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The return of inflation and the weakness of the side of production

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ABSTRACT

The acceleration of inflation in the early 2020s following the pandemic shock poses significant risks for financialised capitalism. This article argues that the root causes of inflation do not lie with excessive money creation, as is claimed by Monetarists. By drawing on Keynes's discussion of war finance, it shows that the causes are to be found primarily in the boost to aggregate demand delivered by core countries of the world economy, while aggregate supply has been persistently weak. Analyzing the weakness of the production side requires recourse to Marxist political economy, especially the role of poor profitability. In this light, a fundamental reason for supply side weakness is the attenuation of the "internal" mechanism of capitalist accumulation in core countries as productivity growth and investment have been feeble since at least the crisis of 2007–2009. The policy options to confront rising inflation are correspondingly difficult.

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The acceleration of inflation

The return of rapid inflation to the core countries of the world economy is a striking feature of the turmoil that commenced with the pandemic of Covid-19 in 2020 (Lapavitsas and EReNSEP Writing Collective 2023).[1] The surge of inflation in 2021 and 2022 is manifest in Figure 1 for the countries of the Organization of Economic Cooperation and Development (OECD).

Rising general price indexes during this period were accompanied by the escalation of the prices of key agricultural and industrial commodities traded globally. Starting in April 2020 and continuing in 2021, prices increased rapidly for crude oil, copper, nickel, and other minerals, but also for steel (World Bank 2021).[2] There were inevitable fluctuations in these

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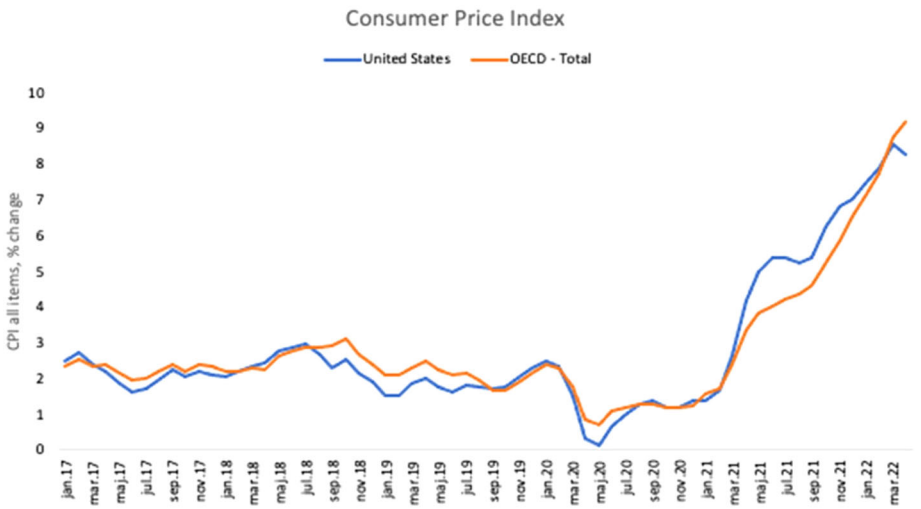

Figure 1. Consumer price inflation. *Source*: Own calculation, OECD data.

prices depending on conditions in particular sectors. Crucially for workers and the poor across the world, the price of wheat soared in 2020–21; the price of rice also rose in 2021, after spiking enormously and then subsiding in early 2020. The war in Ukraine worsened conditions by pushing prices up even further in the first half of 2022(World Bank 2021; Igan et al. 2022).

The combined pressure of energy, food and other price increases is shown in Figure 2.

Throughout 2021 policy makers in core countries either ignored or dismissed the acceleration of inflation, but in 2022 concern spread, particularly in the USA (Landau 2021; Aggarwal and Kimbal 2022).[3] The issue was whether inflation would prove transitory, or become entrenched, and the question mattered greatly for policy. The answer, needless to say, depended on what had caused the acceleration of inflation.

The significance of the rise in inflation cannot be downplayed. The financialisation of capitalism picked up speed in the 1980s on the back of suppressing the high inflation that had embroiled core countries in the crisis-ridden 1970s. Suppression of inflation in the 1970s involved severe monetary stringency by central banks, the so-called "Volcker shock" in the USA, dramatically raising the rate of interest, and exacerbating deep recessionary tendencies (Meltzer 2005; Goodfriend and King 2005; Morgan 2012).[4] Throughout the ensuing decades of financialisation, central banks turned the control of inflation into their primary task.

It is argued in this article that the return of inflation is, at an immediate level, the result of the boost to aggregate demand delivered by core states in 2020–2021. At a deeper level, however, the return of

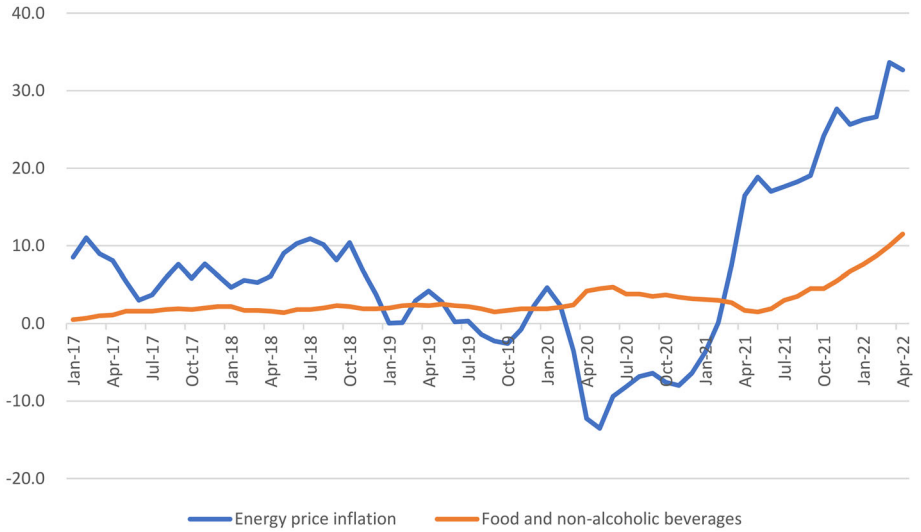

Figure 2. Consumer price inflation in energy, food and nonalcoholic drinks. *Source*: Own calculation, OECD data.

inflation reflects the underlying weakness of aggregate supply – the side of production – and the entrenched malaise of capitalist accumulation in the years of financialisation. In 2020 austerity was set aside by the core countries of the world economy, but state intervention did not deal with the underlying weakness of aggregate supply, which has structural causes. From this perspective, the acceleration of inflation in the 2020s is a further indication of the persistent feebleness of capitalist accumulation in the core countries of the world economy since the outbreak of the global crisis of 2007–2009, the answer to which is not immediately obvious.

Too much money?

The old Monetarist explanations of inflation, drawing on the Quantity Theory of Money, were quick to stage a return as inflation began to pick up (Castañeda and Congdon 2020). The Monetarist argument was, as ever, simple: policies to confront the pandemic in 2020–2021 led to an extraordinary increase in the money supply and, given the relatively stable velocity of money and the inability of aggregate supply to increase commensurately, the result was inflation. On these grounds, inflation could be expected to continue at high levels for the first half of the 2020s, above all in the USA.

The Quantity Theory of Money has frequently proven misleading for both theoretical analysis and government policy in the history of capitalism. There is no doubt that the money supply in core countries rose

dramatically in response to the pandemic shock and certainly in comparison with the Great Crisis of 2007–2009. But the simple mechanics of Monetarism offer little guidance to the surge of inflation after 2021.

A point of vital importance is that inflation is a blanket term that could obfuscate price movements as much as revealing underlying tendencies. The aggregate price level is calculated across several economic sectors, often masking great differences in the behavior of the price of output in one sector compared to another. The rate of inflation is supposed to capture the common elements in price increases (or decreases) observed across economic sectors. But these common elements are notoriously difficult to isolate empirically, and they are practically impossible to connect to increases (or decreases) in the money supply.

The fundamental reason for these well-known difficulties is that, in every period, the price of the output in each sector is determined by qualitatively different factors, reflecting real resource adjustments. These can vary widely, including the patterns of the weather in agriculture, the introduction of new technology in manufacturing, the existence of adequate shipping capacity for minerals, the impact of monopolistic arrangements by oil producers, the changes in seasonal or other demand for certain commodities, and so on. The more closely one examines the price behavior of the output of a sector, the clearer it becomes that price fluctuations result primarily from real, not monetary, factors, which are usually specific to the sector and hard to generalize.

This long-standing conclusion of radical monetary theory regarding inflation has been frequently confirmed by empirical research (Arnon 1991).[5] Thus, for the USA in 2021, mainstream economic research showed that, when inflation is generally low, the fluctuations of aggregate price indices are determined primarily by sector-specific forces (Borio et al. 2021). The common elements that presumably drives inflation are generally weak. Upward movements of prices tend to be the result of adjustments in real resources within sectors, a feature that is particularly prominent across the service sector.

That is not to say that monetary factors could not generate rapid inflation, and even hyperinflation. Indeed, in advanced capitalism, in which the final means of payment is effectively fiat money created by the central bank, monetary authorities could potentially induce substantial fluctuations in the price level. The extraordinary increases in the money supply in the USA and other core countries in 2020–2021 were certainly related to the burgeoning of aggregate demand. The real issue, however, was not the boost to demand but the inability of aggregate supply to respond commensurately and in this regard the Quantity Theory of Money has little to offer.

Considerable light on this issue can be cast by briefly revisiting Keynes' analysis of a broadly similar economic predicament, summed up in his celebrated pamphlet "How to Pay for the War" written soon after the outbreak of World War Two. However, the discussion would be far from adequate without also calling upon Marx.

Keynes on using inflation to cover the resource costs of state expenditure

The problem that concerned Keynes in 1940 was covering the huge military costs of the unfolding world conflict. How would the vast resources that the British government had begun to direct toward military production be obtained?

Keynes noted that the supply side of the British economy could not possibly meet the requirements of both war production and peacetime consumption (Keynes (1940, ch. 1)). Consequently, private consumption would have to be reduced to release resources for war. But a decline in private consumption would never take place through a rise in voluntary saving that would somehow occur spontaneously (Keynes (1940, p. 9)). How, then, could the problem be solved?

Keynes further noted that the required resources could not be obtained in full by taxing the wealthier strata of society – the rich and the middle class – as the sums simply did not add up. Taxes could be a means of obtaining extra resources, as also would voluntary saving, but they would not be enough by themselves, and certainly not if they were exclusively imposed on the wealthy Keynes (1940, ch. 4). Moreover, only a part of the required resources could be obtained by borrowing from the capitalist class and the rich, with the additional drawback that these social strata would acquire further claims on the National Debt, thus altering the distribution of income in their favor after the war.

For Keynes, it followed that the bulk of the required resources would have to be released by reducing the consumption of workers and others on modest incomes. This was hard enough to achieve but became even more complex as government military spending would inevitably boost aggregate demand, leading to full employment and even beyond. It followed that workers would have considerable disposable income and would naturally seek to increase consumption. An imbalance of aggregate demand and supply would result, and thus the prospect of inflation would arise.

Inflation could potentially be an answer for how to pay for the war. Since an established system of wage indexation did not exist in Britain, the nominal income of workers would hopelessly chase after the rising prices

of goods. Thus, workers' consumption would fall in real terms. In effect, inflation would operate as a tax on workers – a "forced saving" in the sense that workers would claim less of the national output – releasing resources for the war effort. At the same time, the rise in prices would favor the profits of capitalists, which might be partly taxed but would still leave net gains for the capitalist class. Inflation would thus transfer income from workers to capitalists, severely worsening inequality. For these reasons, Keynes was opposed to funding the war by generating inflation (Ohanian 1997; Barnett 2009).[6]

It should be stressed that Keynes's arguments did not stop Britain from adopting precisely the "forced saving" method in India, which was at the time still a British colony (Patnaik 2018).[7] Faced with the threat of Japanese invasion and heavily constrained by the expenses of war in Europe and Africa, Britain opted for inflation to cover the costs of re-arming the Asian subcontinent. As inflation accelerated, the purchasing power of vast swathes of the poorest peasants in West Bengal was destroyed. "Forced saving" to meet war expenditures in India took the form of a famine that killed three million people, while capitalist profiteers were enriched. Keynes and other British liberals obviously did not advocate this outcome, but nor did they actively oppose it. Imperial considerations held sway.

The disaster of India aside, for Keynes, the preferred method of paying for the war was through a national plan to create "forced saving" directly. The plan did not include heavy reliance on a system of rationing and price fixing, both of which seemed problematic to Keynes (Keynes (1940, ch. 8)). Rather, his aim was administratively to defer a part of workers' income by placing it in personal deposits that would be kept in special national accounts (Keynes (1940, ch. 2)). There would also be increased taxation of other income, including that of capital, but the main release of resources would be through the planned deferment of workers' income, thus avoiding the boost to aggregate demand leading to inflation and the inevitable swelling of capitalist profits.

Keynes's plan would still increase the National Debt, but workers would also have a strong claim on the augmented debt of the state and would be able to draw down the accumulated funds after the war. The best time to allow for such withdrawals would be at the onset of the first postwar slump, that is, as soon as aggregate demand fell below aggregate supply.

Not surprisingly, the labor movement in Britain opposed Keynes's plan because of its calculated contractionary effect on workers' income (Toye 1999; Deutscher 1940).[8] In the event, the plan was not adopted by the British government and the war was financed through higher taxation, higher domestic borrowing, rationing, and borrowing heavily from abroad, above all, from the USA. The exercise was mostly of theoretical value.

The weakness of aggregate supply in the 2020s – drawing on Marxist theory

Keynes's "How to Pay for the War" became a point of reference in UK public debate as soon the health emergency occurred in early 2020 (Skidelsky 2020; Bollard 2020; Goldin 2021). The crisis, after all, bore a resemblance to war, with curfews and restrictions, extraordinary government intervention in economic and social life, and a vast escalation of public debt.

But the pandemic was not a war, and its social conditions were very different from those that concerned Keynes. Even if it was catalyzed by the state, the economic turmoil remained a recognizable crisis of financialised capitalism, reflecting the sustained loss of dynamism by capitalist accumulation in core countries. In dealing with the economic shock, powerful states emerged as arbiters of the direction of capitalist accumulation amidst intensified global competition, including a determined struggle for hegemony.

Still more complexly, and unlike a war, the pandemic shock initially depressed aggregate demand and disrupted aggregate supply, leading to rapid increases in unemployment and severe underutilization of resources. Several governments were faced with falling consumption and rising saving by workers and other strata, while enterprises postponed investment. Without the extraordinary fiscal and monetary boost of 2020–2021, unemployment and underutilized resources would have reached unprecedented levels.

The response of core governments did, however, result in a problem similar to that faced by Keynes. For, in substance, Keynes believed that the aggregate supply of peacetime goods when full-scale war broke out in 1939–1940 would be unable to meet growing aggregate demand as full employment was reached by expanding military production. A boost to aggregate demand in the great depression of the 1930s, on the other hand, would not have led to inflation since there was extensive underused productive capacity that would have generated extra output (Keynes (1940, p. 4)). Keynes's war problem reappeared in core countries in 2022, even though overt war conditions were absent, except for Ukraine.

Inflation emerged in the 2020s as aggregate supply proved unable to meet the boost delivered to aggregate demand by governments in 2020–2021, especially in the USA. The discrepancy became even greater as living conditions were steadily normalized, and workers and other strata found themselves in possession of savings accumulated during the period of severe restrictions.

It should be stressed that rising inflation also reflects the soaring prices of primary commodities traded internationally, above all, oil and natural gas providing energy. Fundamental to these price increases is the

disturbance to global production networks as states imposed severe restrictions on work, travel, and trade, thus also increasing transport costs (Javorcik 2020; Miroudot 2020). Global supply processes were further disrupted by severe sectoral disparities, as digital services and industrial activities recovered quickly but other services (entertainment, restaurants, hotels, and others) lagged behind (Andersson, Battistini and Stoevsky 2021).[9] The war in Ukraine in 2022 and the sanctions imposed on Russia further exacerbated the disruption.

A rise in the price of basic inputs represents a severe worsening of the terms of trade for core countries relying on heavy imports. The cost could be potentially financed out of productivity increases that would give a boost to aggregate supply but, as is shown below, this solution is not forthcoming. Thus, the cost will be met by either reducing wages or profits (or both). Given the strength of demand and the underlying weakness of supply – together with the higher cost of imported energy and primary commodities – the result is inflation. Accelerating inflation in practice determines the extent to which the cost will be borne primarily by reducing wages, while boosting profits (Rowthorn 1977).[10]

The structural reason for the rise in inflation is, therefore, the weakness of aggregate supply. To obtain insight into this fundamental issue, this section turns briefly to the performance of five core countries of the world economy – the USA, Germany, France, the UK, and Japan – since the Great Crisis of 2007–2009. For Marxist political economy, the variable that most usefully sums up the underlying condition of aggregate supply is the average rate of profit, particularly that of non-financial enterprises. The point of departure for the analysis of accumulation weakness in the 2010s is the conduct of profitability.

The average rate of profit depends on real wages, while also reflecting the growth of labor productivity, which obviously relies on technological change. Labor productivity is the driving engine of capitalism, the means through which profits rise and enterprises win the battle of competition in the medium to long run. To facilitate analysis, it is instructive to deploy the simplest formulation of the average rate of profit in Marxist political economy:[11]

$$r = (S/V)/[1 + (C/V)]$$

where S is surplus value, V is variable capital, and C is constant capital (in money terms: profit, the real wage bill, and investment in fixed and variable goods respectively). The numerator varies directly with the rate of exploitation of labor, S/V, (i.e., with surplus value relative to the value of the wage basket), while the denominator varies inversely with the value

composition of the capital invested, C/V, (i.e., with the value of the investment goods relative to the value of the wage basket).

If real wages (V) fell, other things equal, both the numerator and the denominator would rise, the former raising the rate of profit and the latter lowering it. The overall effect, however, within reasonable assumptions about magnitudes, would probably be to raise the rate of profit. It stands to plain economic reason that the average rate of profit falls when real wages rise.

If labor productivity rose, other things equal, both V and C would fall, as the value content of the wage basket and the investment goods would decline. Since V would fall, the rate of exploitation in the numerator would rise, similarly to a fall in real wages. However, the impact on the value composition of capital in the denominator would be ambiguous: if C fell by more than V, the value composition would fall; if, on the other hand, V fell by more than C, the value composition would rise.

Therefore, the overall impact on the average rate of profit would be ambiguous. The rise in the rate of exploitation would boost the rate of profit, and the impact might be even bigger, if the value composition fell. If, on the other hand, the value composition rose, it would give a downward push to the rate of profit that could potentially exceed the boost from the rising rate of exploitation, thus bringing the rate of profit down. Once again within reasonable assumptions about magnitudes, however, a rise in productivity would probably raise the average rate of profit.[12]

Consequently, the trajectory of the average rate of profit, which reflects the underlying strength of accumulation, could be usefully analyzed through the movement of real wages and the productivity of labor. Their interplay could be considered as the "internal mechanism" of capitalist accumulation determining the rate of profit.[13] If labor productivity tended to increase slowly, profitability would be unlikely to rise in sustained fashion. The overall outcome on the rate of profit, however, would depend on real wages since profitability could still be sustained through downward pressure on real wages.

Consider now some evidence on the operation of the "internal mechanism" in recent years in core countries, above all, in the hegemonic USA. The trajectory of the profit rate of non-financial enterprises in the USA since the early 1980s and up to the pandemic shock is shown in Figure 3 (Dumenil and Levy 1994; Shaikh 2011; Lapavitsas and Mendieta-Muñoz 2016).[14]

The chart indicates that coronavirus arrived at a time of distinct feebleness of productive accumulation in core countries. During the last four decades, the profit rate of non-financial enterprises in the USA exhibited a rather level trend – perhaps rising gently – while following a cyclical path, broadly in line with the overall fluctuations of the economy. After the Great Crisis of 2007–2009,

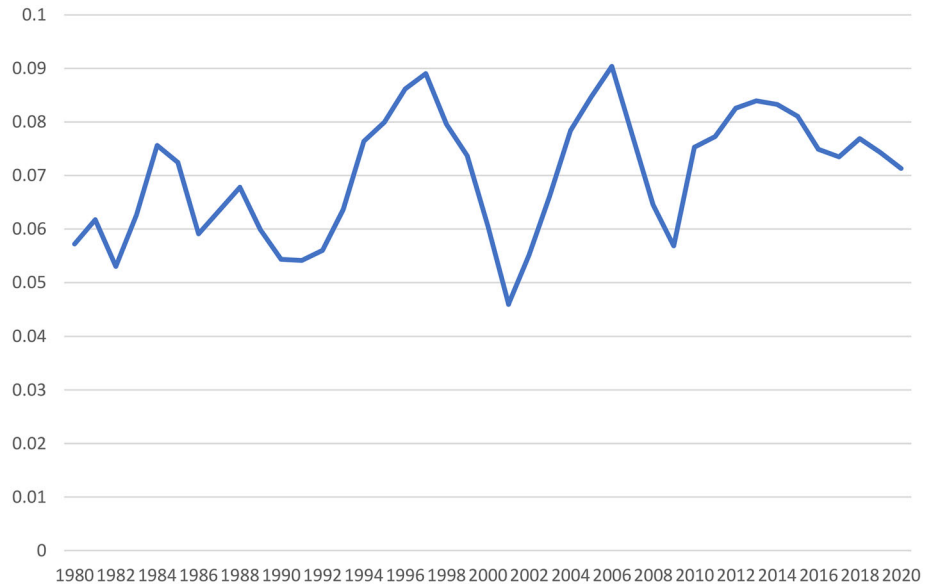

Figure 3. Profit rate of non-financial enterprises, USA, 1980–2020. *Source*: Own calculations; data from BEA and NIPA.

the profit rate recovered mildly, peaked in 2014, and then began to decline again. Covid-19 struck the US economy when profitability was weak and accumulation showed signs of exhaustion. Broadly similar points hold for capitalist accumulation in the EU, which was further weighed down by the malfunctioning of the euro and lodged in stagnation for most of the 2010s.

Further insight into the operation of the "internal mechanism" can be gained by considering labor productivity during this period. The important factor in this respect is not the absolute level of labor productivity, which typically tends to rise over time in capitalist economies, but its rate of growth.

Figure 4 shows the trajectory of productivity growth in the five core countries during the last four decades, a period of cataclysmic technological change, particularly in telecommunications, information technology and artificial intelligence. For most of this period, core countries were plagued by declining rates of productivity growth, despite sustained technological innovation. Poor productivity growth has been particularly striking following the Great Crisis of 2007–2009, especially in the USA and the UK but also in Germany, France, and Japan.

Weak productivity growth, a well-known feature of capitalism in recent decades, has been extensively discussed in the mainstream literature (Gordon 2016; Ollivaud Guillemette, and Turner 2016; Young Eun and Loayza 2019; Dieppe 2021).[15] Its causes are a matter of debate, but there is no doubt that the relentless technological advances in information and communications technology have not resulted in productivity gains

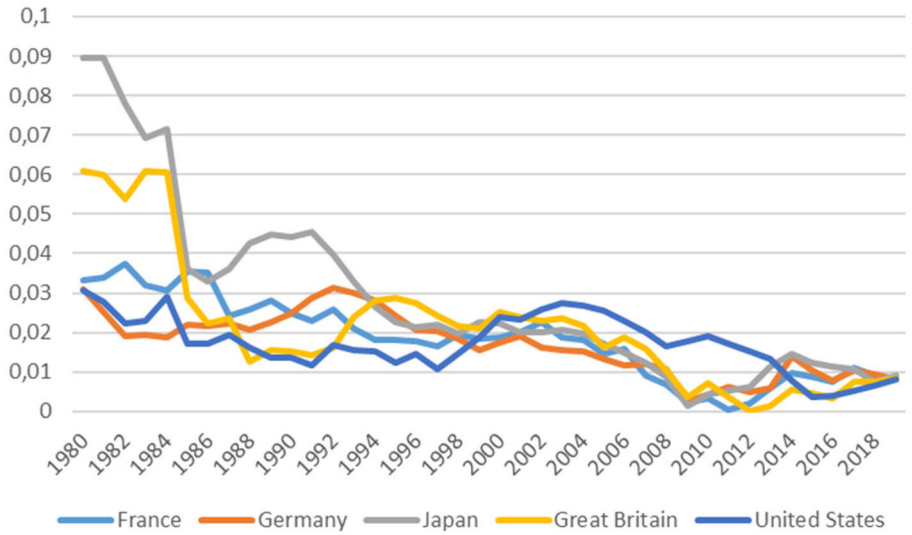

Figure 4. Rate of growth of labor productivity, 5 year moving average. *Source*: Own calculations based on OECD data.

comparable to previous historical periods, such as the introduction of the railways, or electrification.[16] It remains to be seen how the latest wave of technological change, particularly artificial intelligence, will impact on productivity growth in the coming years.

During the decades of financialisation, flimsy productivity growth attenuated the "internal mechanism" in core countries. Confronted by poor productivity growth during this period, capitalist oligarchies supported profitability by applying downward pressure on real wages, particularly as "de-localisation" of production entailed the loss of hundreds of thousands of manufacturing jobs and trade union organization weakened (Onaran et al. 2015; Auvray et al. 2020).

There were, however, significant differences among core countries in this respect. After 2007-9 real wages remained broadly stagnant in the UK and Japan, but rose in the USA, Germany, and France. Even in countries in which real wages rose during the 2010s, there were great variations among different strata of wage earners. In the USA, for instance, most of the growth in real wages was concentrated in the upper deciles of the wage earners' distribution, while median earners faced stagnation (Behringer and van Treeck 2021).[17] The rise signified worsening inequality rather than improving conditions for the working class. Similar points hold for Germany, where real wages showed some upward movement but only after a long period of an extraordinary wage freeze since the 1990s (Dustmann, Fitzenberger and Zimmermann 2022; Blundell et al. 2018).[18]

Moreover, core countries also supported profitability through what might be called the "external mechanism" of capitalist accumulation, that is, by

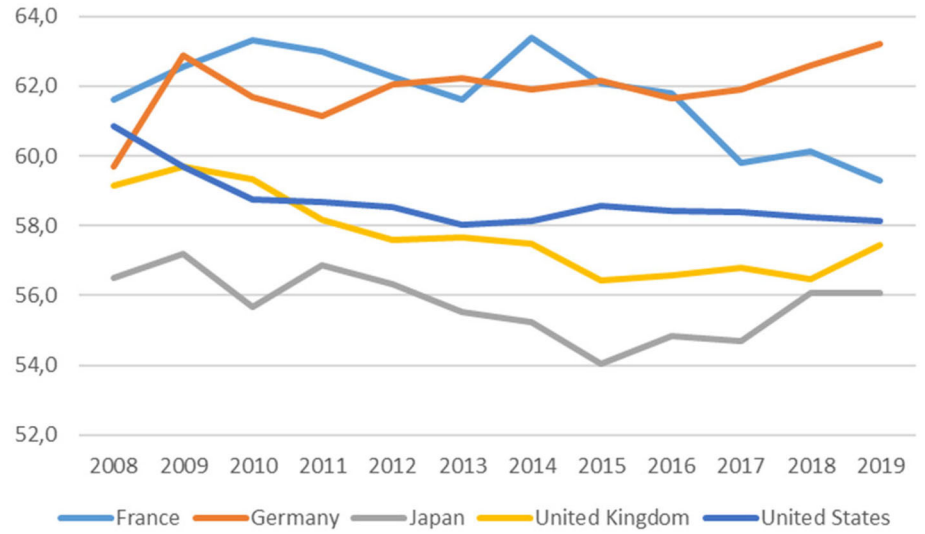

Figure 5. Labor income share as % of GDP. *Source*: Own calculations based on ILOSTAT.

importing cheaper wage and other goods from abroad. As global trade expanded during the decades of financialisation, core countries took advantage of the enormous expansion of wage labor in China and elsewhere in East Asia, which went together with rapid increases in productivity (Mason and Shetty 2019).[19] Core countries also moved industrial capacity to East Asia, Central America, and Eastern Europe, thus benefiting from lower wages and laxer labor regulations.

Downward pressure on real wages and importing cheap wage goods from abroad allowed capitalists in core countries to appropriate most of the gains in productivity – modest as these were – leaving little for workers. The result has been deepening, acute, inequality. Figure 5 confirms the relentless worsening of the functional distribution of national income for labor in the years following 2007–2009.

Steadily escalating inequality has been a prominent feature of capitalist economic, social, and political development in recent decades, fully reversing the gains made by workers in the years after the Second World War (Piketty 2013; Milanovic 2016).[20] The escalation of inequality corresponds with the emergence of hugely powerful and wealthy oligarchies across core countries, the weakening of the middle strata, and the frequently catastrophic decline in the material conditions and life prospects of the working class. The precise causes of rising inequality vary from country to country, but there is no doubt that profits have commanded an increasing portion of domestically produced output compared to wages, thus compressing labor's share in national income (Guschanski and Onaran 2018).[21]

Confronting the rise in inflation

Rising inflation in core countries in the 2020s is associated with the great boost to aggregate demand, particularly as the expansionary policies of core states were compounded by the lifting of restrictions in 2021. It appears, furthermore, that growing demand was allocated toward goods rather than services since the networks of the latter took the strongest blow from the pandemic. But more fundamentally, rising inflation reflects the inability of aggregate supply adequately to respond to growing demand, and at the root of that lies the malaise of capitalist accumulation in core countries summed up by poor profitability and poor productivity growth.

The trajectory of inflation in core countries will hinge on the future conduct of labor markets and the corresponding path of wages. In political economy terms, the path of inflation will depend on the struggle over the distribution of value, output, and income. For, once inflation takes off, it becomes a matter of distributional struggle between capital and labor. The rise in prices could, for instance, amount to a loss of real income for workers that would be appropriated as profit by capitalists. Or it could turn into a loss of profits for capitalists, if workers' income kept pace with inflation and prices were then administratively controlled. This is what is at stake when mainstream economists engage in debates on whether the expectations of inflation already are or will become "de-anchored" (Gobbi, Mazzocchi, and Tamborini 2019; Dash, Rohit, and Devaguptapu 2020; Nautz, Pagenhardt, and Strohsal 2017).[22] Inflationary conditions will reflect the level of organization and the confidence of workers as well as the growth of labor productivity.

To be a little more specific, if workers lost out in the conflict over distribution, nominal wages would fail to keep up with inflation. With nominal wages rising less than the prices of goods and services, the real income of workers would fall, and it is possible that the overall tendency of prices to rise would gradually subside. The loss of income for workers would directly correspond to a transfer of income to capitalist profits, as is discussed below in relation to Keynes's original analysis of inflation. It is notable that even in countries where employment has recovered more strongly, as in the USA and the UK, nominal wages failed to keep pace with inflation since 2021 (Forster van Aerssen et al. 2021; Howard, Rich and Tracy 2022).[23] Profits were the direct beneficiary, sustaining inflation.

It is possible, on the other hand, that increases in nominal wages would match the rise in prices, thus avoiding an income loss for workers. The outcome for inflation would then depend on the response of enterprises, especially of the large monopolists within the global networks of production. If the rise in non-wage costs, such as energy and other inputs, was absorbed as a loss of profits, inflation could again begin gradually to

subside. That would be the socially rational thing to do since inflation was not spurred by rising wage costs in the first place. But the spontaneous reaction of enterprises would be to raise prices seeking to maintain the same level of profits. If workers responded by seeking further wage increases to protect their income, a chain reaction could set in, keeping inflation high.

In short, the underlying weakness of aggregate supply together with the distributional struggle between labor and capital might entrench inflation.[24] Wages would be the passive factor in this process as workers would attempt to maintain living standards. The active factor would be capitalists passing cost increases onto output prices to ensure their profits, and potentially to obtain the income loss of workers as additional profits. To prevent that outcome and protect workers' income, it would be necessary to impose administrative controls on prices and wages.

The outcome of this distributional struggle is far from certain. The rise of financialised capitalism during the last four decades – accompanied by the relocation of industrial capital across borders – has dealt a major blow to workers' ability to organize in high-income countries (Milberg and Winkler 2013). Relocation went together with a global wave of labor market reforms that worsened the conditions of labor, including sustained attacks on trade union organization and the gross weakening of public welfare provision. Formerly thriving industrial areas experienced surges of unemployment, often impacting on workers along racial and ethnic lines, as manufacturing was relocated to East Asia, East Europe, Mexico and elsewhere to take advantage of cheaper wages and looser labor and environmental regulations (Starosta 2016).

The trajectory of labor markets during the last four decades was thus very different from what one might expect from a historical analysis of capitalism. Far from the formal practices of wage labor in core countries acting as benchmark for peripheral countries as industrial capitalism took root, the opposite occurred. Labor markets in high-income countries have acquired a distinct resemblance to labor markets in low-income countries, long characterized by precarious, temporary, and informal employment (Greenstein 2020). The consequences have included stagnation of real wages, increases in inequality, and a decline in labor's share in national income, as was shown in earlier chapters (Benanav 2020). Technological advances related to digitalization and platform work have further intensified the growth of precarious employment (Muntaner 2018).

When the pandemic struck in 2020, the growth of unemployment was relatively modest in countries that had strong labor protection measures in place. There were also pronounced differences between informal and

formal workers since the latter were often shielded from unemployment and their incomes were protected (ILO 2020). But working hours in 2021 remained significantly below pre-pandemic levels, and across the world economy there were great volumes of underutilized wage labor, especially among low-wage earners and the young (women in particular) (ILO 2021). In high-income countries there were significant levels of underutilized labor in 2022 (Domash and Summers 2022).[25] Labor is the most important factor of production, and since substantial numbers of workers still lay outside the process of value creation, they contributed to the weakness of aggregate supply as well as the loss of power of workers relative to capital.

The distributional struggle and the resulting trajectory of inflation are issues of the first importance as the broader implications of the turmoil of the 2020s continue to emerge. For, if high inflation became entrenched, it would deliver a body blow to financialised capitalism (Bolhuis, Cramer, and Summers 2022; DeLong 2022).[26] It would thus be unacceptable to the ruling elite as a method of dealing with the resource costs of the turmoil. But, at the same time, a fall in profits would also be unacceptable as a way of constraining inflation while protecting the income of workers. Administrative policies to control and regulate prices, thus lowering profits, would certainly be opposed.

If rapid inflation became a realistic threat, the monetary authorities of core countries would draw on the accumulated experience of the last forty years and seek to suppress it by hiking interest rates and imposing austerity. Already in June 2022 the Federal Reserve began significantly to increase interest rates signalling the likely path of policy. But the issue is far from simple and a repeat of the "Volcker shock" in the 2020s would be a very different affair compared to the 1980s. In the intervening decades the world economy has become awash with private and public debt, the bitter fruit of financialisation in both core and periphery (Gaspar, Medas, and Perrelli 2021).[27]

The pandemic shock, coming hard on the heels of decade of weak accumulation, has resulted in exceptionally hard policy choices. Escalating interest rates would not only bring recession and further losses for workers but also major debt crises across the world, particularly among peripheral countries that are already exposed to high public debt. Moreover, the precipitous fall in asset prices that would ensue high interest rates would also entail substantial losses of wealth for the capitalist class. At bottom, then, dealing with inflation is a matter of class contestation. We shall have to wait and see how that unfolds in core countries in the coming period.

Notes

1. This article draws heavily on Lapavitsas and the EReNSEP Writing Collective (2023).
2. Price increases followed a short, though significant, downward shock to commodity prices at the very start of the pandemic as aggregate demand and supply took an enormous blow.
3. The public debate took place mostly in the pages of newspapers, blogs and – inevitably – twitter, was conducted mostly among the conservative neo-Keynesian guard that dominates contemporary mainstream Economics. The side that rang the alarm bell included O. Blanchard and L. Summers, while the side that downplayed the risks counted P. Krugman and J. Stiglitz among its members. For an early snapshot of the debate, see Landau (2021). Throughout 2021 the Federal Reserve and the Biden administration were broadly on the side of the "downplayers" but by the middle of 2022 things had changed and there was global concern regarding the persistence of inflation. Concern was also evident among the economists of the multilateral international organisations.
4. The bibliography on this issue is extensive. For a historical account of the inflationary pressures leading to the Volcker shock, see Meltzer (2005). For an assessment of Fed under Volcker and the issue of credibility, see Goodfriend and King (2005). For the changed role of the Fed after the Volcker shock, see Morgan (2012).
5. This crucial point regarding inflation was established already in the nineteenth century by Thomas Tooke of the Banking School in his classic History of Prices. Tooke lacked the notion of the price level, as was common among political economists at the time, but was able to show through empirical analysis that the observed price fluctuations in key markets were typically due to real factors. There is little doubt that this was also Marx's fundamental view. For further detail on Tooke's arguments in this connection, see Arnon (1991).
6. Keynes's analysis had a sustained influence on the theory of war finance
7. For an exemplary analysis of Keynes's plan and the disastrous implications of British imperial policy, see Patnaik (2018).
8. For a political rejection of Keynes's plan from the left, see Deutscher (1940).
9. In this light, inflation in developing or peripheral countries was not primarily due to government policy boosting aggregate demand but rather associated with the mechanisms of production across the world economy.
10. The main elements of this argument were developed by Rowthorn.
11. It is important to bear in mind that the average rate of profit contains considerable dispersion and may disguise significant variation on the supply side. A substantial proportion of enterprises in core countries, for instance, have low, or even very low, profitability, reflecting profound competitive frailty. The presence of these "zombie firms" underscores the weak performance of accumulation since the Great Crisis and is considered more fully in subsequent chapters.
12. The drive to increase productivity would typically rest on a rising technical composition of capital, that is, on more machinery and other inputs per worker, or an increasing capital/labour ratio in physical terms. A rising technical composition would push up the organic composition of capital, i.e., the simple value reflection of the technical composition. If the organic composition rose, the rate of profit would fall – a standard result in Marxist analysis. In short, for productivity to rise the technical composition of capital must also rise, and that would exercise downward pressure on the rate of profit. What matters for our purposes, however, is the effect of rising productivity *per se* on profitability. If productivity is not rising rapidly,

despite increases in the technical composition of capital, profitability is unlikely to register a sustained increase.

13. Always bearing in mind the impact of changes in the organic composition of capital as well as the impact of changes in the intensity of labour. Both of these factors are integral parts of the "internal mechanism". In particular, changes in the intensity of labour could alter the rate of exploitation independently of the value of the wage basket or the division of the working day into a necessary and a surplus part.
14. The calculation is based on the method of Dumenil and Levy (1994). The pre-tax rate of profit for the corporate sector was also computed following the adjustment proposed by Shaikh (2011). The results were similar. For further detail on the method of calculation, see Lapavitsas and Mendieta-Muñoz (2016).
15. Mainstream economists typically refer to the slowdown of productivity growth in the period after the Great Financial Crisis as the "productivity puzzle". A detailed discussion of the factors that might have contributed to the slowdown in the USA over a longer period of time can be found in Gordon (2016). For empirical evidence on productivity growth trends worldwide, see Ollivaud, Guillemette, and Turner (2016).
16. It is plausible that the weak growth of productivity in core countries also reflects the relative contraction of the manufacturing sector in core countries along the lines of "induced technological change" proposed by Kaldor (1957, 1961) in his sharp critique of neoclassical growth theory. Shifting manufacturing capacity abroad – especially to Asia – and applying sustained downward pressure on real wages might have boosted profits in the short term in core countries but has helped productivity growth in the longer term.
17. The income of chief executives and other managers, which has increased rapidly in recent years, is accounted as wages, thus artificially boosting the wage share even in the face of increasing income inequality.
18. See the hard-hitting Congressional Research Service Report, US Congress (2020). For a recent German account on income inequality and the role of housing, coupled with a historical analysis of the changes in last two decades, see Dustmann, Fitzenberger, and Zimmermann (2022). For a comparative study of income inequality in Britain and the USA, see Blundell et al. (2018).
19. For a recent analysis of East Asian economic growth and gains in productivity, see Mason and Shetty (2019).
20. The literature on this issue is very extensive, most notably Piketty (2013) but see also Milanovic (2016).
21. In recent years there has been a surge of research into inequality by both mainstream and heterodox authors. While the focus of mainstream economists has been directed at personal inequality measures at both the national and international level, including gender and race disparities, heterodox scholars have typically focused on functional inequality. For inequality in the countries in our sample group, see, for example, Guschanski and Onaran (2018).
22. Economists have long been concerned about the possibility of inflation expectations becoming "de-anchored"; for a formal model analysis, see Gobbi, Mazzocchi, and Tamborini (2019). For the USA, Dash, Rohit, and Devaguptapu (2020), claimed that household inflation expectations have been "de-anchored" since the 1990s. For the Eurozone, Nautz, Pagenhardt, and Strohsal (2017) argued that expectations have become de-anchored since 2011.

23. The US and UK labour markets in the post-pandemic recovery. In ECB Economic Bulletin, Issue 8/2021.
24. Goodhart and Pradhan (2020) argue that such a process is already under way as the great surge in globally available labour power during the last three decades is coming to an end.
25. The point held even in view of econometric attempts to show that the US labour market was in practice far more tight than official figures of employment suggested. Even if these calculations were right, there were still millions of workers available for hiring, and that is without even mentioning the poor quality of the jobs created.
26. Already in 2022 there were voices claiming that entrenchment was well under way in the USA and that a policy response similar to the "Volcker shock" was required. Others appeared more sanguine, but their deep concern could not be disguised, see DeLong (2022).
27. For an estimate of total debt levels in 2021 see Gaspar, Medas, and Perrelli (2021).

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