government to enterprises)
- A range of other, smaller factor income flows (including gross operating surpluses of government-owned enterprises, an income flow ascribed to the economic surplus arising from home ownership, and a statistical discrepancy).

The COVID pandemic and policy responses to it produced unprecedented volatility in these factor flows, experienced in several distinct stages:

- Initial COVID lockdowns produced a decline in production and income, experienced by all factors.
- Government assistance to enterprises implemented during the lockdowns (most important being the JobKeeper wage subsidy, providing employers with over $100 billion in assistance from April 2020 through March 2021) supplemented profit incomes for both corporations and small businesses.[1]
- The uneven reopening of production and trade after the lockdowns was associated with major swings in prices (and hence factor incomes) for many crucial products.
- As the global and national economies reached fuller utilisation in 2021 and 2022, most countries (including Australia) experienced an acceleration of more general inflation, which had further impacts on factor incomes and aggregate income distribution.

Figure 1 illustrates the ups and downs of incomes for the three most important factors of production in Australia: labour, corporations, and small business. The figure portrays quarterly changes in nominal factor incomes since the December quarter of 2019 (just before the onset of the pandemic). ABS data is available up to the September quarter of 2022.

Figure 1. Quarterly Changes in Nominal Factor Incomes, Dec.2019 to Sept.2022



[11] Other government programs also delivered assistance to individuals affected by the disruption of work and production during the lockdowns, such as the Coronavirus Supplement top-up to JobSeeker benefits. However, those payments to individuals are treated as transfer payments to individuals, not factor incomes, and hence do not appear directly in GDP statistics.

Source: Author's calculations from ABS National Income Accounts.

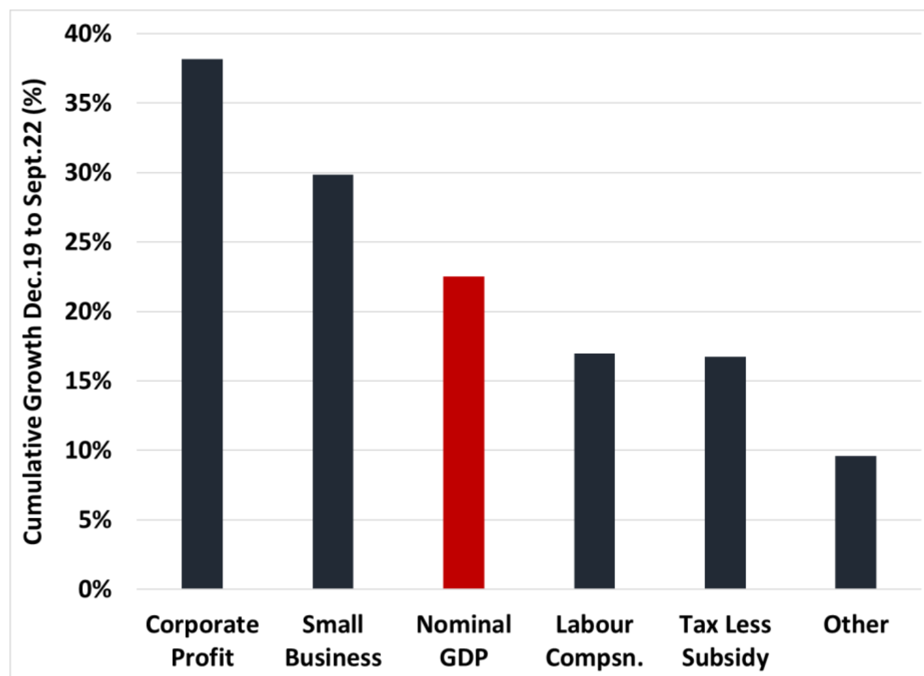
The pandemic initially resulted in an unprecedented decline in output and employment, as many industries were closed for public health orders. This caused a decline in total labour compensation (offset, for many affected individuals, by expanded JobSeeker benefits which are not captured in Figure 1). In contrast, gross operating surpluses for both corporations and small businesses expanded dramatically during the June quarter of 2020, thanks mostly to massive JobKeeper wage subsidies. Labour compensation began to recover later in 2020 as workplaces reopened. Business profits declined at the end of 2020 with the phase-out of government subsidies – although the level of profits for both corporations and small business was still higher after the removal of subsidies than before their introduction.[2]

Beginning in early 2021, a more widespread inflation began to take hold, and it is clear from Figure 1 that increased corporate profits were the most dramatic manifestation of that inflation. From March 2021 through June 2022, corporate profits exploded by 29%. Small business incomes grew 11%, and labour income by just 8%. Record profits on petroleum and mining activities (reinforced by a spike in global oil and gas prices following the invasion of Ukraine) led this surge, but the overall corporate sector experienced the most rapid growth in profits of any comparable period in 35 years. Labour compensation picked up momentum more gradually, lifted by both growing employment and a modest acceleration of wage growth as 2022 progressed. In the September quarter of 2022, corporate profits receded modestly (by 3%) in the wake of a partial moderation in energy prices.

In sum, the last three years have seen unprecedented fluctuations in the nominal incomes received by the various stakeholders in economic activity. Lockdowns, emergency government payments, supply chain disruptions, and then more generalised inflation pressures have caused dramatic ups and downs in factor incomes. Through the whole course of the pandemic, however, it is very clear that business has main the largest beneficiary of these events. Figure 2 indicates the cumulative change in nominal incomes received various factors of production (blue bars), along with the corresponding increase in the aggregate value of nominal GDP in the same period (red bar).

[2] Corporate profits in the December quarter of 2020 were 11% higher than year-earlier levels, and small business profits were 17% higher.

Figure 2. Cumulative Change in Factor Incomes, Dec.2019 through Sep.2022



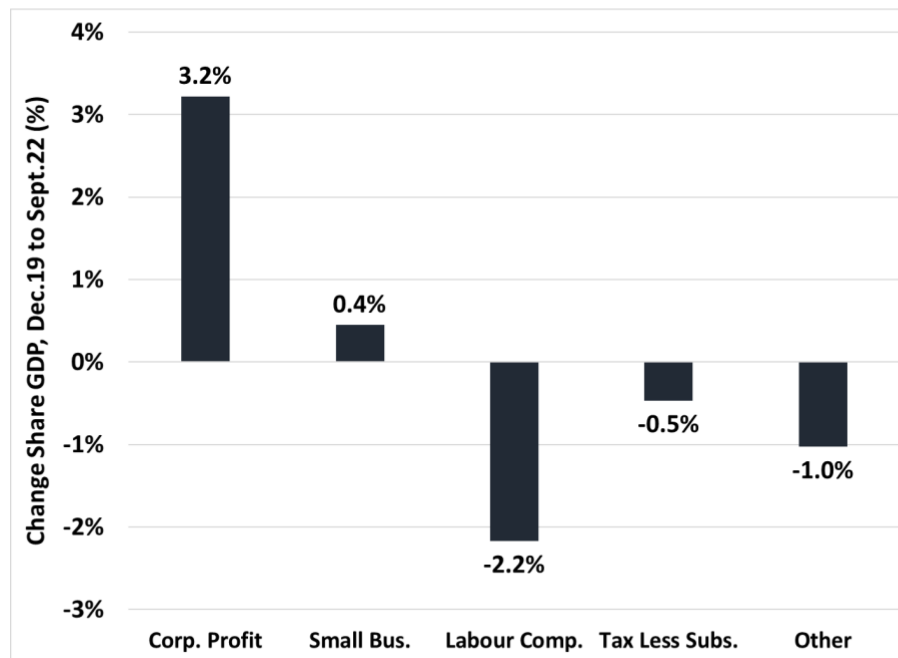
Source: Author's calculations from ABS National Income Accounts data.

By the September quarter of 2022, corporate gross operating surpluses had increased 38% since the quarter immediately preceding the pandemic (December 2019). That represents an average annualised rate of profit growth of 12.5% per year over this whole period. Almost three-quarters of that profit growth was registered since March 2021: after the major production disruptions of the first stage of the pandemic, and coincident with the take-off of inflation. Small business income has also grown impressively since the pandemic, by a cumulative 30%. Corporations and small business are the only factor income categories that saw nominal incomes grow faster than nominal GDP (which expanded 22.5% in the same period). Aggregate nominal labour compensation grew less than 17% over the same period (less than half the growth in profits); this reflects both higher employment and higher nominal wages. Indirect taxes net of subsidies grew at a similar pace: first falling rapidly (during the period of JobKeeper subsidies) and then rebounding to normal as those subsidies were phased out. Other factor incomes increased more modestly – by less than 10% over the entire period since December 2019.

Any factor which experienced factor income growth more rapid than the expansion of GDP enjoyed an expansion in its share of GDP. As indicated in Figure 3, only corporations and small businesses experienced a positive change. Through all the ups and downs of the pandemic, corporations increased their share of nominal incomes by over 3 percentage points. The increase in small business incomes was less dramatic (up 0.4 percentage points in this time): both because the rise in small business profits was less spectacular than for

corporations, and because the share of small business income in the overall economic pie is much smaller.[3]

Figure 3. Changes in Factor Income Shares Since Dec.2019



Source: Author's calculations from ABS National Income Accounts.

In contrast, workers have lost a significant share of national income through the dramatic events of the pandemic – including through the outbreak of profit-led inflation since early 2021. The share of labour compensation in total GDP declined by 2.2 percentage points from December 2019 through September 2022. The GDP shares of other factor incomes (including government enterprise profits and dwelling-owner surpluses) also declined, but more modestly.

This analysis of factor incomes confirms that the business sector, particularly corporations, has been the major net beneficiary of the disruptions and policy responses resulting from the COVID pandemic. Corporate profits have been especially vibrant since the acceleration of more generalised inflation since early 2021. The partial decline of global energy prices later in 2022 moderated those profits somewhat. But corporate profits remain far above historical norms. Labour compensation, in contrast, fell during the initial stages of the pandemic, and has been unable to keep up with inflation since. This analysis of factor incomes casts grave doubt on the myopic focus of the RBA and some economic commentators on the role of wage pressures in driving inflation.

[3] On average in the first three quarters of 2022, corporate gross profits equaled 29% of GDP, the highest in Australian history. Gross small business incomes equaled 8% of GDP.

Unit Production Costs and Inflation

Factor incomes can increase either because of expansion in the real economic activity undertaken by that factor, or because of inflation in overall prices (including the prices of production inputs). To consider the impact of changing factor incomes on inflation, it is necessary to distinguish those two sources of growth. A common method for doing so is to compute unit costs of various productive factors. After adjusting for changes in the quantity of real output, remaining changes in unit factor costs can serve as an indicator of upward pressure on final prices of output.

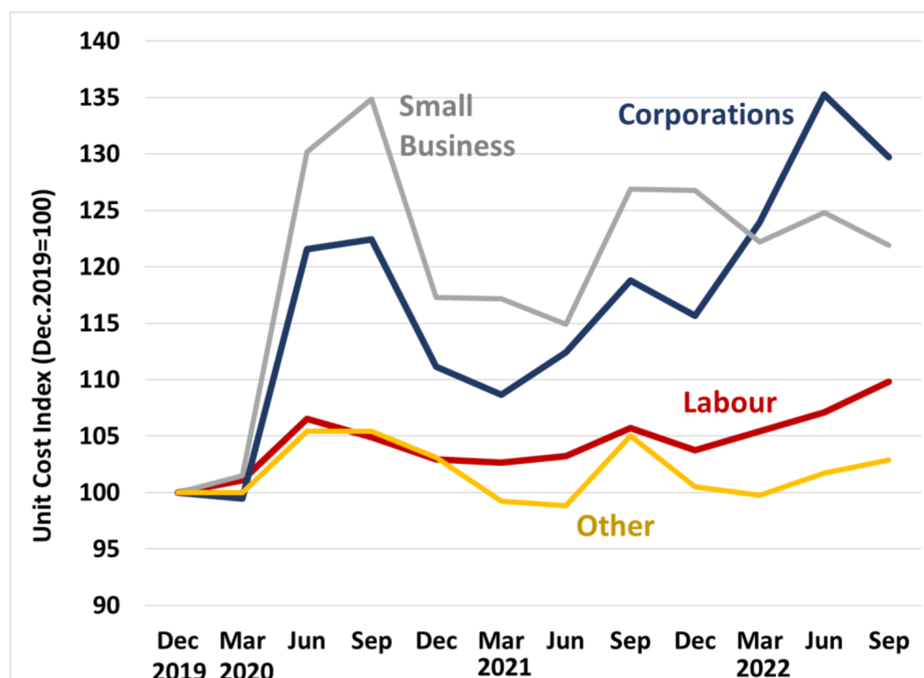
Analysis of unit costs is commonly reported for labour: the ABS regularly publishes various measures of unit labour costs, representing the cost of total labour compensation (including superannuation contributions) to firms for each unit of production. Unit labour costs are calculated and reported in both nominal and real terms (the latter adjusting for changes in the nominal price of output). Normally, if nominal unit labour costs are growing approximately as fast as target inflation (2.5% under current RBA policy), then labour costs have no inflationary impact, and labour's share of nominal GDP would be constant. Nominal wages can grow faster than this, since productivity growth reduces the impact of faster wage growth on final unit production costs. Measures of real unit labour cost are also adjusted for changes in the price of final output; constant real unit labour costs correspond to stability in labour's share of GDP. In the years leading up to the pandemic, nominal unit labour costs grew more slowly than target inflation, and real unit labour costs declined; this indicated that wages were growing more slowly than the combination of target inflation and labour productivity growth, and that labour's share of national GDP was already declining.

Unit costs for other factors (most notably unit profit costs) are not generally reported by the ABS, the RBA, or other economic agencies – but they should be. The long-term growth of business profit in Australia means the profit margin on production can no longer be considered a 'residual' in overall costs and pricing decision. On average in 2022, corporate gross profits equaled 64% of the total value of labour compensation. Including small business profits, that ratio exceeds 80%. In other words, for every dollar in labour compensation paid in the economy, the broader business sector collects over 80 cents. It is thus clearly inappropriate to exclude this large and growing flow of income from analysis of production costs and their impact on inflation over time, while putting sole focus on labour costs as a potential cause of inflation.

We can calculate indicators of unit costs for all the major factors of production noted above by adjusting the flow of nominal factor incomes for changes in real output.[4] These indicators are illustrated in Figure 4, with a base period (set to 100) established for the December quarter of 2019 (last full quarter prior to the COVID pandemic).

[4] This approach allows for comparability between the unit cost measures computed for each factor. The implied unit labour cost index computed via this method differs slightly from published ABS measures of unit labour cost, but the general trends are closely similar.

Figure 4. Unit Factor Cost Measures, Dec.2019 through Sept.2022

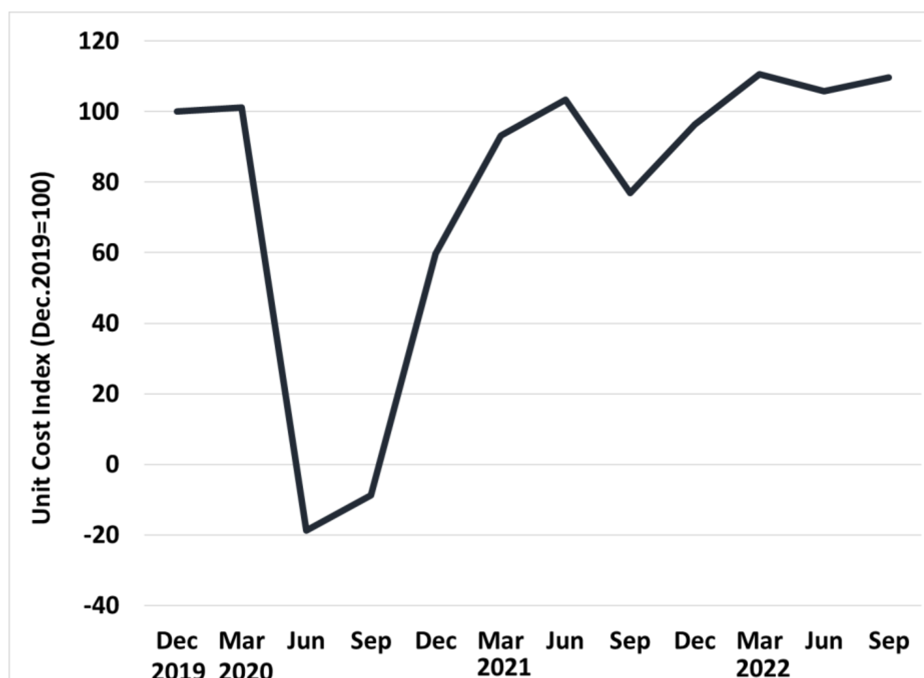


Source: Author's calculations from ABS National Accounts data.

After adjusting for the growth of real output since the pandemic (which increased 6.5% by September 2022 compared to end-2019), Figure 4 confirms that the surge in business profits has vastly outstripped the expansion of the real economy. In unit terms, measured per unit of real output, corporate profits were 30% higher as of the September 2022 quarter than before the pandemic started, less than three years earlier. Small business profits per unit of output were 22% higher. Unit labour costs were less than 10% higher. Unit costs of other factors (including government enterprise profits and dwelling-owner surplus) were just 3% higher.

A unique impact on unit costs and hence final price trends has been played by changes in government subsidies. They are portrayed separately, in Figure 5, due to the extreme scale of their changes. The massive JobKeeper and other business subsidies paid out during the early stages of the pandemic resulted in an overall net subsidy paid out by government for a few months (more than offsetting the value of GST collections). That contributed both to deflationary price trends in the early period of the pandemic, as well as to the initial surge in business profits (visible in Figures 1 and 4). The phase-out of those programs in late 2020 and early 2021 led to an equally dramatic increase in the unit value of indirect subsidies less taxes – and a corresponding restoration of nominal price levels. Since then, the impact of indirect taxes generally simply follows the overall pattern of nominal price increases (rather than causing them), since they are levied on a proportionate basis.

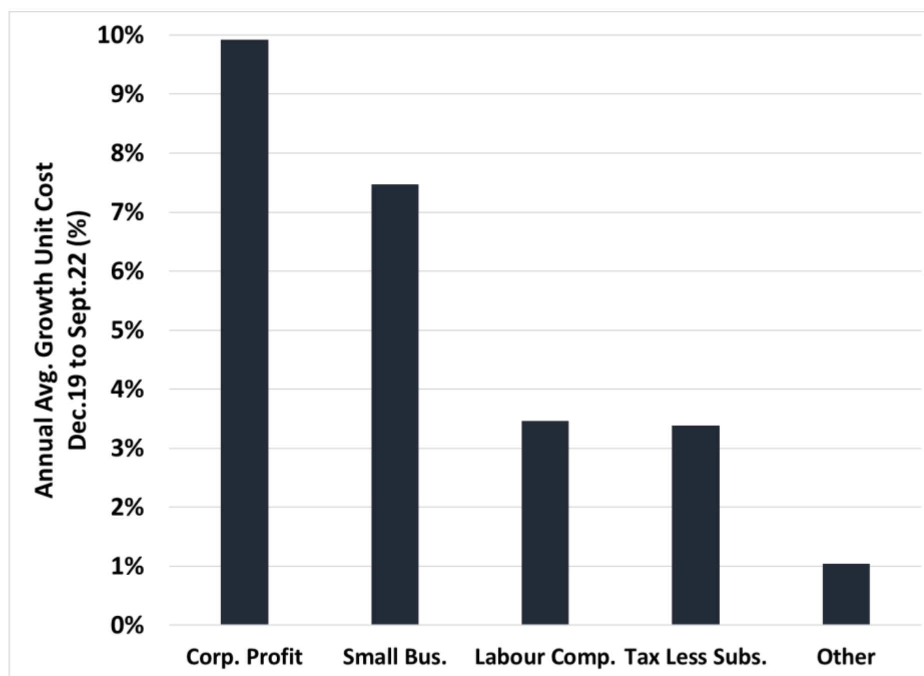
Figure 5. Unit Indirect Taxes Less Subsidies, Dec.2019 through Sept.2022



Source: Author's calculations from ABS National Accounts data.

The cumulative impact of these dramatic swings in unit costs associated with various factor inputs can be captured by computing the annualized growth rates of unit costs for each factor over the entire period of the pandemic. These are illustrated in Figure 6.

Figure 6. Annualized Growth Unit Factor Costs, Dec.2019 to Sept.2022



Source: Author's calculations from ABS National Accounts data.

Over the nearly three years since the start of the pandemic, the 'cost' of corporate gross profit per unit of real input increased at an average annual rate of 9.9% per year. This captures both the initial negative impact of production lockdowns, the temporary subsidies paid to businesses by government, and the subsequent acceleration of broader inflation (manifested mostly in higher profit margins). This increase in the unit burden associated with higher profit payouts was almost 4 times faster than the RBA's target rate of inflation. Higher unit profit payouts can be understood as both a cause and a consequence of rising prices during this period: companies were able to build much larger profit margins into their prices as a result of the conjuncture of circumstances (supply chain disruptions, consumer desperation, and global energy and price shocks) unleashed during the pandemic. Small business profits per unit of real output grew three times as quickly as target inflation over this period: at an average annual rate of 7.5%.

Other unit costs grew at a fraction of the pace of business profits. Nominal unit labour costs increased one-third as fast as unit profit costs, at an annual average rate of under 3.5% over the full period. The unit cost of government indirect taxes (net of subsidies) grew at about the same pace. The unit cost of other factor incomes increased just 1% per year over the full period. It is clear that the acceleration of inflation in Australia since early 2021 cannot be ascribed to cost pressures arising from labour compensation.

Excess Profits and the Take-Off of Inflation

A more complete and formal decomposition of Australian inflation into its factor price components can be conducted, with the use of ABS price deflator data. ABS deflators are calculated from quarterly national accounts data, and are thus compatible with the factor cost indices described above.[5] The economy-wide growth of nominal price levels is portrayed by the aggregate GDP price deflator. It differs from the more conventionally reported consumer price index (CPI) because it includes prices of other types of expenditure (including business investment, government services, and exports and imports). The trend in aggregate inflation as measured by the GDP deflator is similar to the general pattern exhibited by the CPI: initial deflation early in the pandemic, reversed as the economy re-opened, and then acceleration in prices beginning in early 2021 continuing through 2022. As of September 2022 (most recent data available for the GDO deflator), year-over-year inflation equaled 6.8% – slightly slower than the 7.3% rise in the CPI over the same period.

The impact of factor price payments on aggregate inflation can be measured by decomposing the growth in nominal GDP into that which reflects an expanded scale of real production, and that which reflects rising prices. The latter amount, in turn, can be

[5] A similar approach to disaggregating the factor sources of inflation according to the GDP deflator has been followed in other research, such as Matt Grudnoff, David Richardson, and Richard Denniss, *Are Wages or Profits Driving Australia's Inflation?* (Canberra: Australia Institute, July 2022); David MacDonald, *Where Are Your Inflation Dollars Going?* (Ottawa: Canadian Centre for Policy Alternatives); and European Central Bank, "Using National Accounts Data to Gauge Price Pressures in the Euro Area," *ECB Monthly Bulletin* (December 2006).

decomposed into that arising from additional payments (above and beyond those expected as a result of increased real output) to each of the main factors of production. Since nominal GDP by definition equals the sum of factor income payments, this decomposition can be performed completely, with no residual.

We conduct two decompositions of inflation (measured by the growth of the GDP deflator) experienced since the outset of the pandemic. The first decomposes all of the increase in prices since the December quarter of 2019. The second considers only inflation that is 'excess,' relative to the desired normal rate of inflation embodied in the RBA's target (2.5% per year). It is generally desirable that the economy demonstrate a certain rate of inflation, in order to lubricate relative price changes and gradually reduce real debt burdens. Unit factor price changes that are consistent with that targeted rate of aggregate price increases, therefore, should not be considered 'inflationary': they are, instead, actually supporting the goal of achieving target inflation. Unit cost increases over and above that pace, on the other hand, can be understood as driving a higher-than-desired pace of price inflation.

Table 1 summarises the aggregate decomposition of total inflation since the onset of the pandemic (going back to the December 2019 quarter), as measured by the GDP deflator. Economy-wide prices increased 15% during that period – for an average annual inflation rate of 5.2% in this period, over twice the RBA's target. Even if there had been zero increases in nominal unit costs for all factors, nominal incomes would still have increased in line with the expansion of real economic output (by 6.5% over the same period). Factor incomes over and above that amount (caused by real output growth) thus explain the increase in nominal prices. Table 1 reports the additional growth in factor incomes from December 2019 through September 2022, beyond that 'justified' by increased economic output. Incremental factor incomes totaling some $322 billion per year[6] been generated in that time. Together those extra incomes explain the 15% increase in average GDP prices over that same period. Of those incremental incomes, 50% are accounted for by the rise in corporate profits in that period above and beyond new profits that can be associated with extra output. Increased labour compensation accounts for 31% of the rise in total nominal GDP over and above what is due to increased output. Higher small business profits account for 11% of the total increase. Indirect taxes less subsidies and other factor incomes account for the remainder.

[6] Data in Table 1 are annualised.

Table 1 Decomposition of Total Inflation, Dec.2019 to Sept.2022 ($ bil. annualised)						
	Labour Comps'n	Corporate Gross Profit	Small Bus. Gross Income	Indirect Taxes Less Subsidies	Other Factor Incomes	Total Economy
Dec. 2019	$959.3	$507.1	$150.9	$199.1	$195.9	$2,012.3
Sept. 2022	$1,122.0	$700.7	$195.9	$232.5	$214.7	$2,465.7
Growth	$162.6	$193.6	$45.0	$33.3	$18.8	$453.4
Due to Real Output Growth	$62.5	$33.1	$9.8	$13.0	$12.8	$131.2
Incremental	$100.1	$160.5	$35.2	$20.4	$6.0	$322.3
Share of Total (%)	31.1%	49.8%	10.9%	6.3%	1.9%	100.0%
Source: Author's calculations from ABS National Accounts data.						

While startling, this analysis understates the importance of corporate profits in explaining the run-up of inflation over and above the RBA's 2.5% inflation target. It is desirable that rising nominal unit factor production costs support that target inflation rate. To the extent that growing nominal unit factor costs are consistent with target inflation, this should not be interpreted as a problem.

Table 2 Decomposition of Above-Target Inflation, Dec.2019 to Sept.2022 ($ bil. annualised)						
	Labour Comps'n	Corporate Gross Profit	Small Bus. Gross Income	Indirect Taxes Less Subsidies	Other Factor Incomes	Total Economy
Dec. 2019	$959.3	$507.1	$150.9	$199.1	$195.9	$2,012.3
Sept. 2022	$1,122.0	$700.7	$195.9	$232.5	$214.7	$2,465.7
Growth	$162.6	$193.6	$45.0	$33.3	$18.8	$453.4
Due to Real Output Growth	$62.5	$33.1	$9.8	$13.0	$12.8	$131.2
Due to Target Inflation	$67.4	$35.6	$10.6	$14.0	$13.8	$141.4
Incremental	$32.7	$124.9	$24.6	$6.4	-$7.7	$180.9
Share of Total (%)	18.1%	69.1%	13.6%	3.5%	-4.3%	100.0%
Source: Author's calculations from ABS National Accounts data.						

Table 2 therefore extends the decomposition of total GDP inflation since the pandemic, by incorporating an additional margin of nominal cost increases that would be consistent with maintaining that 2.5% inflation target. This margin is calculated as the amount of additional nominal factor income required to allow for a 2.5% annual increase in nominal unit factor costs over the period from December 2019 through September 2022.

After making allowance for normal (target) inflation in unit costs for all factors of production, a total of $181 billion in additional (excess) factor incomes can be associated with the run-up in inflation beyond target rates since early 2021. Of that total, 69% is due to the collection of extra corporate profits. 18% can be associated with increases in unit labour costs above and beyond the target 2.5% inflation rate. Excess small business profits account for another 14% of excess increases in the GDP deflator. Taxes net of subsidies, and factor incomes to the other smaller factors, have had little impact on above-target inflation.

Counterfactual: Inflation Without Excess Profit

Corporate spokespersons in Australia claim their businesses are mere intermediaries in the inflation experienced since the COVID pandemic: merely passing along to consumers the higher costs they have had to pay for their own purchased inputs. The unprecedented expansion in booked corporate profits during this period confirms that this claim is false. In addition to higher costs for inputs, companies have increased prices much further. These excess price increases were facilitated by the conjuncture of economic disruptions and pressures associated with the pandemic: including supply shortages, pent-up consumer demands, and global developments (such as an energy price shock which lifted prices for energy, even that produced in Australia). Moreover, higher prices for intermediate inputs purchased at any given stage of the overall economic supply chain themselves embody higher profits collected at previous stages of production. Integrated through the entire supply chain, therefore, these additional profits have translated into a record expansion of aggregate business profits.

By September 2022, corporations were charging final purchasers of Australian-made goods and services an annualized total of $165 billion above and beyond the incremental costs they paid for other productive inputs (including labour compensation, indirect taxes, and small business services), and above and beyond the profits normally associated with the increased scale of production since end-2019. Even if we allowed corporations a 'normal' expansion of nominal profits during this time (in line with a healthy, target rate of inflation), corporations still charged final purchasers $125 billion too much by September 2022: above and beyond the costs of their own purchases, normal profits expected from economic growth, and a 2.5% lift in nominal profit margins to support target inflation. These excess profit margins amount to a significant share of total expenditure across the economy. By the September quarter of 2022, these excess profits amounted to between 5.1% and 6.5% of nominal GDP (the former making allowance for normal 'target' expansion of nominal profits since 2019, the latter including all expansion of nominal profits).

Without excess profits, the course of price inflation since the pandemic would have been considerably moderated – even with the supply disruptions and other shocks which have affected price levels in this period. Excluding all excess profit growth since December 2019 (above and beyond economic growth and the costs of other productive inputs), GDP inflation would have averaged just 2.7% per year through to September 2019. That is barely half the 5.2% average annual rate of inflation actually experienced since end-2019. More significantly, the 2.7% adjusted inflation rate (in the absence of excess profits) falls within the RBA's target band (equal to the 2.5% target plus or minus one-half percentage point). In other words, without the excess profits opportunistically collected by Australian corporations during this period, inflation would have remained (on average) within the RBA's target range, and no dramatic change in monetary policy – in particular, the record-breaking nine consecutive interest rate increases imposed in the last year – would have been required.

Even if we accepted that nominal profit margins (on a unit basis) should be allowed to increase in line with an accepted target rate of inflation since end-2019, annual GDP inflation would then have averaged only 3.3% in the period since December 2019. That is well below actual realized inflation, and only slightly above the RBA's target band. Even in this case, the disruptions and risks arising from the rapid acceleration of inflation (including harsh monetary tightening) would have been avoided. It is clear that excess profit-taking by corporations, taking advantage of the unprecedented conjuncture of economic circumstances during and after the pandemic, has been the dominant driver of the difficult macroeconomic output presently facing the country.

Differences from the 1970s

The preceding analysis makes it clear that the acceleration of inflation in Australia in the last two years had nothing to do with wages or unit labour costs. Only now, well into the worst inflationary episode in four decades, are nominal wages showing any uplift at all – and they still lag well behind the growth of consumer prices. Business profits (especially for corporations, supplemented to a lesser extent by small business profits) rose dramatically and early in the course of this inflation. Wages lagged far behind, both in scale and in timing.

Despite this clear association of current inflation with surging business profits, policy-makers have attached (and continue to attach) primary attention to fears that labour costs will exacerbate or prolong inflation. Policy statements and speeches by RBA official refer darkly and repeatedly to the dangers of a 'wage-price' spiral, and employers are urged to strictly limit wage growth lest this spiral be sparked. Virtually no reference is made to the role of excess corporate profits in driving inflation.[7] An analogy is commonly made to the experience of the 1970s: when inflation was widely ascribed to a so-called 'wage overhang', and unduly rapid wage growth was believed to exacerbate inflation.

[7] The RBA's most recent Statement of Monetary Policy (for February 2023) mentions wages 75 times; it mentions profits once.

Table 3 Distributional Indicators, 1970s and 2020s		
	1970-1980	**2019-2022**
Average Annual Growth, Real Average Weekly Earnings[1]	+2.51%	-3.08%[2]
Change Labour Share of GDP[1]	+2.42 %pts	-2.35 %pts
Change Profit Share of GDP[1]	-2.58 %pts	+3.38 %pts

Source: Author's calculations from ABS National Income Accounts, Average Weekly Wages, Consumer Price Index.
1. Compares annual averages for start and finish years.
2. To May 2022.

Table 3 provides empirical data confirming that the experience of the current inflationary episode is exactly opposite to the circumstances of the 1970s. Real weekly earnings have declined since 2019 at an average annual rate of over 3% – meaning that an average of 3% of the real purchasing power of Australian workers' incomes has been eroded by inflation every year since the pandemic hit. During the 1970s, wages grew faster than inflation, generating average real wage growth of 2.5% per year (over and above inflation) through the decade. That pace of real wage growth exceeded labour productivity growth at that time (which increased at an average annual rate of 1.4% through that decade[8]), producing a 2.4 percentage point increase in the share of GDP going to labour compensation over the decade – and a corresponding decline in the share of GDP going to corporate profits. In contrast, through the current inflationary episode, workers lost an equivalent share of GDP (2.4 percentage points) in just three years, while the corporate profit share swelled by an even larger amount.[9] These indicators confirm that the distributional dimensions of current inflation are completely opposite to the experience of the 1970s.

Frightening predictions that unless wages are further suppressed in real terms, a wage-price spiral akin to the 1970s will erupt, are misplaced and one-sided. Australia has not experienced a 1970s-style 'wage-price spiral'. It has experienced an unusual 'profit-price spiral', in which corporations have used their freedoms and structural power to extract additional surplus from purchasers – despite the conditions of social and economic crisis of the time. The marked erosion of structural supports for workers' wages (including union representation, industrial action, and the relative value of minimum wage protections[10]) since the 1970s certainly help to explain why workers' incomes have fared so badly in the

[8] Author's calculations from OECD *Economic Outlook* data.
[9] The corporate profit share of GDP has grown by more since 2019 than the labour share declined, supplemented by the erosion of other factor shares in the same period.
[10] Union membership has averaged 12% of employment since 2020, compared to 54% on average in the 1970s. Industrial action has resulted in an average of 11 days work lost per 1000 workers since 2020, compared to 542 on average in the 1970s. The national minimum wage has averaged 53% of median wages since 2020 compared to over 60% during the 1970s.

current inflationary upsurge. Restoring the power of those institutional supports for wage growth, and imiplementing more balanced strategies to control inflation than currently followed by the RBA,[11] will be essential to short-circuit this profit-price spiral, and recoup some of the absolute and relative wage losses that workers have experienced since the pandemic.

Conclusion and Policy Implications

The main beneficiary of the acceleration of inflation in Australia since the COVID pandemic has been the business sector. Corporations have increased their profits much faster than the nominal growth of Australia's economy, and hence increased their share of GDP significantly. As Australia was traversing an unprecedented series of economic, social, and public health challenges (including lockdowns, supply chain disruptions, and accelerating inflation), corporations lifted prices far above and beyond the cost of their own input purchases. The excess expansion of profits per unit of production (that is, the amount of profit built into average unit prices for all goods and services produced in Australia) accounts for the lion's share (69%) of the acceleration in inflation beyond the RBA's 2.5% target rate. Growth in labour compensation beyond what would normally be expected (given economic growth and target inflation) has played a small role: accounting for just 18% of this above-target acceleration in inflation.

Analogies drawn between the current inflationary episode and the experience of the 1970s are inappropriate. Wages have grown much more slowly than prices, workers' real wages and their share of total GDP have declined rapidly, and profits have expanded to unprecedented highs: both in absolute terms and as a share of GDP. All of these indicators are opposite to the experience of the 1970s. The focus in current anti-inflation policy on suppressing wage growth, enforcing a permanent reduction in real wages, while ignoring the role of record profits in driving post-pandemic inflation reflects an ahistorical and ideological approach to macroeconomic management. It blames the victims of inflation, while ignoring its perpetrators, and will impose further needless harm in coming months through further real wage reductions, and quite likely an economic recession.

[11] For the elements of a more balanced and effective anti-inflation strategy, rather than relying solely on rapid interest rate hikes to 'cool off' the labour market, see the ACTU's discussion paper, *An Economy That Works For People* (August 2022).