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Comments on Heine/Herr (2024) ‚The Resurgence of Inflation: Lessons from History and Policy Recommendations‘

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Some clarifications at the beginning

- Inflation requires inconsistent claims of main group of actors and may be triggered by any increase in claims:

(1) rentiers and firms (broad profit share, including retained profits, interest and dividends)

➔ profit-driven conflict inflation

(2) workers (real wage, wage share)

➔ wage-driven conflict inflation

(3) government (net tax revenues)

➔ tax-driven conflict inflation

(4) external sector (import prices in domestic currency)

➔ external cost-/import price-driven conflict inflation

➢ **Inflation is always and everywhere a conflict phenomenon.**

➢ Distinction between demand-pull, cost-push, imported, … inflation can only relate to the trigger but not to the essence of inflation.

1. Achievements

Historical case studies on inflationary/deflationary episodes

- German hyperinflation 1923
- Inflation from late 1960s until mid 1980s in Germany, US, UK and Italy
- Post-2008 financial crisis, Covid-19, energy price shock and stagflation

Contextualisation in long-run development tendencies of modern capitalism

Economic policy implications for short-run energy price shock induced inflation and long-run challenges, both nationally and internationally

➢ Valuable and stimulating read with only minor problems (German ‚Debt Brake' not ‚Debt Break', NGEU only 1 per cent of EU GDP p.a. over 6 years, not 6 per cent of EU GDP, …)

2. Agreements

- Rejection of neoclassical quantity theory of money and the price level
- Deflationary tendencies are as (or even more) dangerous as (than) inflationary tendencies
- Importance of unit cost development for the price level and inflation – but also unit profits!
- Macroeconomic policy mix for dealing with inflationary/deflationary pressure and demand failures, but which?
- Applicability of MMT is seriously limited in the real world with open capital accounts, current account deficits, and indebtedness in foreign currency
- ....

3. Problems with theory I: Price level or inflation?

Heine/Herr rely on Keynes's fundamental equation for open economy with government

Economy imports raw materials and semi-finished products which enter domestic production which is then partly exported:

$$p = \frac{W + ap_f M + \Pi^*}{Y} + \frac{pI - S + G - T + pEx - ap_f\, Im}{Y} \tag{1}$$

$$= \frac{w}{y} + ap_f \mu + r^* v + \frac{pI - S + G - T + pEx - ap_f\, Im}{Y}$$

- Excess demand triggers changes in the price level ➔ flex price model
- Interaction of income and profit inflation in Keynes and in Heine/Herr remains unclear
- Currency depreciation/rise in import prices has an ambiguous effect on the price level: it raises equilibrium price through an increase in costs, but it lowers disequilibrium price through a leakage of demand ➔ price-wage-price spiral??

3. Problems with theory II: Conditions for price-wage-price-… spiral?

Heine/Herr frequently mention price-wage-price, wage-price-wage, depreciation-price-wage-price spirals: but what exactly is required for this?

Robinson‘s (1956, 1962): real wage resistance & inflation barrier? Analytically also not fully clear – seems to assume full pass through of wage increase to prices and price increases to wages

Marglin (1984): reconciliation of real wage resistance of workers and firms‘ target profit share given by I-S equilibrium by constant wage and price inflation, if wage/price inflation are positively related to distance of wage share/profit rate from respective targets – but no inflation expectations

Modern Kaleckian models of conflict inflation (Blecker/Setterfield 2019, Hein 2023, Lavoie 2022): price-wage-price spiral only if full pass-through of wages to prices and prices to wages (as in Carlin/Soskice NCM model)

Incomplete pass-through of wages to prices and/or prices to wages lead to stable inflation and distribution … price-wage inflation Phillips-curve is back (Hein/Schoder 2024, Lavoie 2024, Serrano et al. 2024, ….)

4. Problems with empirics I: almost complete pass-through?

Heine/Herr rely on almost complete pass-through of nulc increase to prices and present correlation coeffient for Germany of 0.85 (p. 36). But correlation does not mean causality – and does not control for other influences

Table A2: Nominal unit labour cost elasticities of the price indices for GDP and for export prices

Study and time period	$\frac{\partial \ln p}{\partial \ln ulc}$	$\frac{\partial \ln p_X}{\partial \ln ulc}$
Onaran/Galanis (2014), 1960-2007	0.62	0.22
Onaran/Obst (2016), 1960-2013	0.38	0.22
Stockhammer/Hein/Grafl (2011), 1970-2005	0.42	0.37

Source: Hein/Truger (2017, p. 442)

4. Problems with empirics II: How to explain simulaneous rise of inflation and the profit share?

- Empiral studies: rise in inflation in the course of Covid crisis and the war in Ukraine has been associated with rising profits/profit shares (Bivens 2022, Ferguson/Storm 2023, Konczal/Luisiani 2022, Stiglitz/Regmi 2022, Weber/Wasner 2023, Ragnitz 2022, Tölgyes/Piecek 2023)
- Profit-driven inflation or ‘sellers‘ inflation‘ (Weber/Wasner 2023) as opposed to (government spending driven) aggregate excess demand or excess money-supply driven inflation
- Weber/Wasner (2023): three stages
  (1) Rising prices in systemically significant upstream sectors create windfall profits and provide an impulse for further price hikes.
  (2) To protect profit margins, downstream sectors propagate, or amplify price pressures.
  (3) Labour responds by trying to defend real wage in the conflict stage.

➢ Heine/Herr‘s Keynesian approach is silent on this … and has difficulties in explaining this (Hein 2024)

5. Problems with economic policies I: Burdening labour or sharing the burden?

- Heine/Herr (Chapter 6) recommend that with an energy price shock nominal wage growth should follow their wage norm (trend productivity growth plus inflation target)
- With mark-up pricing on unit variable costs - and complete pass-through of costs to prices this means that labour should accept a lower target wage share – while capitalists gain a higher profit share in national income
- Alternative: Allowing for pass through of unit cost increases without marking these up ➔ lower average mark-up and share the burden

Mark-up pricing in industry and services and distribution

(3) $$p = \left[1 + m(i)\right]\left(\frac{w}{y} + p_f a\mu\right), \qquad m > 0, \frac{\partial m}{\partial i} \geq 0$$

p: domestic prices, m: mark-up, i: long-term real interest rate, w: nominal wage rate, y: labour productivity, a: exchange rate, p_f: prices of imported foreign goods in foreign currency, a: nominal exchange rate, μ: raw material-output ratio

➔ Increase in prices can be triggered by increase in mark-up, unit labour costs and/or unit imported material costs

Relationship between unit material costs and unit labour costs (z):

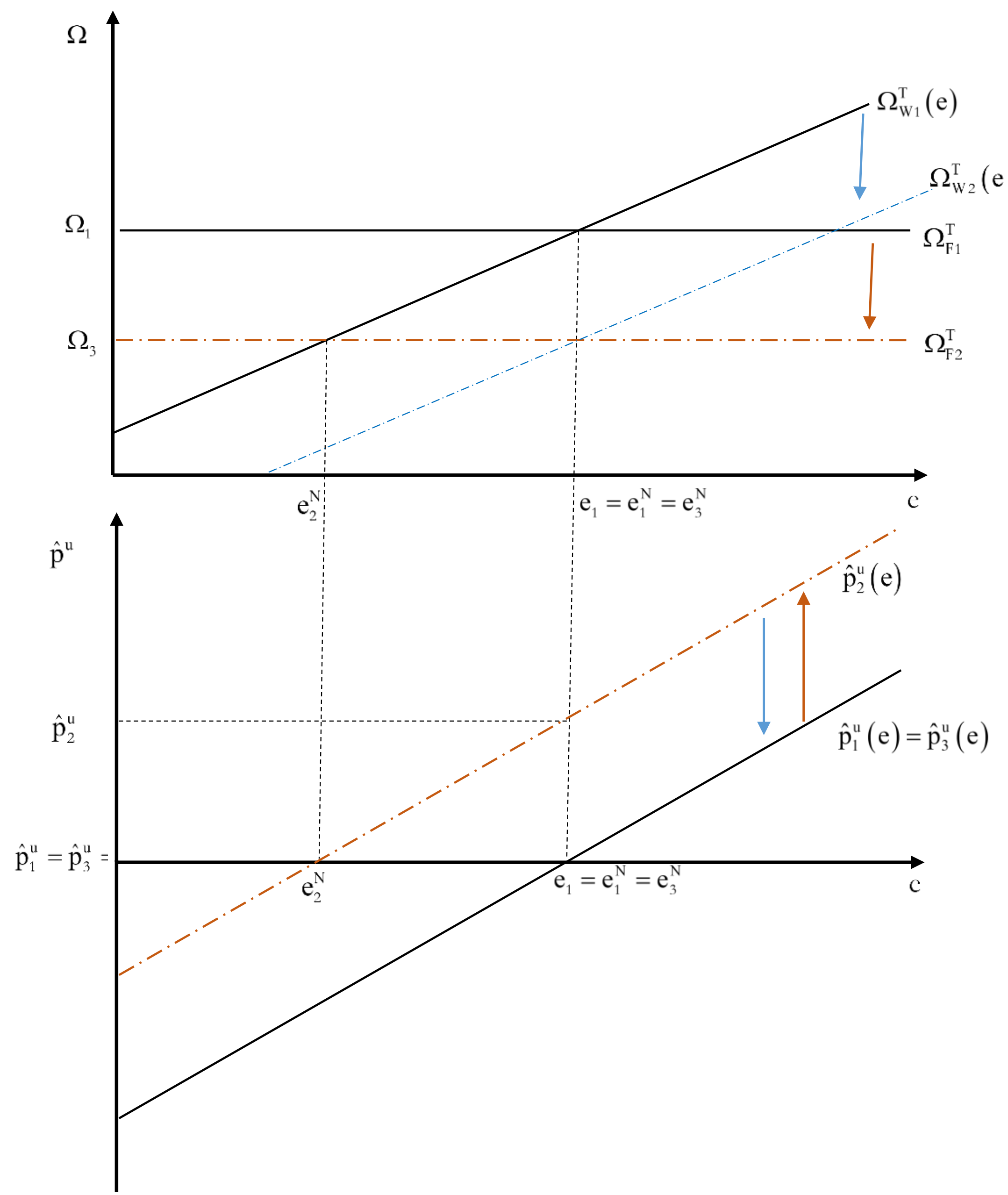
(4) $$z = \frac{p_f a\mu}{\frac{w}{y}}$$

The profit share (h), including overhead costs, in domestic value added:

(5) $$h = \frac{\Pi}{pY} = \frac{\Pi}{\Pi + W} = \frac{m\frac{w}{y}(1+z)}{m\frac{w}{y}(1+z) + \frac{w}{y}} = \frac{m(1+z)}{m(1+z)+1} = \frac{1}{\frac{1}{m(1+z)}+1}.$$

➔ Rise in z increases profit share even with a constant mark-up
➔ changes in unit labour costs and unit material costs affect domestic wage and profit share

Figure 1: An increase in imported energy prices in the Rowthorn and Hein/Stockhammer framework – and workers carrying the burden a la Heine/Herr



Open economy

- Workers’ distribution target is not affected by real exchange rate, firms’ target profit/wage share is

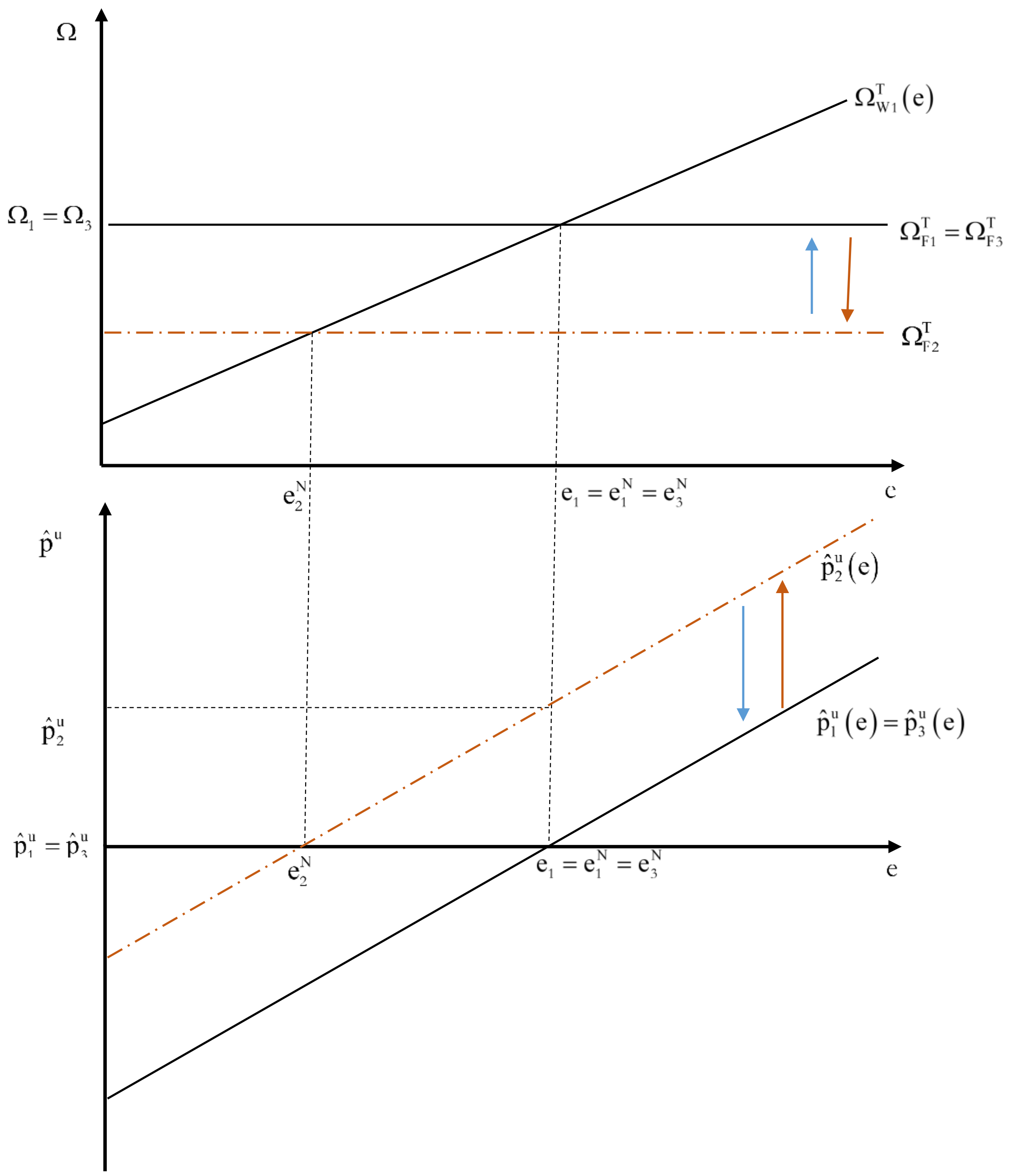
Increase in imported energy prices and hence real exchange rate (orange)

- ➢ firms keep mark-up on unit variable costs constant
- ➢ lower target wage share curve of firms
- ➢ unexpected inflation Phillips curve shifts upwards

Workers carry the burden (blue)

- ➢ downward shift of workers‘ target wage share curve
- ➢ Downward shift of unexpected inflation Phillips curve
- ➢ Lower wage share at e_1

Figure 2: An increase in imported energy prices in the Rowthorn and Hein/Stockhammer framework – sharing the burden



Increase in imported energy prices and hence real exchange rate (orange)

- If firms keep mark-up unit variable costs constant
- lower target wage share curve of firms
- unexpected inflation Phillips curve shifts upwards

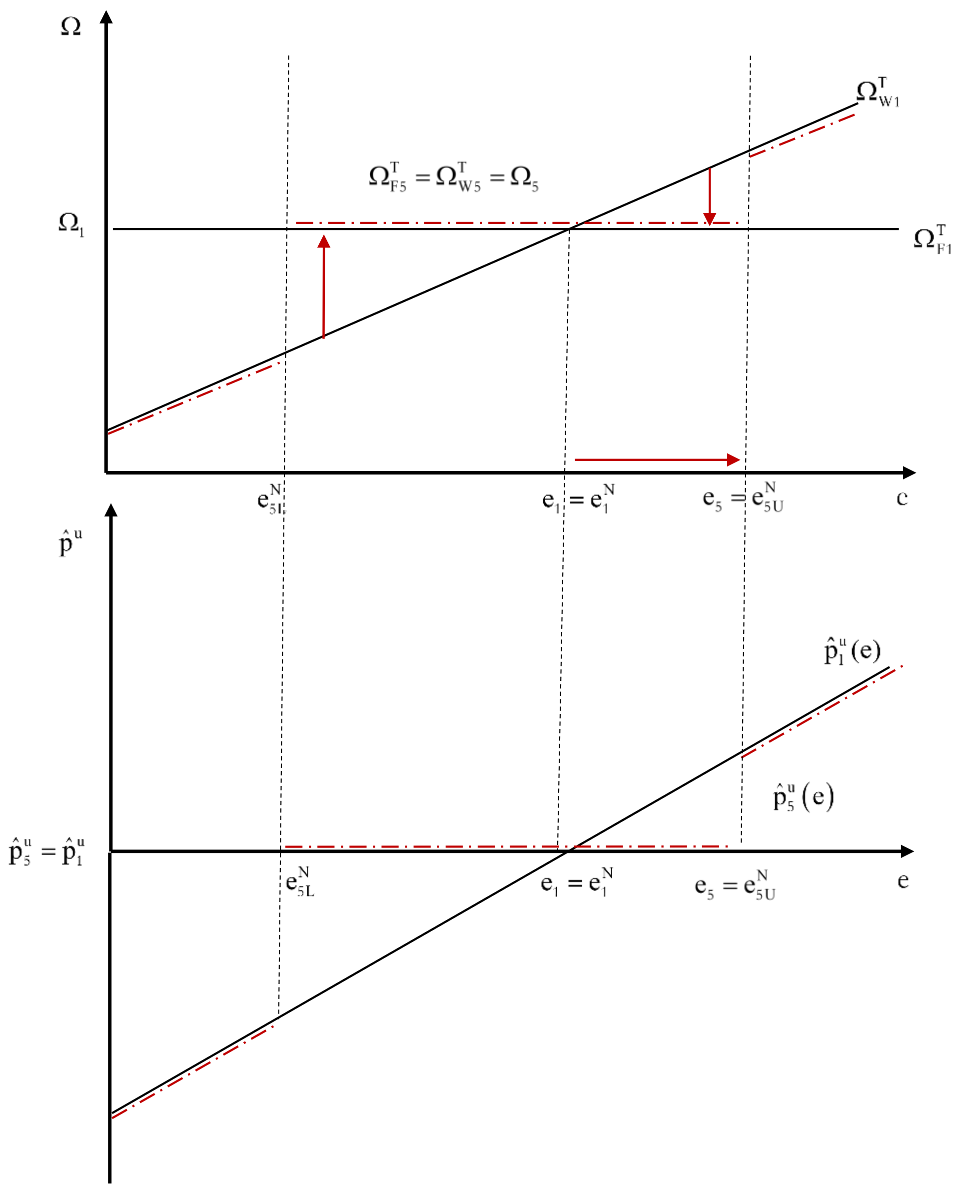
Sharing the burden (blue)

- Firms are forced to lower average mark-up, i.e. pass through higher energy costs without marking them up
- upwards shift of firms‘ target wage share curve
- Downward shift of unexpected inflation Phillips curve
- Disribution (at lower real GDP) remains constant

Policy measures:

- price controls/caps in the short run
- Tax cuts for firms
- Interest rate cuts
- Increase competition in the long run
- Public investment to reduce bottle necks ….

Figure 3: The stabilising role of wage bargaining coordination and a PK policy mix in the Rowthorn, Hein/Stockhammer framework



Wage bargaining coordination (red, no. 5)

- Align workers' target wage share with the feasible wage share given by firms' pricing, i.e. make make SIRE a corridor and Phillips curve horizontal in a relevant range ➔ Wage bargaining coordination
- Follow wage norm in the medium to long run: nominal wage rate should rise at target rate of inflation plus trend productivity growth for the economy as a whole
- Target rate of inflation should be in line with inflation rate of main trading partners, to contribute to constant nominal and real exchange rates ➔ international coordination
- Fiscal policy demand management can shift employment curve to maximum employment rate consistent with constant inflation at the target rate,
- Tax and social policies should reduce inequality and support lower income households carrying the burden

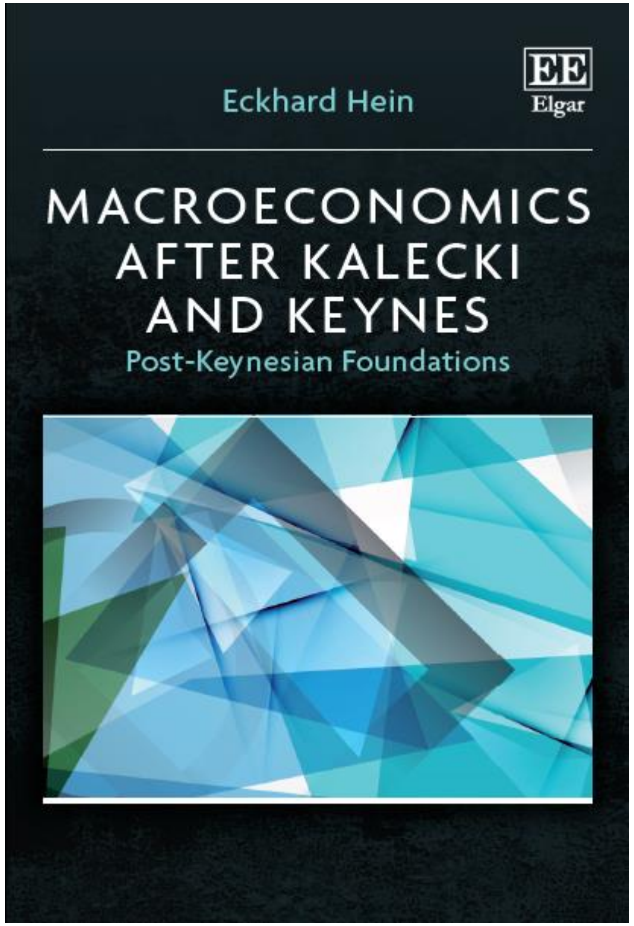
5. Problems with economic policies II: Activist interest rate policies as part of the macroeconomic policy mix?

- Heine/Herr propose acitivist interest rate policies to cope with inflation
- But: Interest cost channel of interest rate reduces firms‘ target wage share and the SIRE, and raise the Phillips curve
- Alternative: Target low long-term interest rates and make use of competition policy to reduce target mark-ups of firms, as well as wage bargaining coordination to align targets of workers and firms. Use fiscal policy for aggregate demand management – also in case of inflation generating employment rates.

6. Conclusion

- Stimulating book
- Informative historical case studies
- Merits contextualisation in the current PK debate on conflict inflation
- Economic policy implications merit discussion
- Read and discuss it!

Further readings



Invited Article

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Inflation is always and everywhere … a conflict phenomenon: post-Keynesian inflation theory and energy price driven conflict inflation, distribution, demand and employment

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This paper reviews the post-Keynesian theory of inflation against the background of the simultaneous rise in inflation and profit shares in the course of the COVID-19 recovery and the Russian war in Ukraine. It distinguishes between the Keynes, Kaldor, Robinson, and Marglin tradition, and the Kalecki, Rowthorn, and Dutt tradition. Two prototype models in the latter tradition — the Dutt, Blecker–Setterfield and Lavoie variant, and the Rowthorn and Hein–Stockhammer variant — are discussed. The paper applies the latter to elucidate recent inflation trends propelled by increasing imported energy prices and then rising mark-ups. The effects of inflation-targeting central bank interest policies versus a post-Keynesian alternative macroeconomic policy approach are evaluated. It is argued that from a post-Keynesian perspective inflation is always and everywhere a conflict phenomenon, *with different potential triggers. Adequate policies should thus focus on moderating distribution conflict by incomes policies, complemented by central banks targeting low long-term real interest rates, functional finance fiscal policies and international coordination of inflation targets.*

Keywords: *conflict inflation, post-Keynesian models, imported energy inflation shock*

JEL codes: *E12, E25, E31, E61*

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Kaleckian Models of Conflict Inflation, Distribution and Employment: A Comparative Analysis

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ABSTRACT

This paper conducts a systematic comparison of two main textbook variants within the Kaleckian tradition of post-Keynesian conflict inflation and distribution theory: the Blecker and Setterfield (2019) and Lavoie (1992; 2022) (BSL) model based on Dutt (1987), and the Hein (2023a) and Hein and Stockhammer (2011) (HS) model founded on Rowthorn (1977). Focusing on a basic closed economy framework sans government, we explore various iterations of each approach. Our analysis reveals that disparities chiefly centre around the treatment of price inflation expectations ('indexation') and the incorporation of bargaining power in wage- and price-inflation equations. BSL variants generally yield stable price Phillips curves, stable distribution and employment curves, and hence stable equilibria. Only the BSL-3 variant with complete indexation and complete pass-through generates shifting Phillips and employment curves, implying instability. It is thus similar to the HS-0 approach, which has bargaining power and complete indexation representing adaptive expectations in wage inflation and incomplete pass-through in price inflation. Introducing a workers' wage share target directly into the wage-inflation equation, but keeping full indexation/adaptive expectations in wage inflation and incomplete pass-through in price inflation, allows for stable and even flat Phillips curves, stable distribution and employment curves, and hence stable equilibria in the HS approach.

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