Austerity and inflation – what you need to know

As the Bank of Canada increases interest rates to bring inflation back down, it's encouraging governments to ensure that that their spending doesn't make inflation worse. Sometimes governments will use this as an excuse to keep wages low for workers, or to avoid making much needed investments in public services.

Wage increases

Making sure that workers' wages keep pace with the cost of living is a matter of fairness. Right now, workers are taking real wage cuts while government revenues and corporate profits are increasing. In other words, we're seeing a transfer of wealth from workers to corporations.

The Bank of Canada is warning that we should keep wage increases low to avoid a wage-price spiral. But the simple fact is that workers' wages are only half of the total value of the economy. To cause a problem, wages would have to increase much faster than inflation – and that's not happening.

The Bank of Canada also wants to keep wages low to limit "inflation expectations." Inflation expectations are the rate at which people expect prices to rise in the future. Inflation expectations are often correlated with actual inflation, so the Bank of Canada wants to keep these expectations low. But this does not mean that wages should stagnate. For example, bargaining cost-of-living clauses linked to CPI would create security for workers without a risk of overshooting estimates of future inflation.

Federal and provincial governments have seen their revenues grow substantially due to inflation and can afford to pass those gains on to workers. However, private sector wage gains are outpacing public sector wage increases. Governments should lead by example and ensure their workers' wages keep pace with inflation.

Government spending

When governments pull back spending too much, it amplifies the economic forces pushing us towards recession, putting all the pain of inflation on the backs of workers. Governments need to step up and take action to protect workers impacted by the pandemic, by inflation, and by the threat of a recession.

There are ways that governments can reduce the inflationary impact of their spending while maximizing the benefits. Mainstream economists believe that new spending primarily financed by increasing taxes is non-inflationary. Restoring corporate taxes to former, fairer levels can help - especially as we're now seeing record corporate profits.

Some economists believe that where government money is spent matters even more than where that money comes from. Their work suggests that governments should

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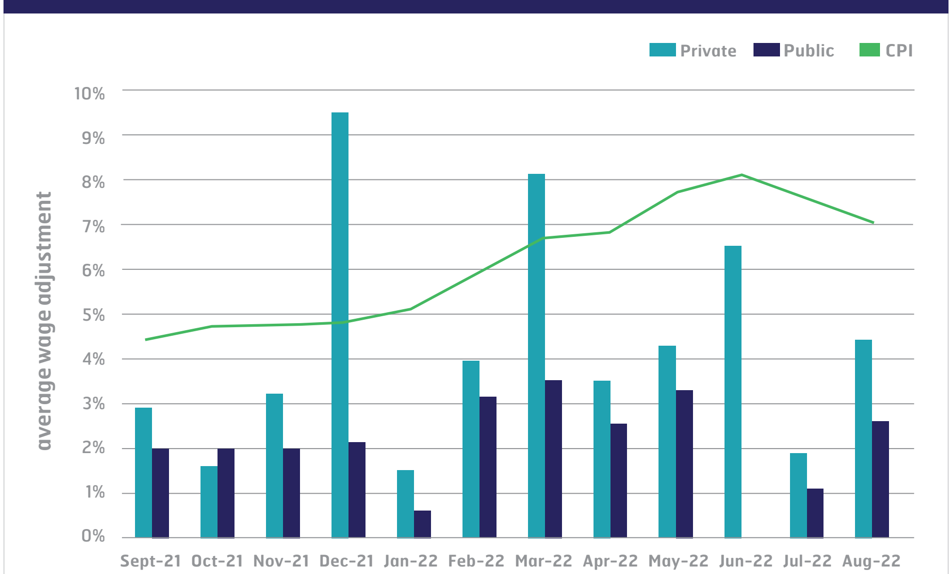
Wage increases in private and public sector collective agreements, September 2021 – August 2022



Labour Canada, Collective agreement settlements

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target spending by providing income supports to those who need it the most. Indexing income supports to inflation, for example, provides immediate help and is far less inflationary than issuing a blanket $250 cheque to every citizen.

Governments can also fight inflation by making medium-term investments that provide lower-cost alternatives for expensive goods. Since in many provinces transportation, energy, and shelter costs are increasing the fastest, these areas are prime candidates for governments to consider. Most of the high-impact spending in these areas – such as building affordable housing, funding deep energy efficiency retrofits, or investing in public transit and rail – might not make an immediate impact, but it is still worthwhile to get started on these efforts now.

If there is a recession next year, as there often is after interest rates are increased so quickly, governments might argue they can't afford to make these critical investments. It will be important to remind them that public services are what makes our economies healthier – in good times and in bad.

Record-high corporate profits behind inflation

There's growing public debate about corporate profits – how much is too much? During the pandemic, large corporations made record gains while households and smaller businesses struggled. And as inflation surges, corporate profit-seeking is contributing to the upsurge in prices.

The Bank of Canada has mostly ignored the role that corporations play in setting prices. Instead, it has continued to suggest that raising wages will lead to higher prices (a wage-price spiral). For example, when the Bank increased interest rates in October, they mentioned wages nine times, and failed to mention corporate profits at all.

Such an approach is disingenuous. We can see that average wage increases are lower than inflation across the board, while corporate profits are increasing.

In fact, as a share of Canada's gross domestic product (GDP), after-tax corporate profits have reached a 60-year high. GDP is the monetary value of all finished goods and services made within a country during a given period. It's often used to estimate the size of an economy. In the second quarter of 2022 (the months of April, May, and June), after-tax corporate profits accounted for 20% of Canada's GDP. This is two percentage points higher than the pre-financial crisis high of 18% that we saw in 2005, and more than double the average we saw between 1960 and 2000.

Why is the Bank of Canada ignoring the role of corporate profits in rising prices? One reason is that mainstream economic theory says it's natural for corporations to set prices as high as they can to maximize profits. The idea is that if corporations set prices too high, consumers will switch to a more affordable option, keeping prices in check.

The problem is that this only works if there is healthy competition in the market, and new businesses can make money by offering goods and services at lower prices. This is difficult in Canada because our laws favour corporate mergers and monopolies, making it harder for new businesses to compete.

Anti-competitive behaviour isn't new in Canada, and neither are our concerns about it. There's been public outcry over a number of large corporate mergers in the past

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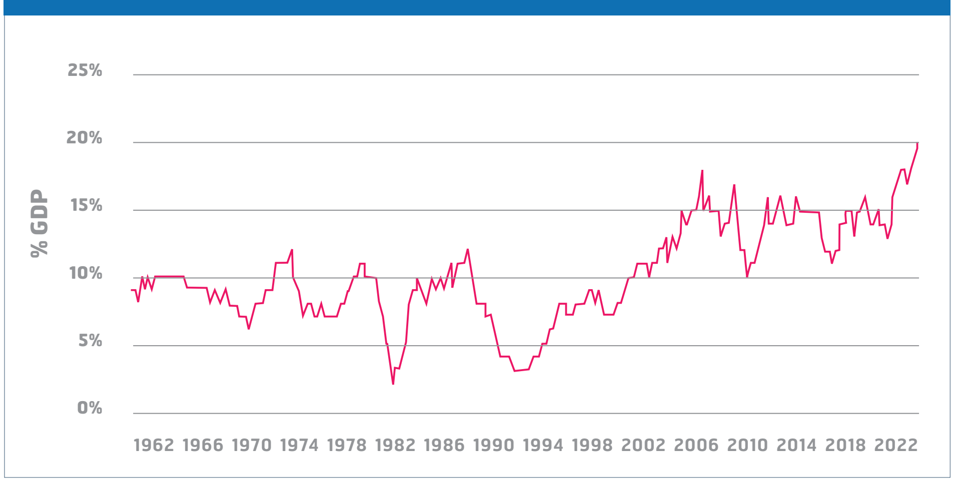
After-tax corporate profits as percentage of Canada's GDP



Source: Statistics Canada Table 36-10-0117-01

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several years, and the federal government just launched a long-awaited competition review in November. Throughout this process, we will need to hold the government to account to improve our competition laws and keep prices in check.

But while improvements to competition law will help, it's not the whole picture. There are also Canadian industries with several players, such as Canada's big banks, which maintain higher prices than we would expect in a competitive marketplace. This demonstrates that competition isn't the magic fix that economists sometimes make it out to be – especially when it comes to goods and services that are necessities, like shelter, food, and energy. Corporations know that consumers will pay more for things that they need, even if they really can't afford it. For true necessities, it makes sense to have a public option that takes profiteering out of the equation – like public energy companies.

Finally, it's important to note that one of the primary drivers of higher after-tax corporate profits has been the dramatic corporate tax cuts that governments at both the federal and provincial levels have implemented since 2000. This has resulted in a huge transfer of wealth from governments and public services into private hands. We need our governments to recognize that this trickle-down approach has failed, and to implement a better balance in corporate taxation.

ECONOMIC BRIEFS

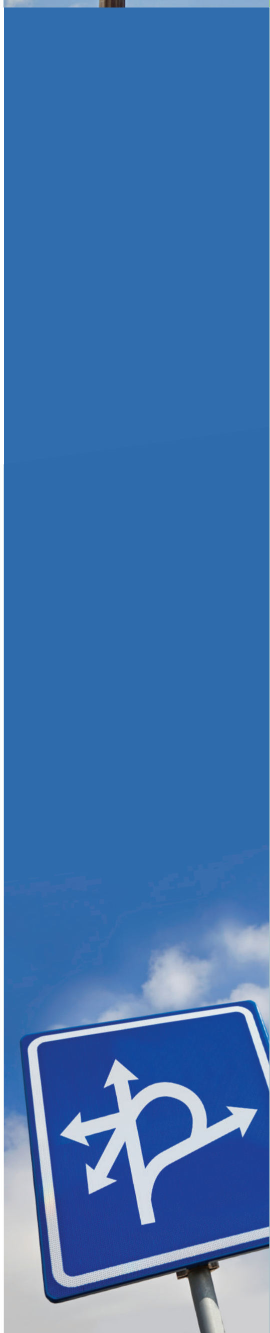
10 out of 10 provinces see improved revenues

Inflation, a strong labour market, and record corporate profits have led to higher-than-expected provincial revenues for the 2021–22 fiscal year, growth which is expected continue for 2022–23. The Canadian Centre for Policy Alternatives has put out a report on this trend with a breakdown for each province. In their 2022 budgets, released this spring, the provinces forecast a combined deficit of $23.5 billion in 2021–22, and $25.1 billion in 2022-23. But the latest fiscal updates show that these deficits have been turned into surpluses. Together, the 10 provinces brought in $2.2 billion more than they spent in 2021–22 and are forecast to bring in $7.1 billion more than they spend in 2022–23. This means provinces have no excuse for failing to pay workers fairly, index provincial benefits to inflation, and properly invest in public education and health care.

A worker-focused approach to inflation

The Canadian Labour Congress teamed up with economist Jim Stanford to put out a thorough report on inflation. The report proposes some key changes to policy makers' standard approach to inflation and backs up the labour movement's position that the current approach puts the burden of inflation on workers. Stanford proposes that the Bank of Canada add targeting full employment to its mandate, that the federal government consider increasing taxes on those who have benefited from the pandemic and inflation, and that federal and provincial governments accelerate investments in non-market housing and energy conservation measures. The report is an excellent resource for anyone pushing federal and provincial governments to tackle inflation in a way that benefits workers and our economy in the long term.

ECONOMIC DIRECTIONS



Economic growth – The International Monetary Fund, an international financial institution, has lowered their expectations for global economic growth in 2023. The global average is expected to be around 1.6%, and both the United States and Canada are expected to see economic growth below 1% for 2023. This would be what economists call "a soft landing," when central banks are able to lower inflation without causing a recession. If central banks continue to increase interest rates, we can expect economic growth to be even lower than financial institutions are forecasting right now.

Jobs – Unemployment was up slightly to 5.2% this fall, above this summer's low of 4.9%. We're continuing to see large numbers of job vacancies in sectors with slow wage growth, such as health care and food services. The federal government is looking to increase targets for immigration to help fill labour market vacancies.

Wage trends – The average hourly wage increased by 5.6% in October 2022 compared to October 2021. This change fell short of the Consumer Price Index (CPI), which calculated the rise in consumer prices during the same time period to be 6.9%. Statistics Canada analysis found that higher wage workers, those already making over $40/hr, were more likely to have received a wage increase than those workers earning $20/hr or less. Non-unionized workers are also more likely to have received a wage increase so far this year. This is due in part to the fact that unionized workers must wait for bargaining periods to bargain higher wages.

Uneven impacts of inflation – Inflation impacts lower income households more severely than higher income households. This means that wage growth at the lower end of the spectrum actually needs to increase faster than CPI to protect purchasing power for these workers. While middle- and higher-income workers are also affected by higher costs, research shows that these households tend to be able to reduce their spending on necessities by buying no-name brands and using coupons. Workers with lower incomes are more likely to be economizing already and so are unable to reduce their budgets without cutting out necessities.

Interest rates – The Bank of Canada has increased interest rates six times so far in 2022, from 0.25% in January 2022 to 3.75% in October 2022. At the end of October, the Bank of Canada reported that while inflation was slowing down according to some indicators, it was still too high. If prices remain high along with low unemployment and moderate wage growth, we can expect the Bank of Canada to increase interest rates again in early December.

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