

Profits, inflation and survival in an age of emergencies: Why we need a new paradigm.

**Ellen Meiksins Wood Lecture
Isabella Weber, May 30, 2024**

We are living in a world of overlapping emergencies.

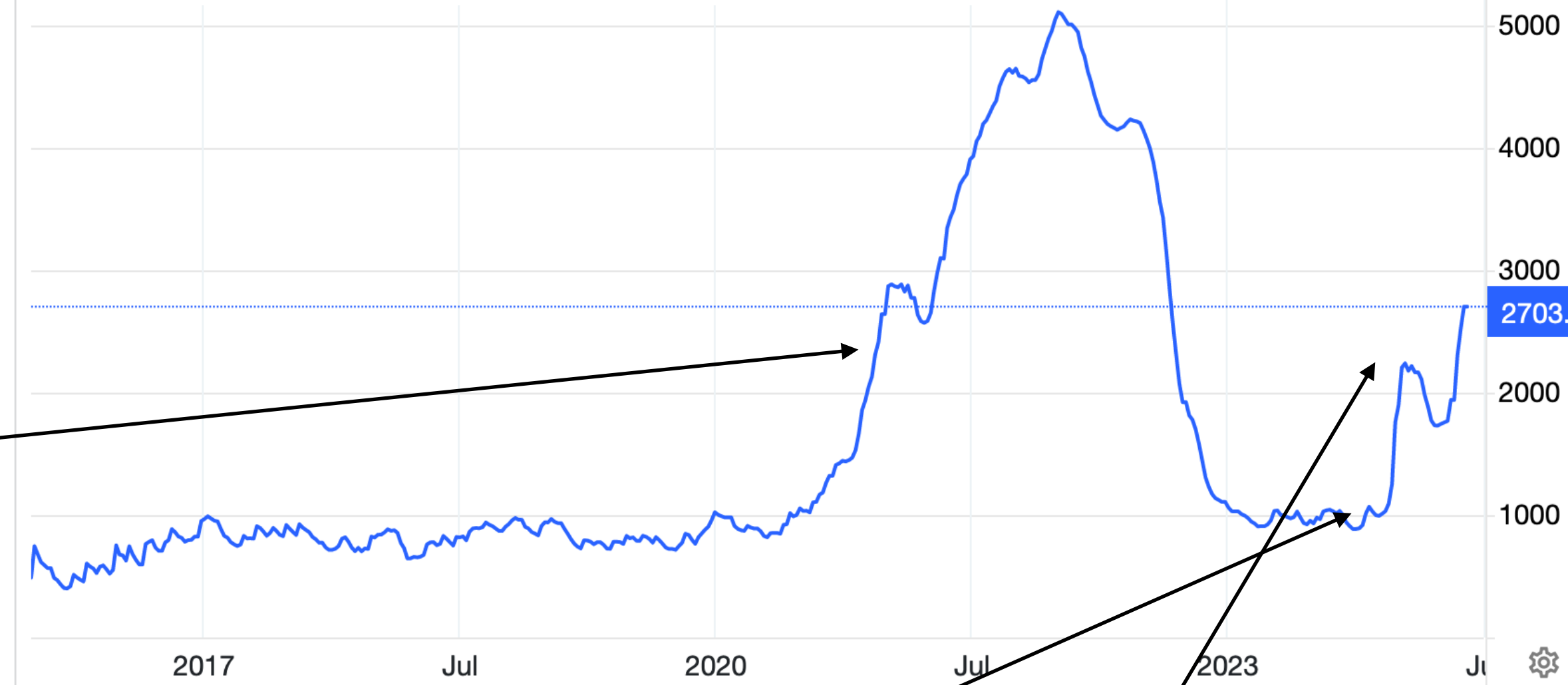
There will be more supply shocks but we do not know when and where they hit.



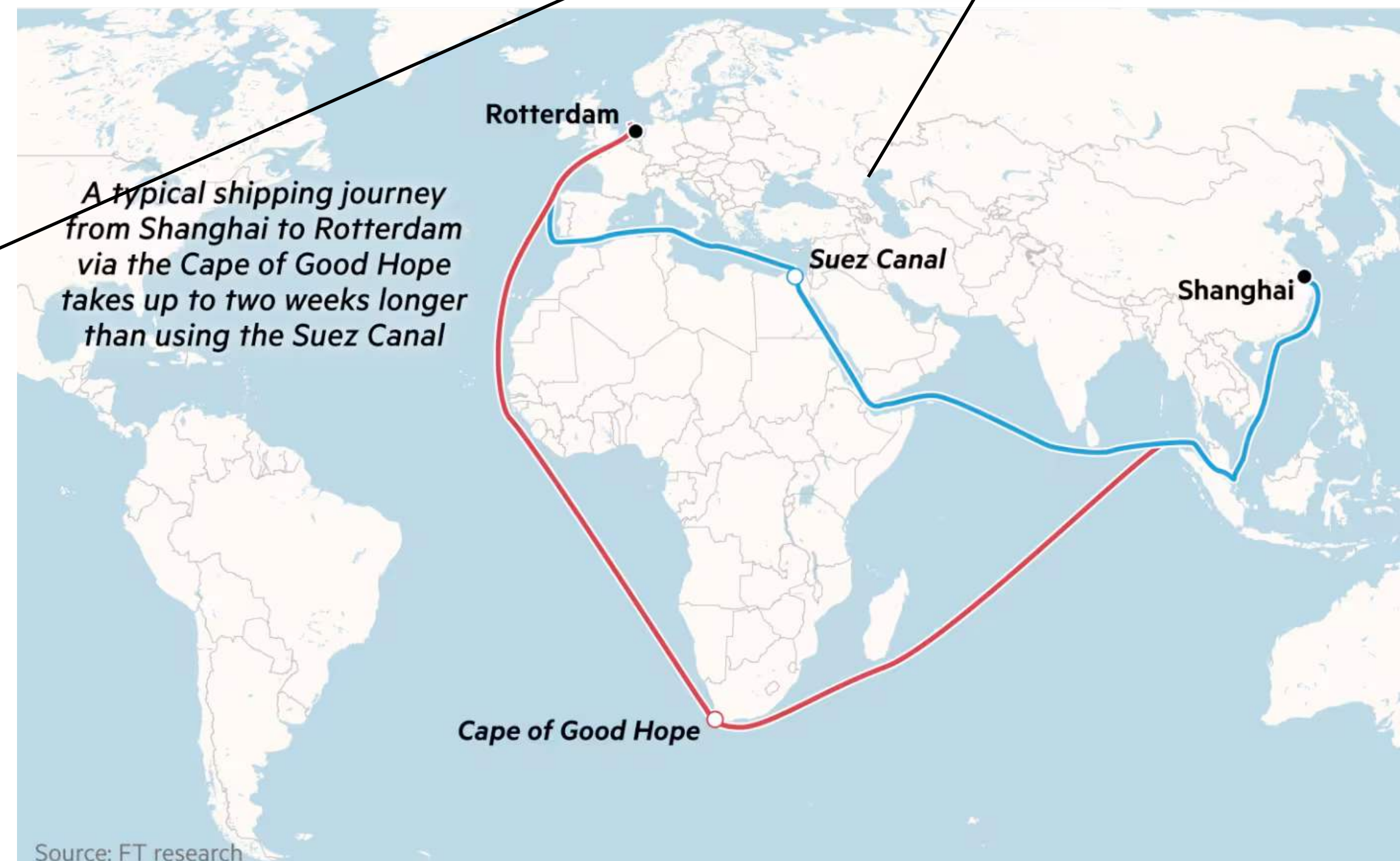
There is no hope for “resilience” when the firms that control ESSENTIALS reap record profits from disasters.



Containerized Freight Index

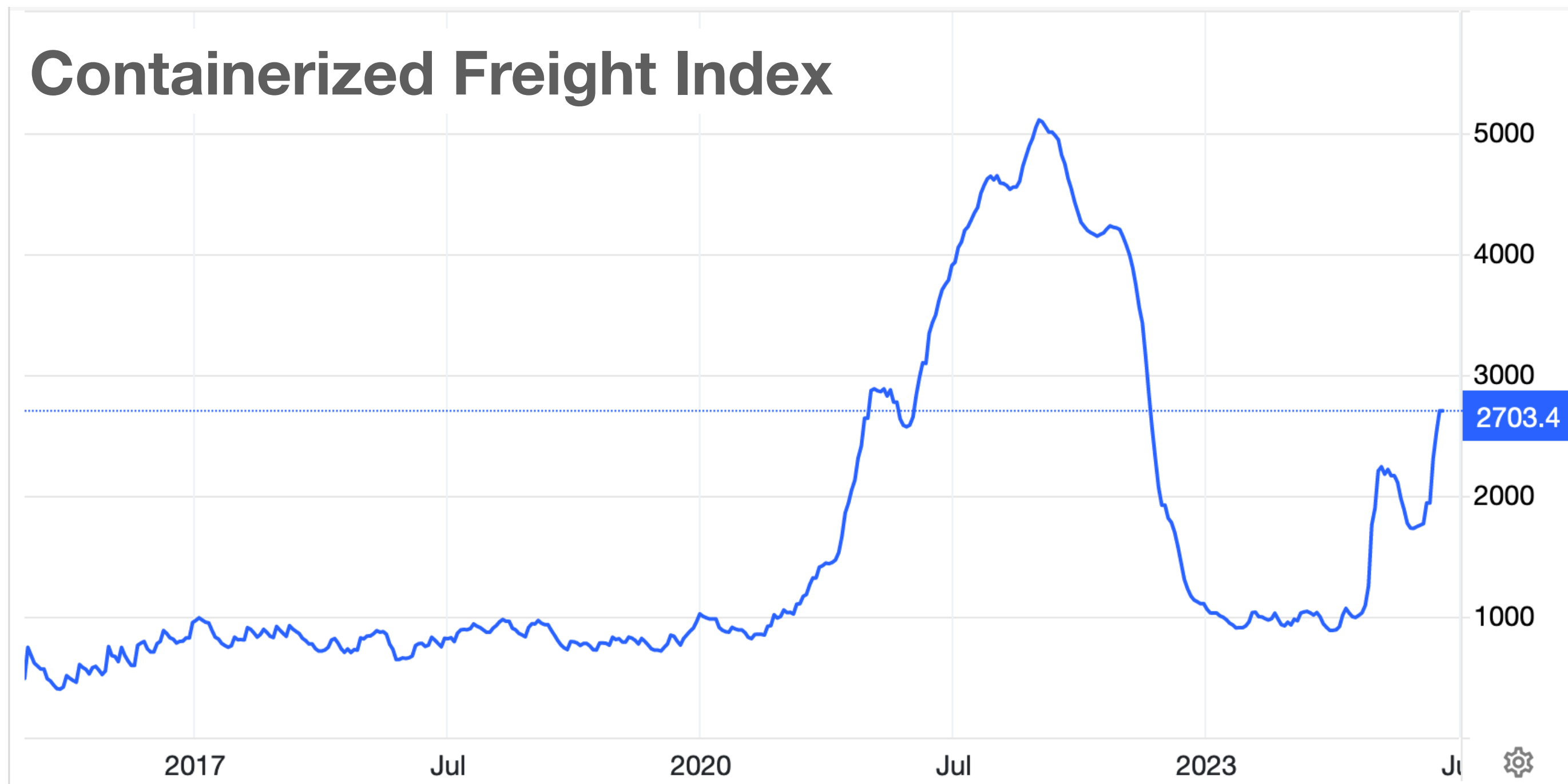


Houthi conflict threatens ocean trade through crucial shipping canal



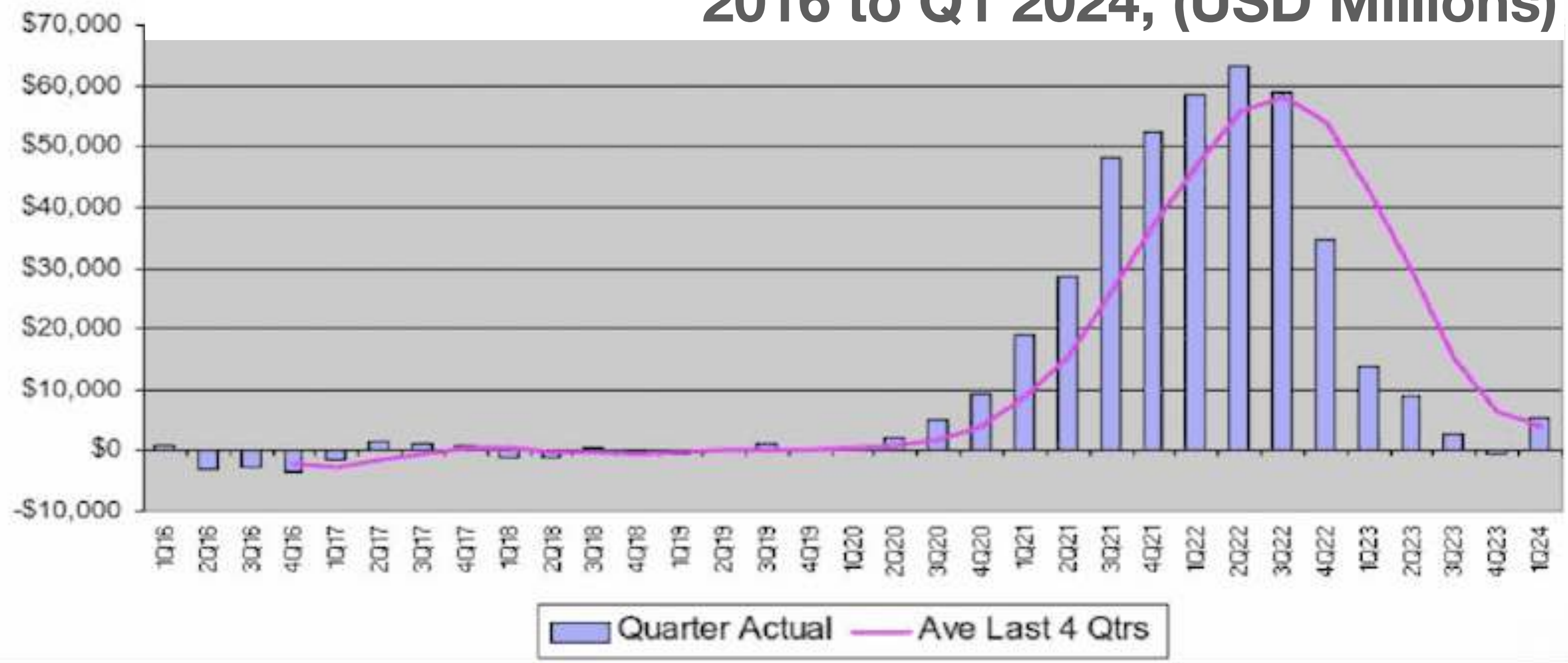
Source: FT research © FT

Containerized Freight Index



The flip side of the price explosion is a profit explosion.

Container Shipping Net Income by Quarter 2016 to Q1 2024, (USD Millions)



IMF Working Paper
Asia & Pacific Department

Shipping Costs and Inflation

**Prepared by Yan Carrière-Swallow, Pragyan Deb, Davide Furceri,
Daniel Jiménez, and Jonathan D. Ostry***

Authorized for distribution by Jonathan D. Ostry
March 2022

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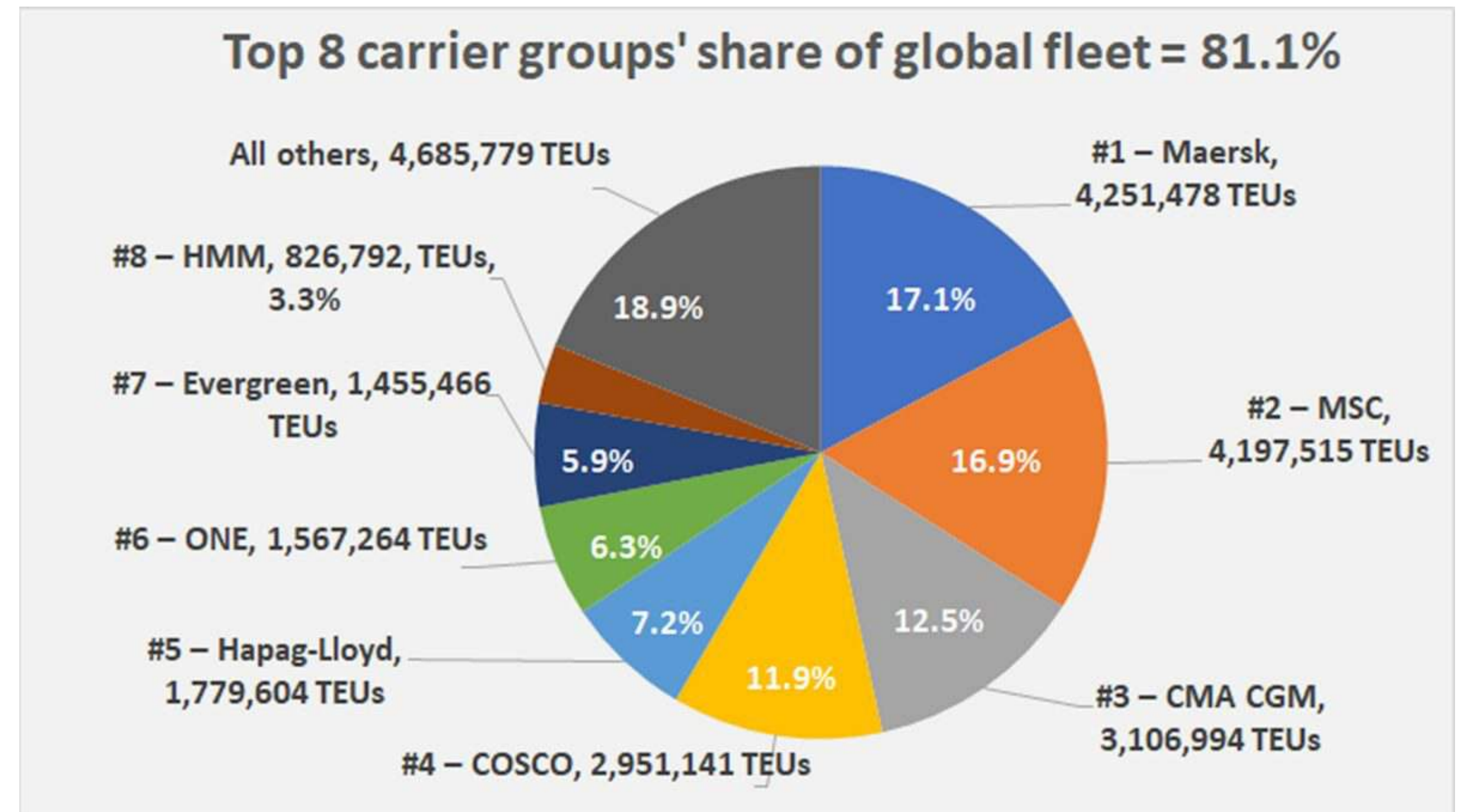
ABSTRACT: The Covid-19 pandemic has disrupted global supply chains, leading to shipment delays and soaring shipping costs. We study the impact of shocks to global shipping costs—measured by the Baltic Dry Index (BDI)—on domestic prices for a large panel of countries during the period 1992-2021. **We find that spikes in the BDI are followed by sizable and statistically significant increases in import prices, PPI, headline, and core inflation, as well as inflation expectations. The impact is similar in magnitude but more persistent than for shocks to global oil and food prices.** The effects are more muted in countries where imports make up a smaller share of domestic consumption, and those with inflation targeting regimes and better anchored inflation expectations. The results are robust to several checks, including an instrumental variables approach in which we instrument changes in shipping costs with an indicator of closures of the Suez Canal.

“Maersk [founded in 1904] recorded its “best financial result in its history” in 2022, showing a net profit of \$29.3 bn USD”
(Loadstar, 2023)

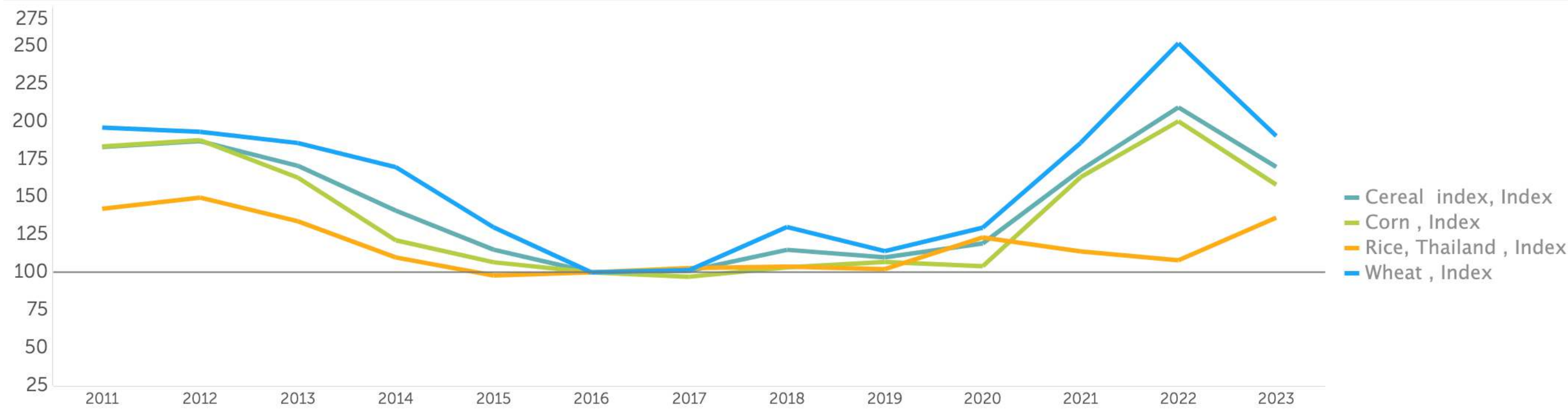
“the privately-held Mediterranean Shipping Company (MSC) achieved an astounding annual net profit of EUR 36.3 billion (USD 38.2 billion) in 2022”
(FullAventeNews, 2023)

“In 2022, CMA CGM had been France's most profitable company, overtaking the likes of TotalEnergies and LVMH with an annual net profit of \$24.88 billion.”
(Reuters, 2024)

The handful of companies that run the global shipping industry reaped record profits at the peak of the global shipping crisis in 2022.



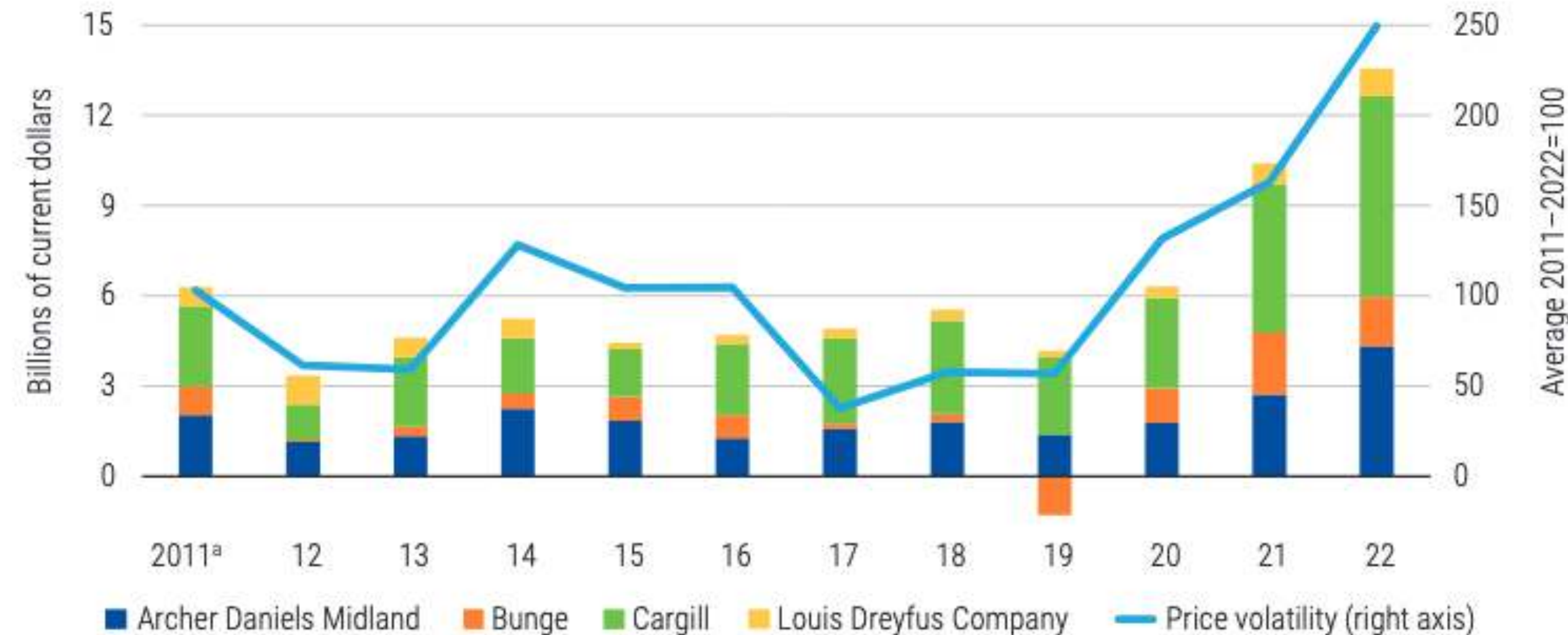
IMF Cereal Price Indices, 2016=100, 2011-2023



Profits of commodity traders thrive on price volatility.

“Cargill [founded 1865] reported that its fiscal year 2022 revenue jumped 23% from a year earlier to a record \$165 billion.”
(Reuters, 2023)

Figure III.4 Profits of the “ABCD” food companies surge during periods of price volatility
Profits of selected large agricultural trading firms and food price volatility

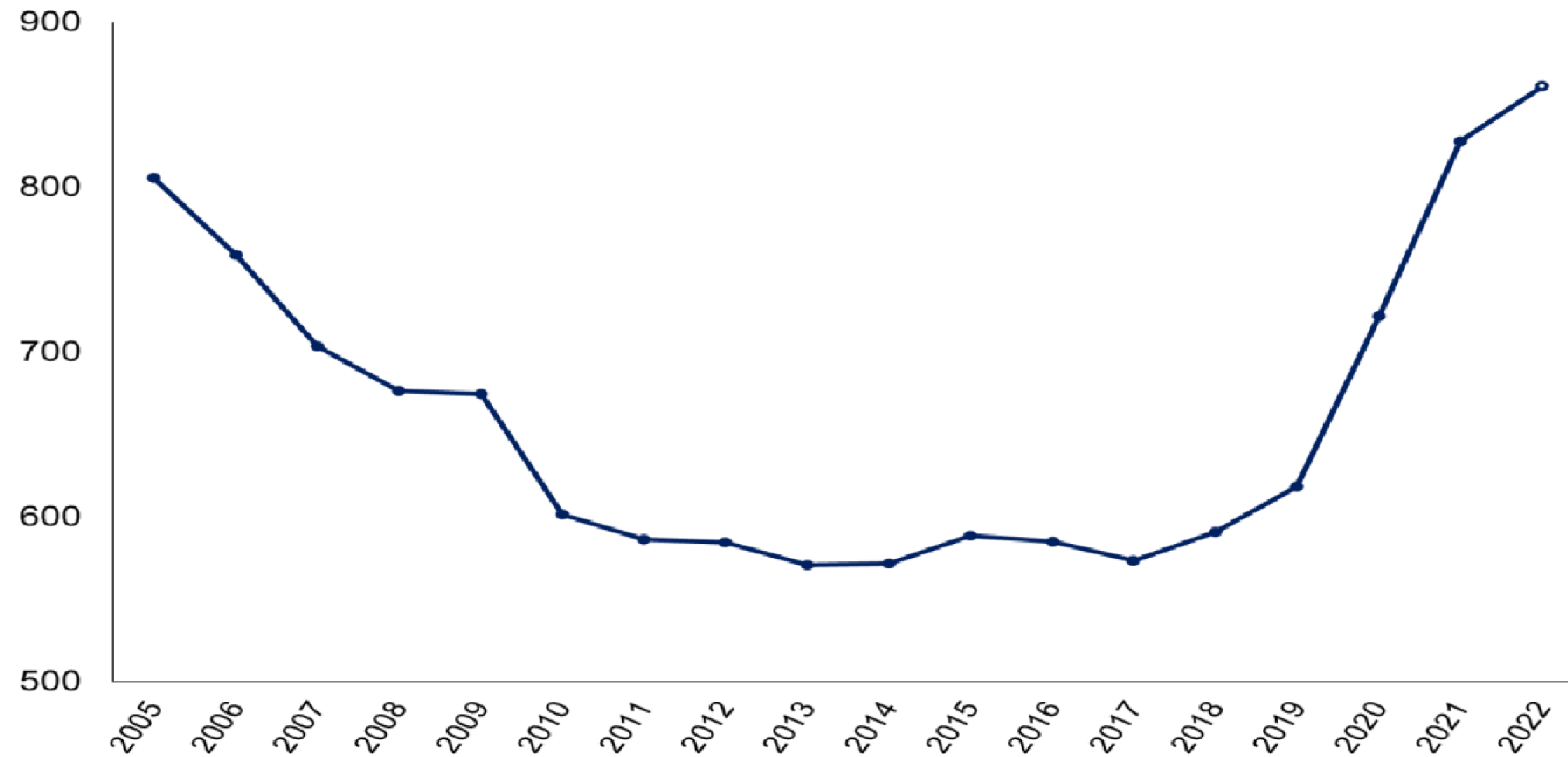


Source: UNCTAD calculations based on FAO *Real Food Price Index*, Blas and Farchy (2021: Appendix ii), Eikon Refinitiv, and Louis Dreyfus Commodities' Financial Results Reports (various issues).

“Gross profits from commodities trading activities – including by banks, hedge funds, independent traders and asset-backed businesses – rose from about \$36bn in 2018 to a record \$148bn in 2022 largely because of fallout from the war in Ukraine”
(FT, 2024)

Figure 4. Global Undernourished Population

(In millions)

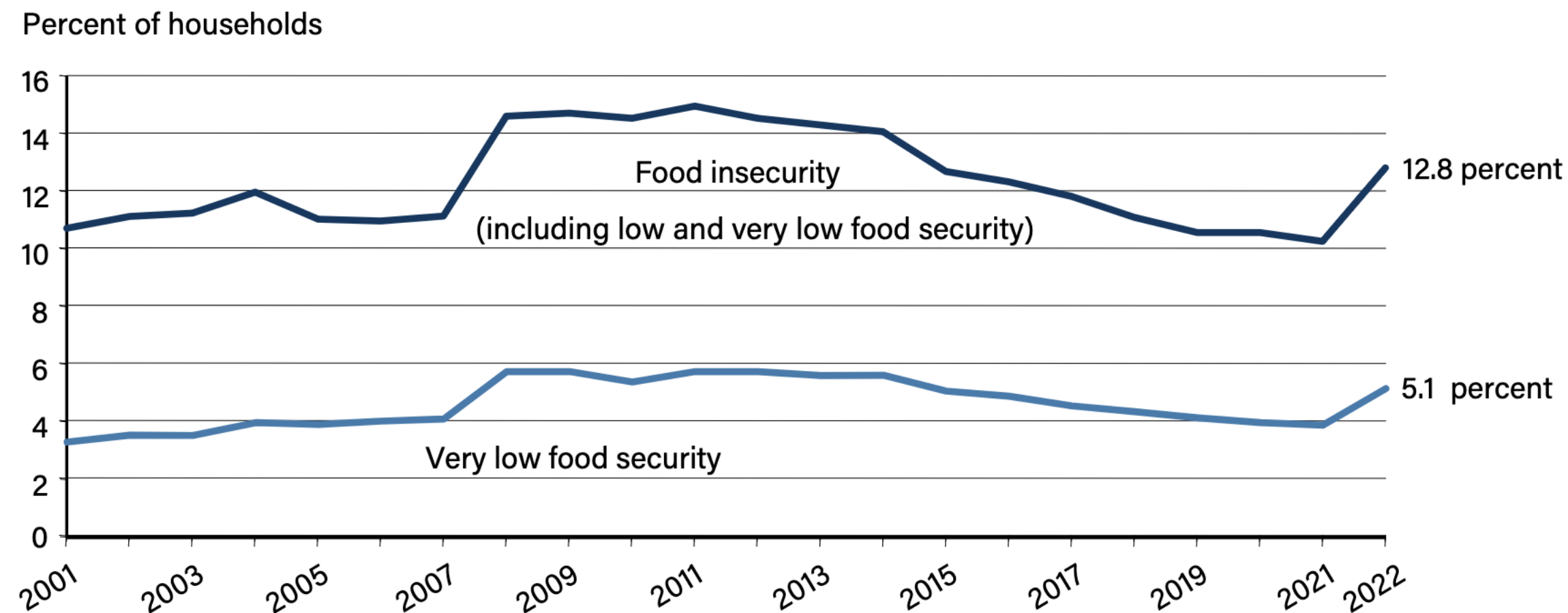


While food commodity traders had the best of times, global hunger has skyrocketed.

Sources: FAOSTAT and [HungerMap LIVE](#).

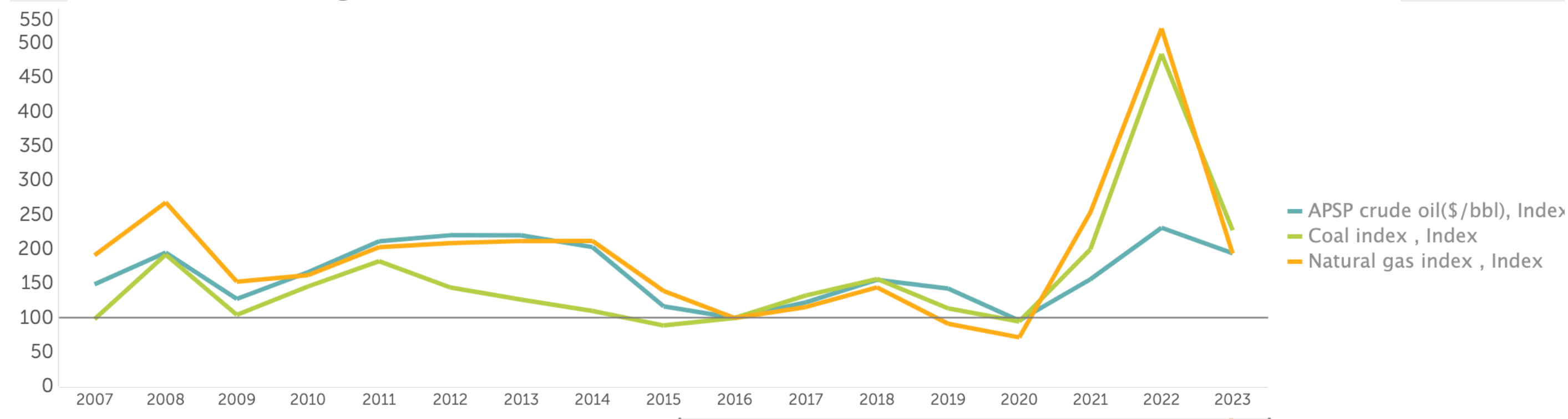
IMF, 2023

Prevalence of food insecurity in 2022 increased from 2021



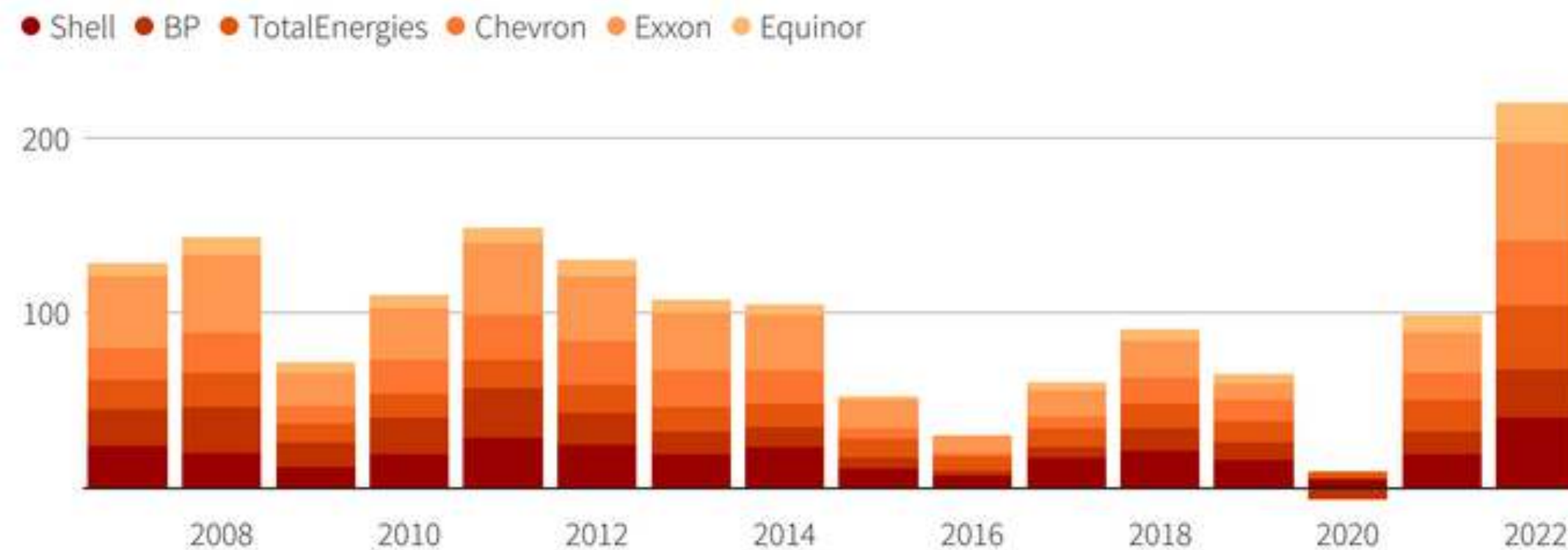
Source: USDA, Economic Research Service using data from U.S. Department of Commerce, Bureau of the Census, Current Population Survey Food Security Supplement.

IMF Energy Price Indices, 2016=100, 2007-2022



Big Oil's record profits

The top Western energy companies' profits soared in 2022 amid volatility in energy markets in the wake of Russia's invasion of Ukraine



Note: Net profits in billions of \$
Source: Company results

Reuters Graphics

Exxon Mobil

Chief Executive Officer, Darren Woods: 'we've created this hole with a lot more capacity coming off-line without a whole lot of new capacity.... That capacity is not coming on. So we've got this gap, demand recovers, and we don't have the capacity to meet that, which has led to a record, record-high refining margins'

Q2 Earnings Call, 7/29/2022

Business / Investing

House Democrats investigate whether Big Oil colluded with OPEC to inflate gas prices

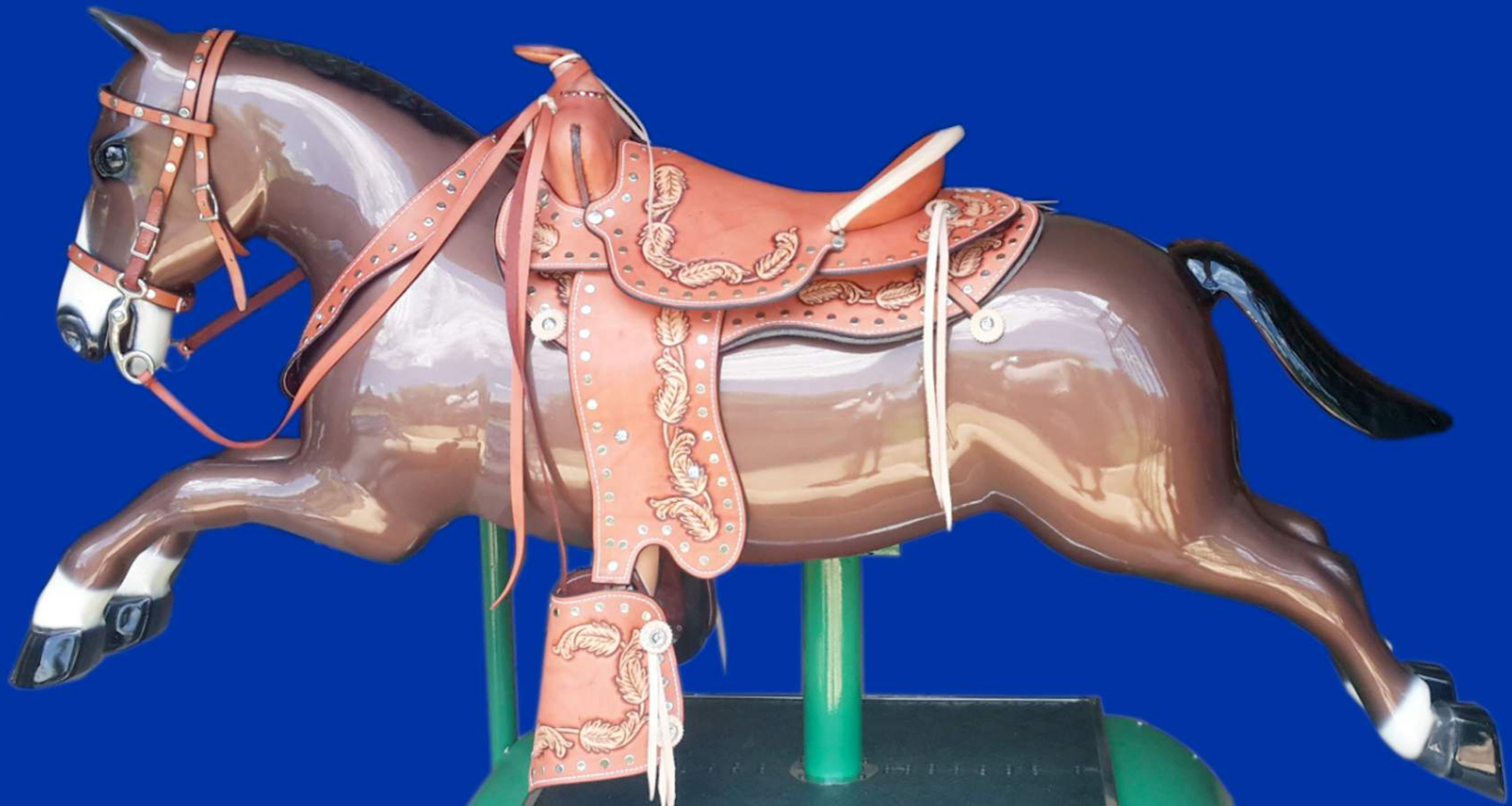
By Matt Egan, CNN
4 minute read · Published 7:00 AM EDT, Wed May 22, 2024

FINANCE · ANTITRUST

FTC rocks oil industry with claim that Texas executive was colluding with OPEC to fix prices

BY KEVIN CROWLEY, LEAH NYLEN AND BLOOMBERG
May 2, 2024 at 12:32 PM EDT





RIDE

Sandy

10¢

Pre-pandemic Common Sense:

Inflation is always and everywhere macroeconomic in origin and cannot be triggered by changes in relative prices

“what of oil and food to which every government official has pointed? Are they not the obvious immediate cause of the price explosion? Not at all. **It is essential to distinguish changes in relative prices from changes in absolute prices.** The special conditions that drove up the prices of oil and food required purchasers to spend more on them, leaving less to spend on other items. Did that not force other prices to go down or to rise less rapidly than otherwise? **Why should the average level of all prices be affected significantly by changes in the prices of some things relative to others?”** (Friedman, 1974)

**<-> Common Sense on COVID-19 Inflation:
Supply shocks and bottlenecks mattered for the return of inflation**

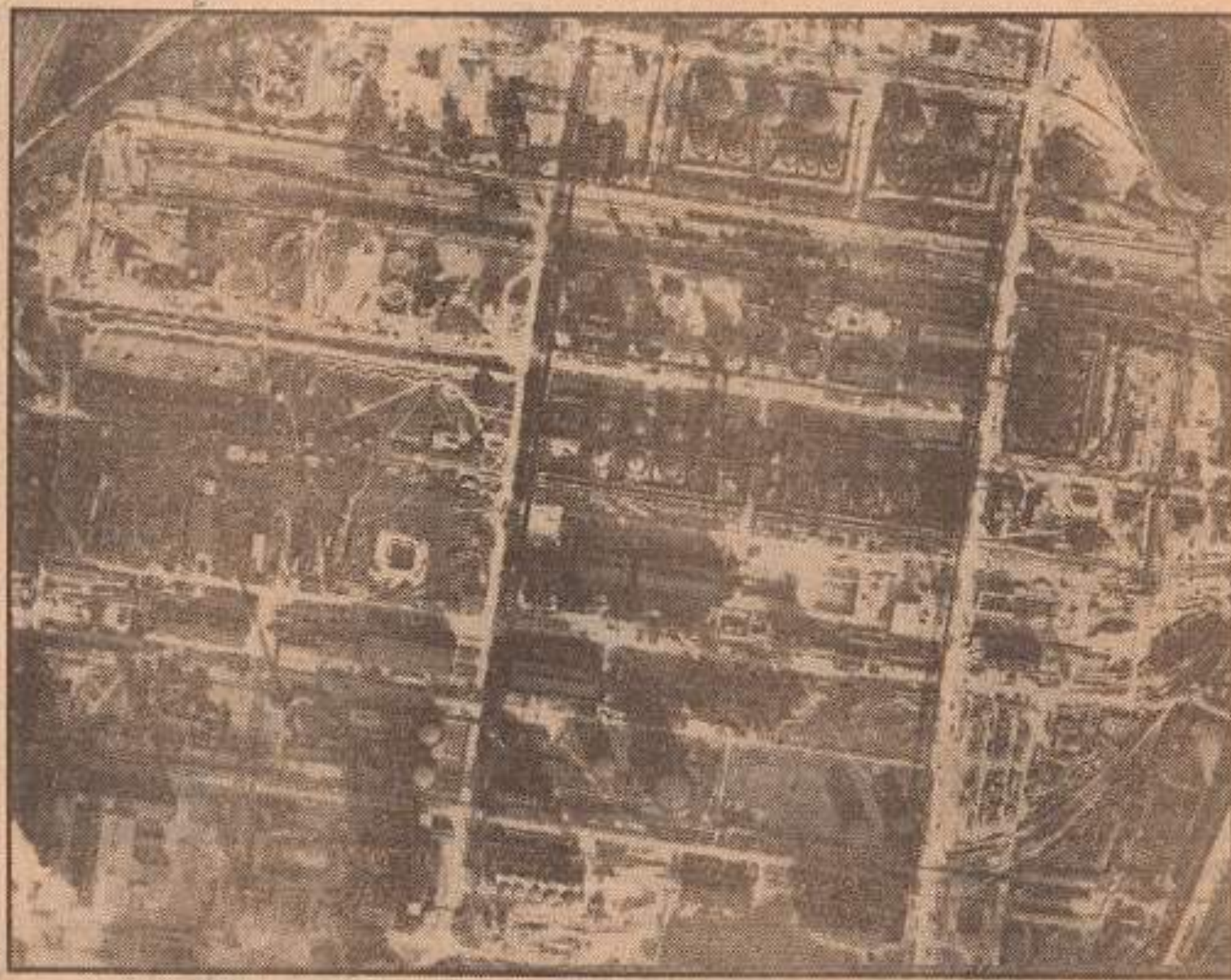
Mistake Operation 16 Jan. 45

NEWS CHRONICLE, Friday, February 23, 1945

This was a German oil plant

British people have become all too familiar with bombing pictures. But examine the two photographs below. They tell more vividly than a dozen communiques the terrible and devastating story of the Allied air attacks on German industry. The place is the synthetic oil plant at Zeitz, near Leipzig. The picture on the left was taken before January 16, 1945; that on the right a month later. The plant employed about 5,000 workers and its output was equal to that of some of the largest plants in the Ruhr. For long periods during the summer of 1944 it was kept out of action by American bombers, but it was managing to produce about half its normal

output when R.A.F. Bomber Command attacked on the night of January 16. The photograph taken on February 17 shows destruction so complete that the plant appears to have been abandoned. Normally the enemy begins repairing his damaged oil plants within a few hours of attack. But there is no sign of any attempt at repair work, or of activity of any kind. The plant is a mass of debris among a dense concentration of craters. Most of the pipelines are broken, and all the vital parts of the plant have been hit. Large numbers of storage tanks and cooling towers are destroyed or damaged. The scene is one of wholesale devastation



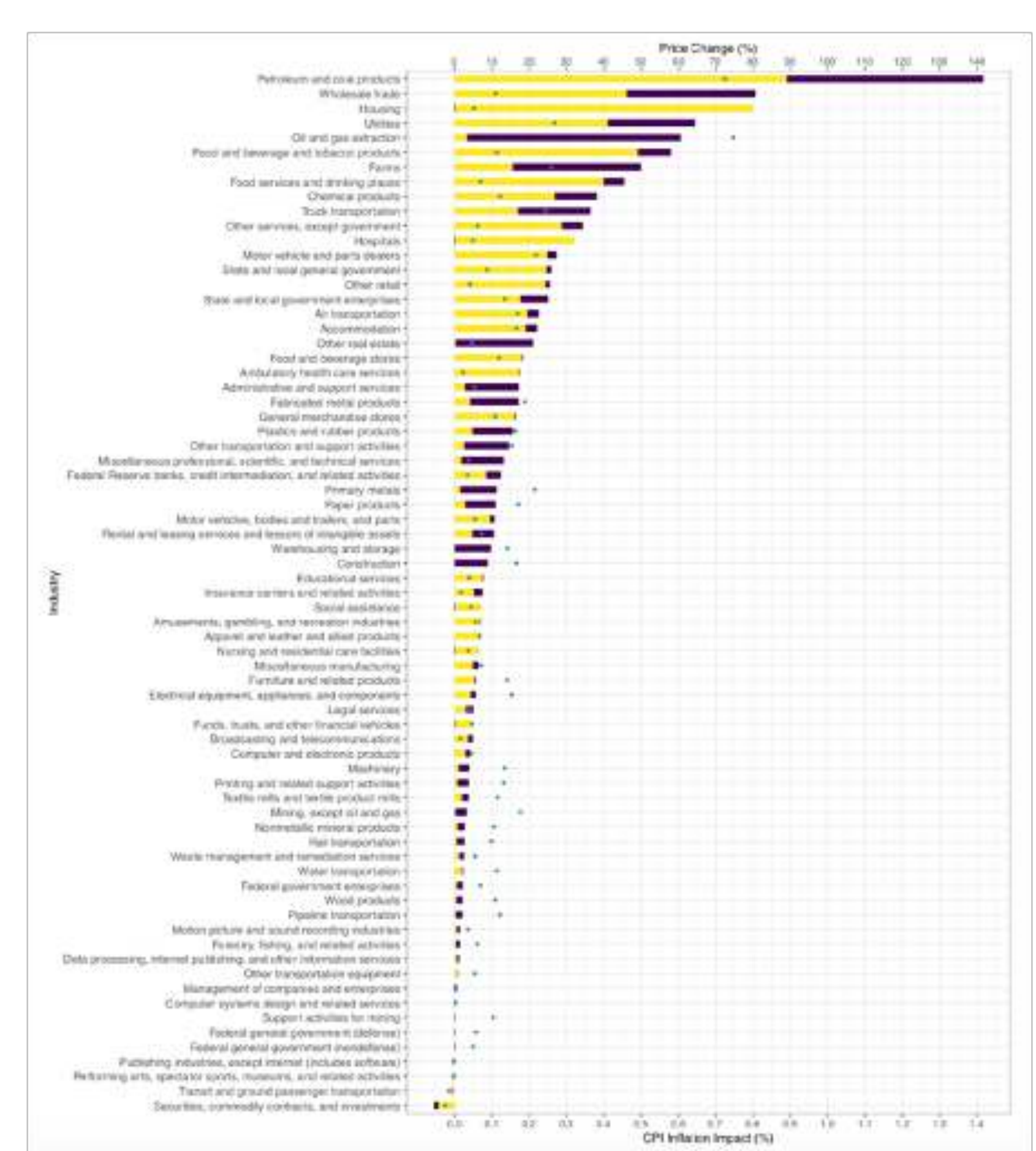
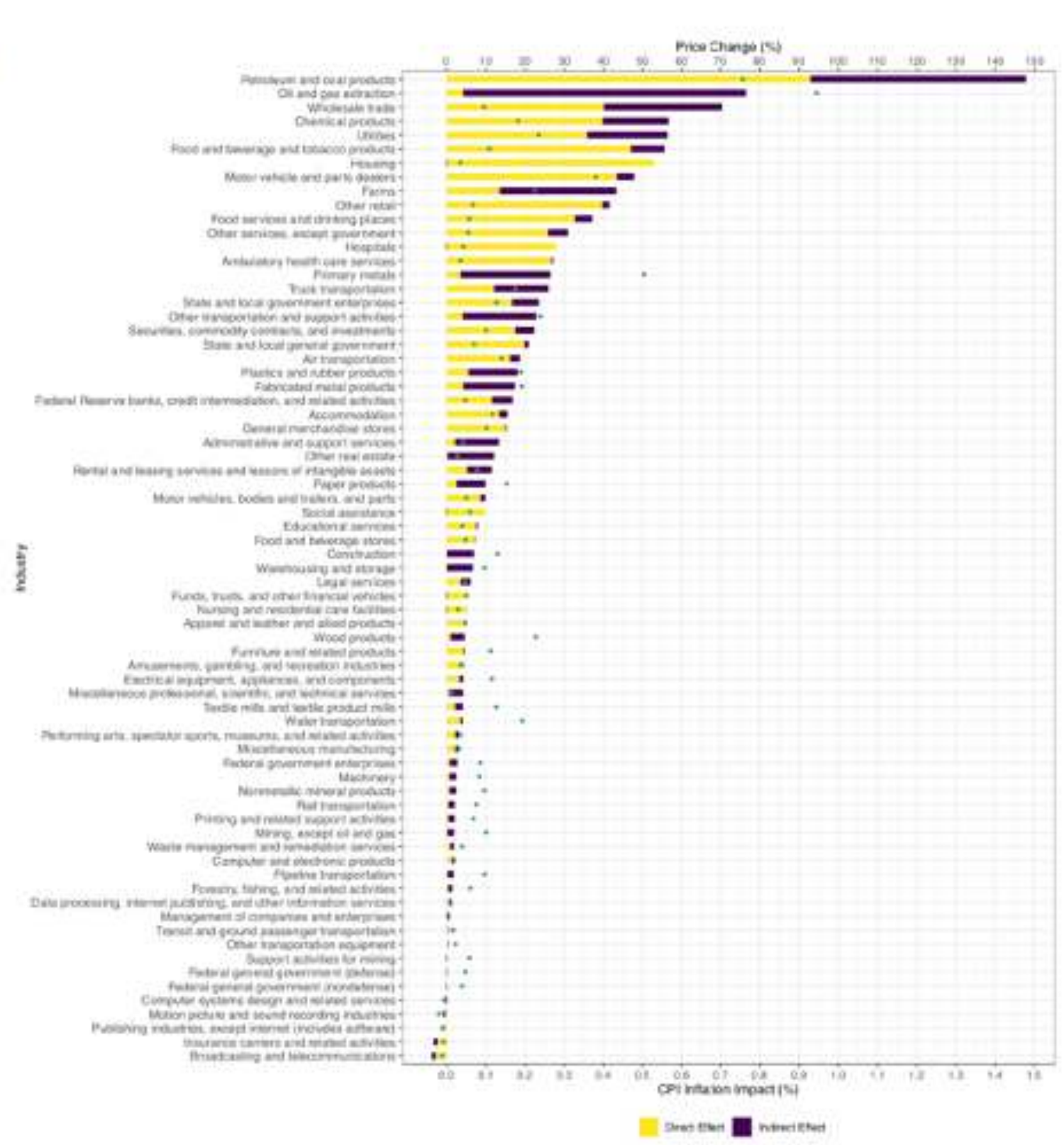
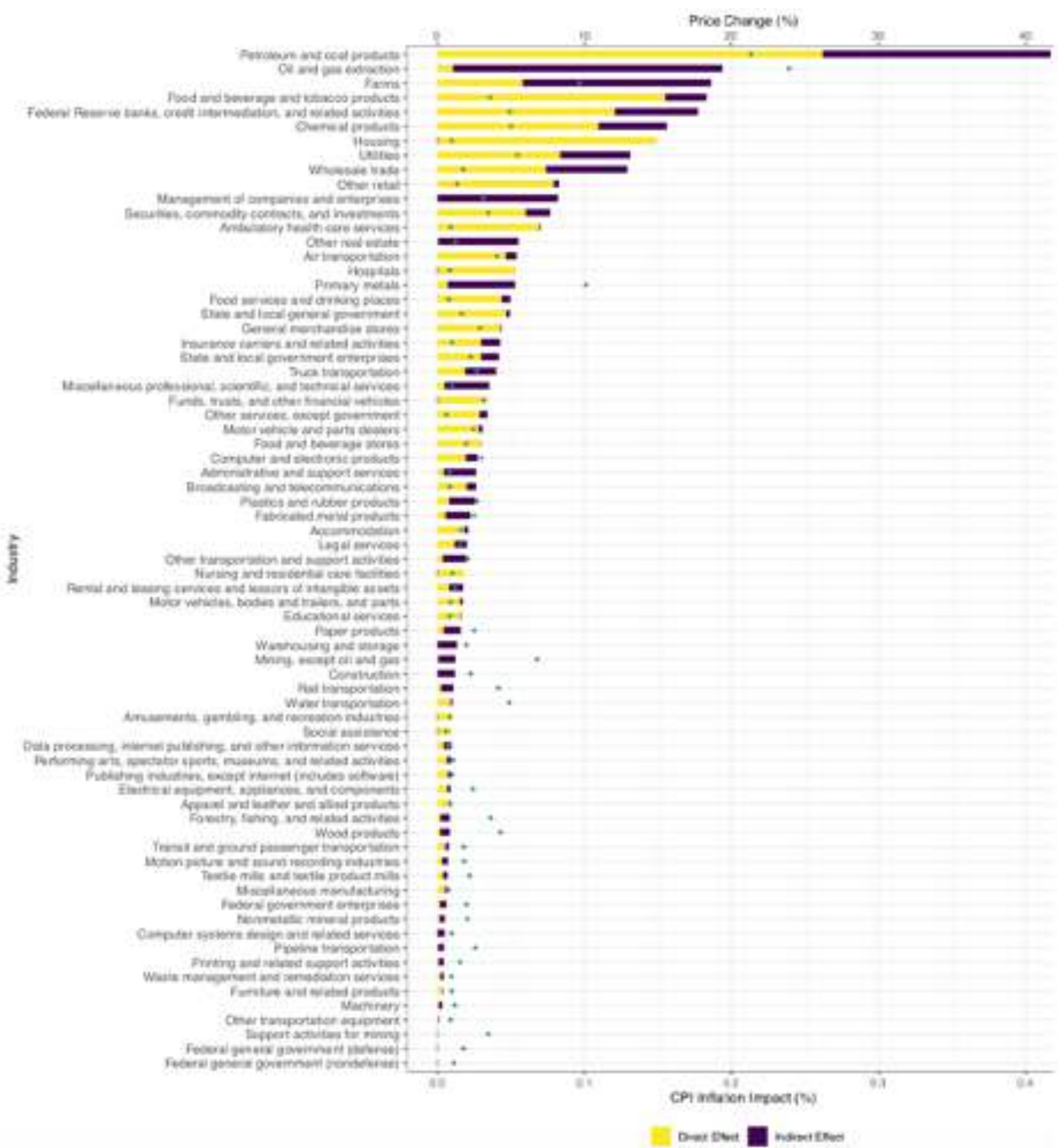
Identifying Systemically Significant Sectors

Goal: Identify systemically significant sectors defined as presenting systemic vulnerabilities for price stability.

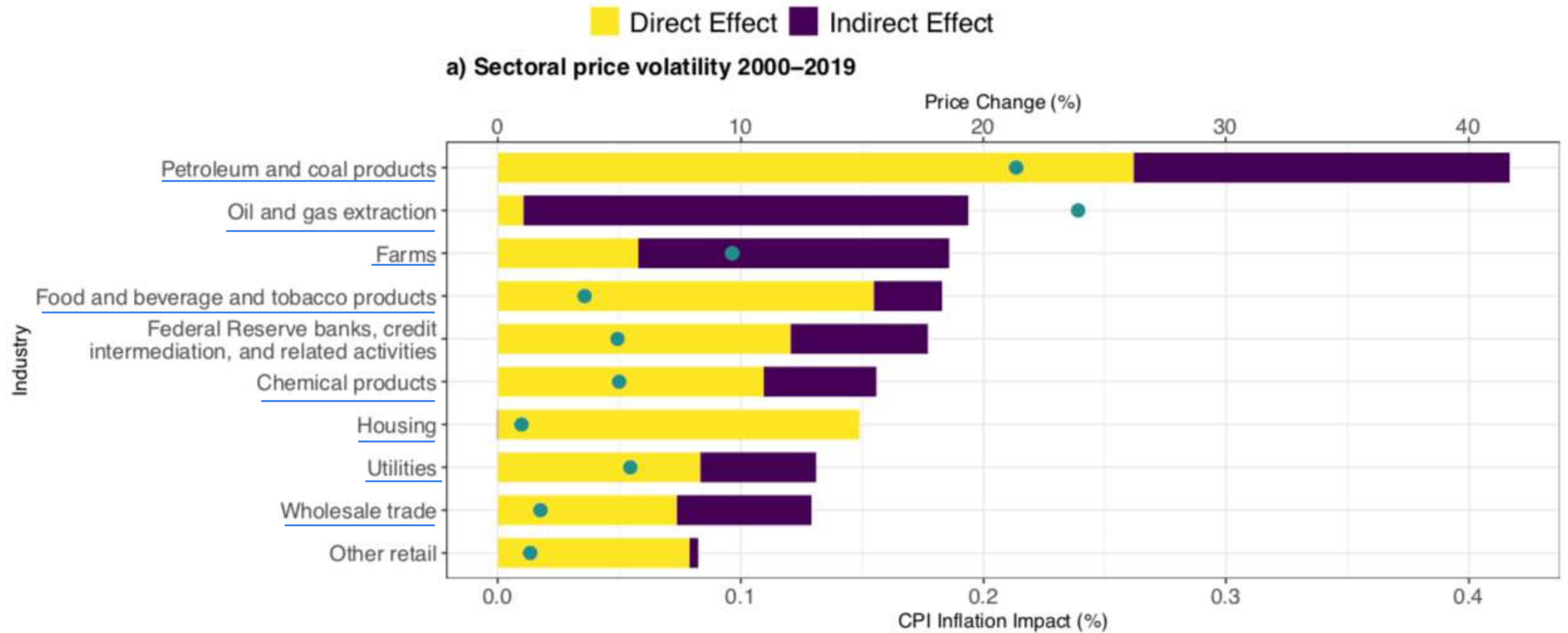
Methodology:

- Leontief price model simulates how a price increase in any one sector translates into price increases in all other sectors via the input-output linkages
- Simulate price shocks based on 1) long-run price volatility and 2) price changes during a) the post shutdown transition and b) the Russian attack on Ukraine
- Sectors that generate largest inflation impact in 1) are latently systemically significant and in 2) have had realized systemical significance in the present inflation

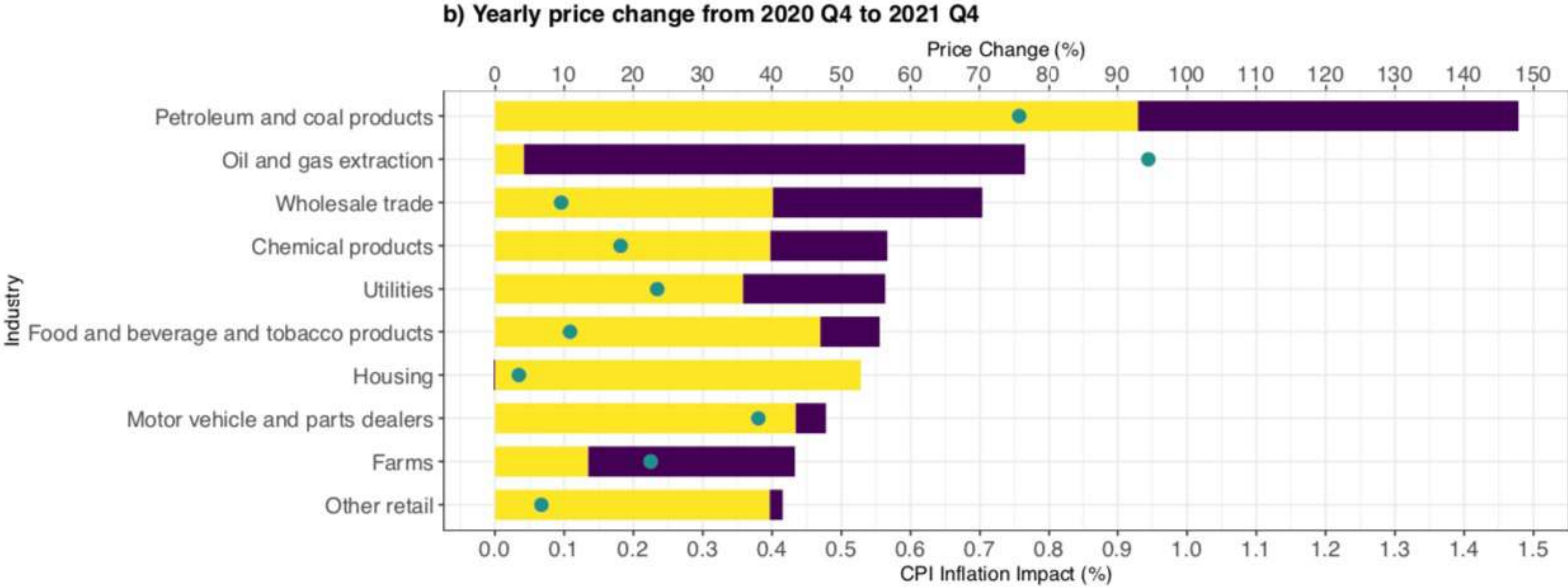
SOME PRICES MATTER MUCH MORE THAN OTHERS FOR INFLATION



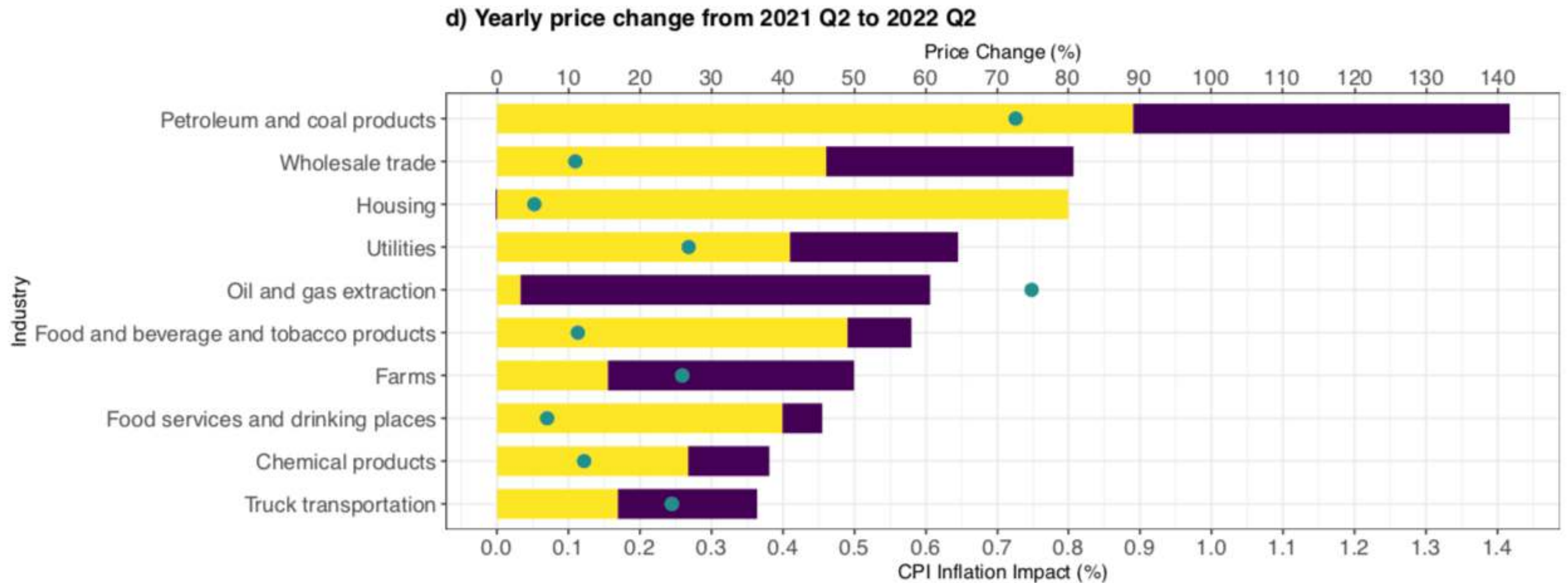
Latent systematic significance



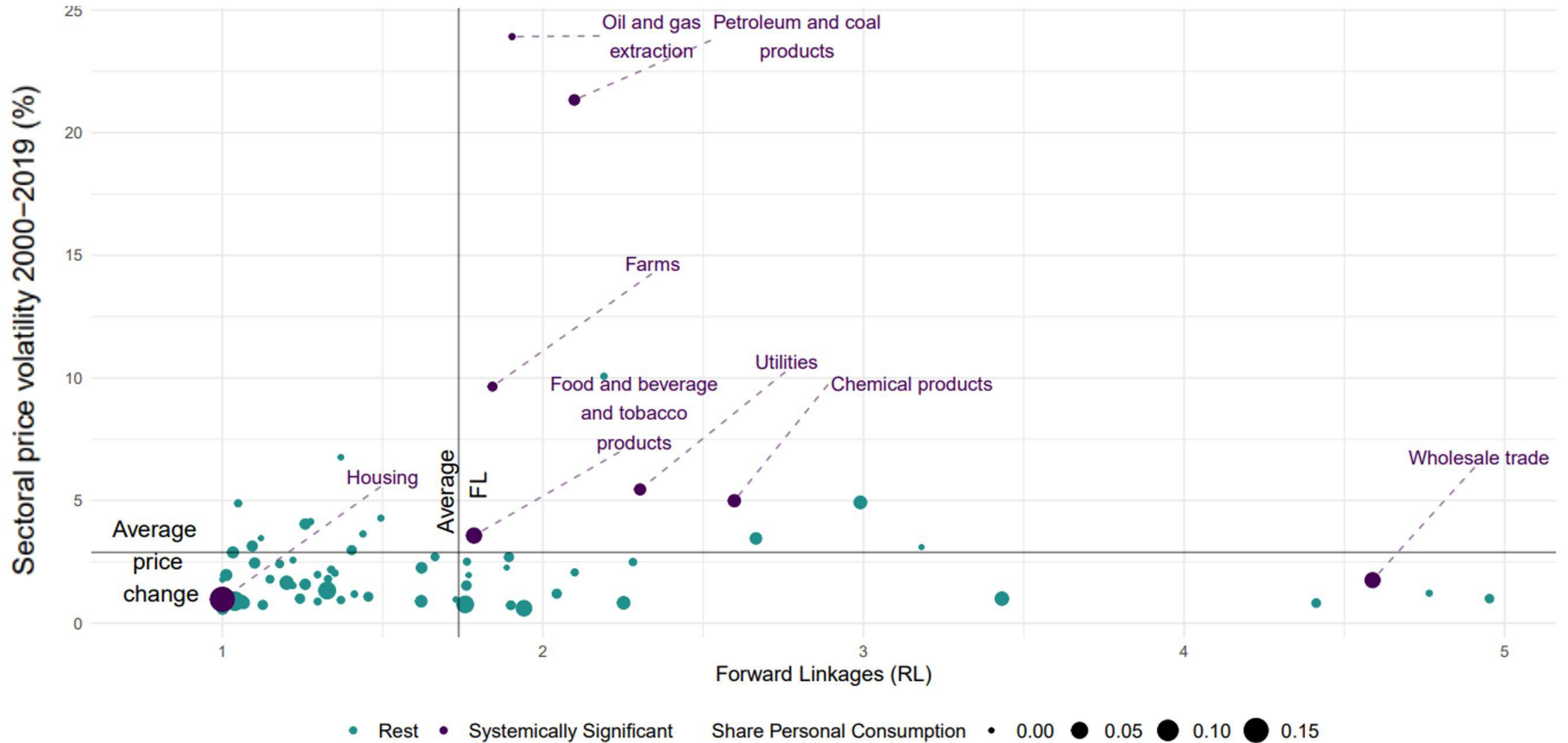
Systemic significance in the post-shutdown inflation

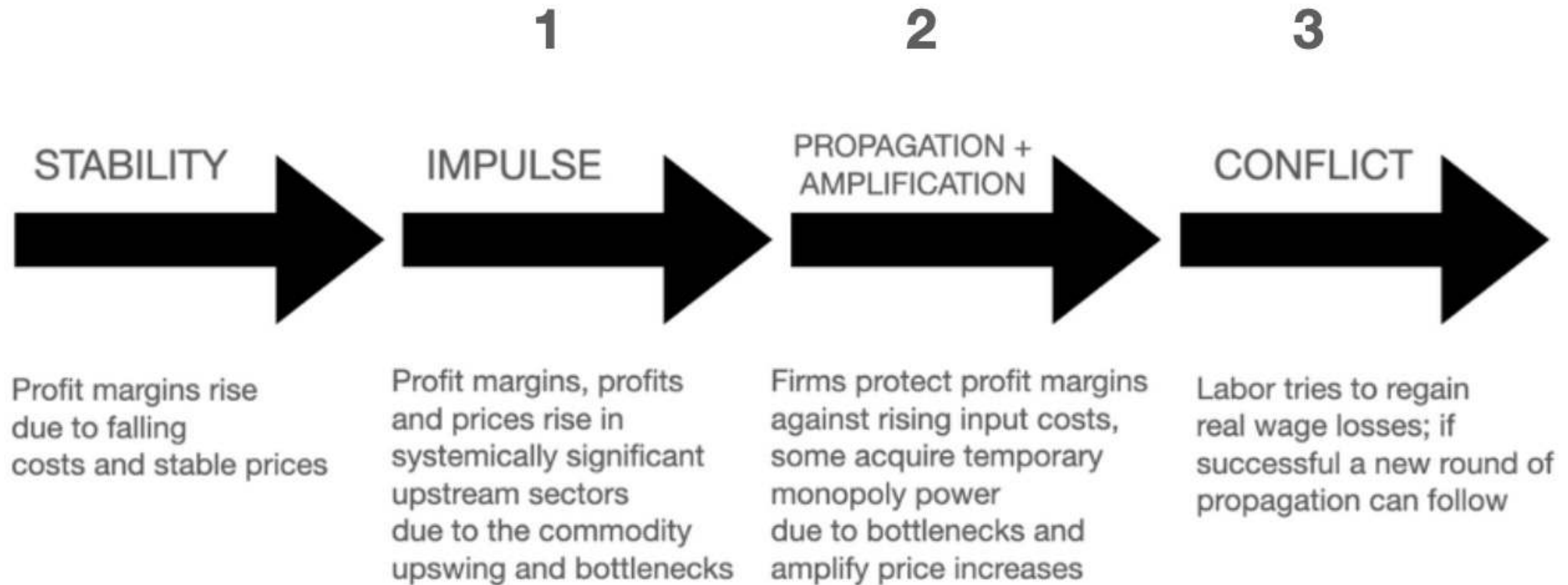


Systemical significance in the war inflation



Pathways to Systemic Significance

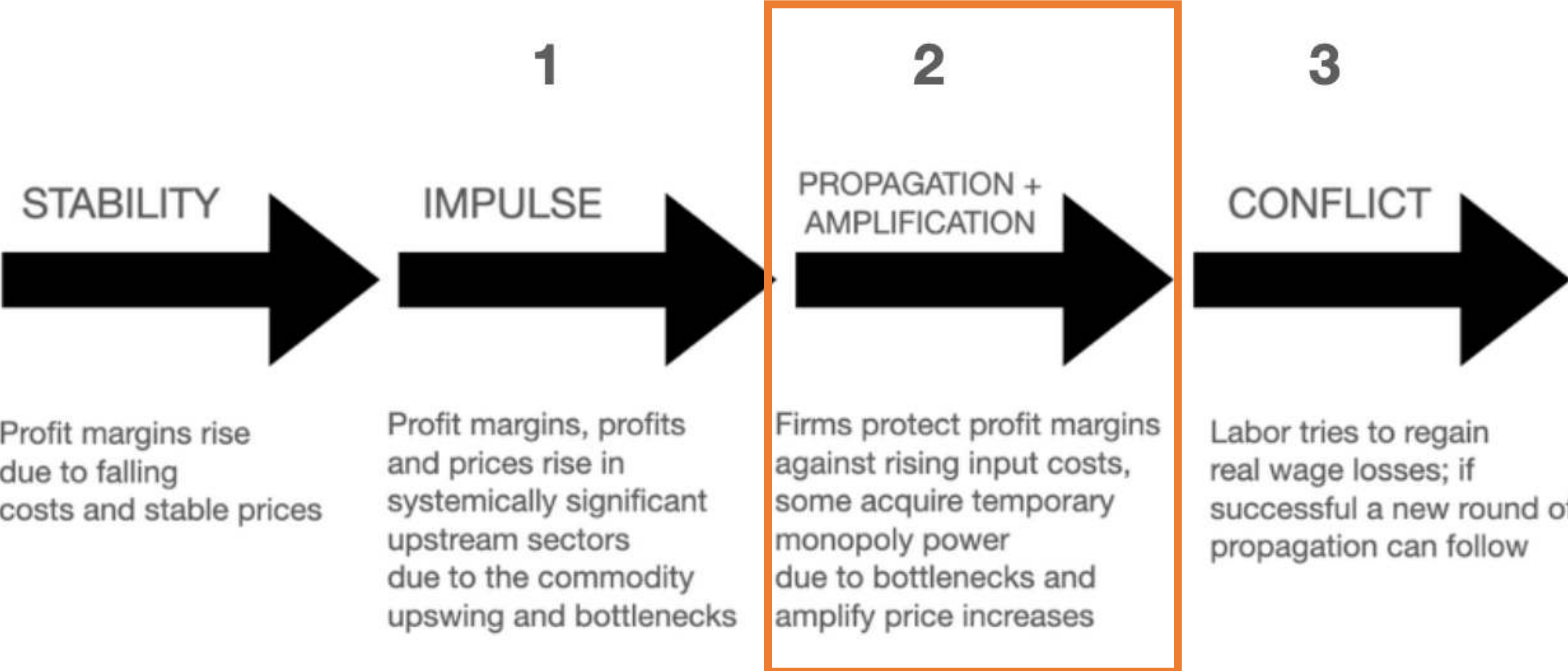




STAGES IN THE INFLATION PROCESS

Weber and Wasner, 2023

SELLERS' INFLATION



STABILITY

Profit margins rise due to falling costs and stable prices

1

IMPULSE

Profit margins, profits and prices rise in systemically significant upstream sectors due to the commodity upswing and bottlenecks

2

PROPAGATION + AMPLIFICATION

Firms protect profit margins against rising input costs, some acquire temporary monopoly power due to bottlenecks and amplify price increases

3

CONFLICT

Labor tries to regain real wage losses; if successful a new round of propagation can follow

STAGES IN THE INFLATION PROCESS

Strategic pricing principles

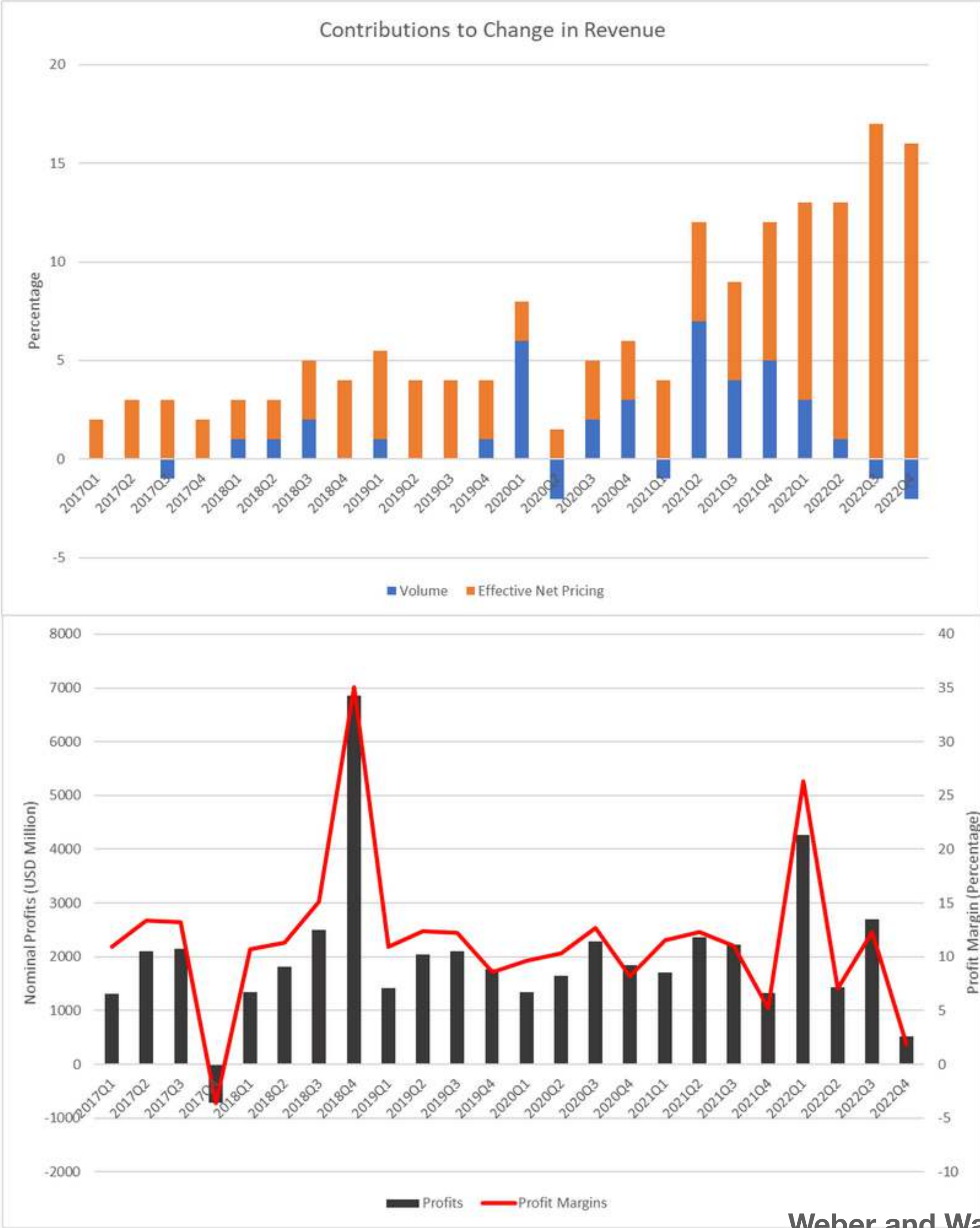
First, price-setting firms typically do not lower prices and, aside from the case of new innovative product lines, raise prices only if they expect other firms to do the same – in other words, they stick to the pack.

Second, besides a formal cartel and norms of price leadership, sector-wide cost increases can function as a coordinating mechanism for price hikes within the industry, since all firms want to protect their profit margins and know that the other firms pursue the same goal. Firms that do not follow this rule can be penalized by financial investors.

Third, if demand outstrips existing capacity by a wide margin – either because of a supply or a demand shock or both – firms can gain temporary monopoly power which allows them to hike prices in ways that increase profit margins. Absent such a temporary monopoly, firms can increase profit margins by lowering costs. But demand from the perspective of large firms is a ‘portfolio of risks’ not a given number.

Pepsico

‘how we’re going to deal with pricing in the coming months, I would say obviously same as everybody else, we’re seeing inflation in our business ...across many of our raw ingredients and some of our inputs ...We’re working with our partners ...to make the right decisions in pricing to [keep] the consumers with us whilst we improve our margin’



Procter and Gamble



‘we’re better positioned for dealing with an inflationary environment... than we’ve ever been before, starting with the portfolio that is is... focused on daily-use categories, health, hygiene, and cleaning, that are essential to the consumer versus discretionary categories which in these environments are the first ones to lose focus from the consumer’

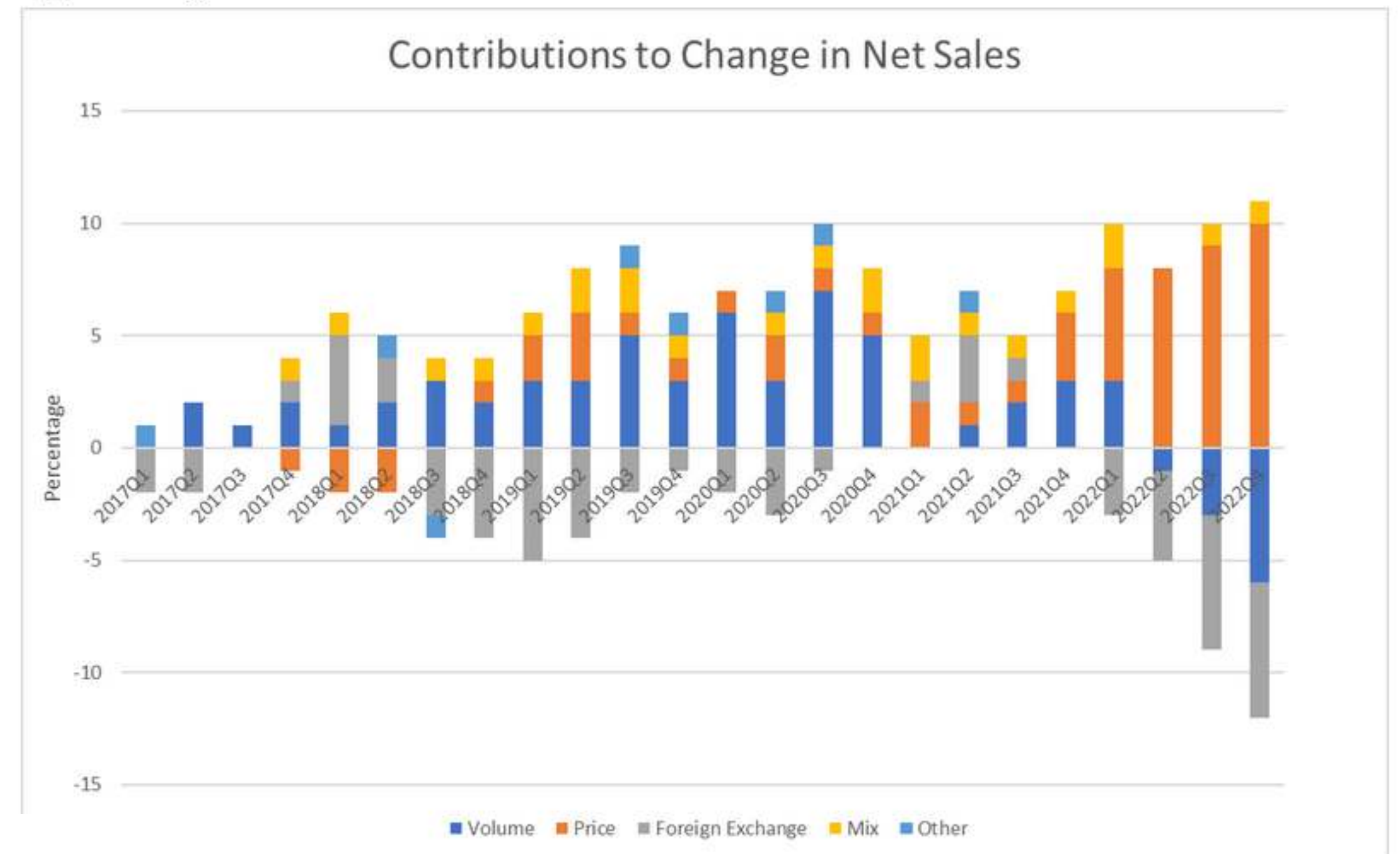


Table A

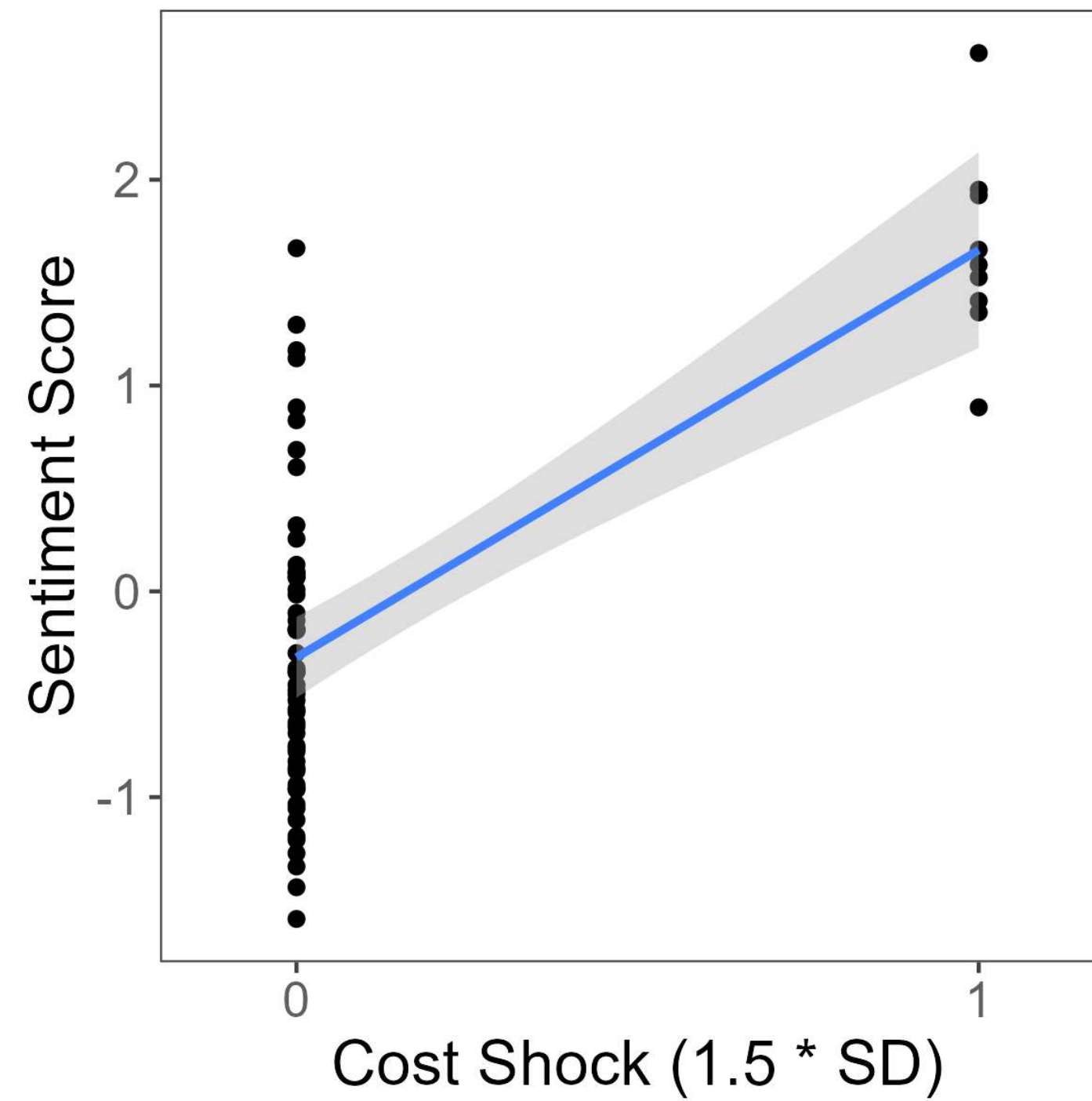
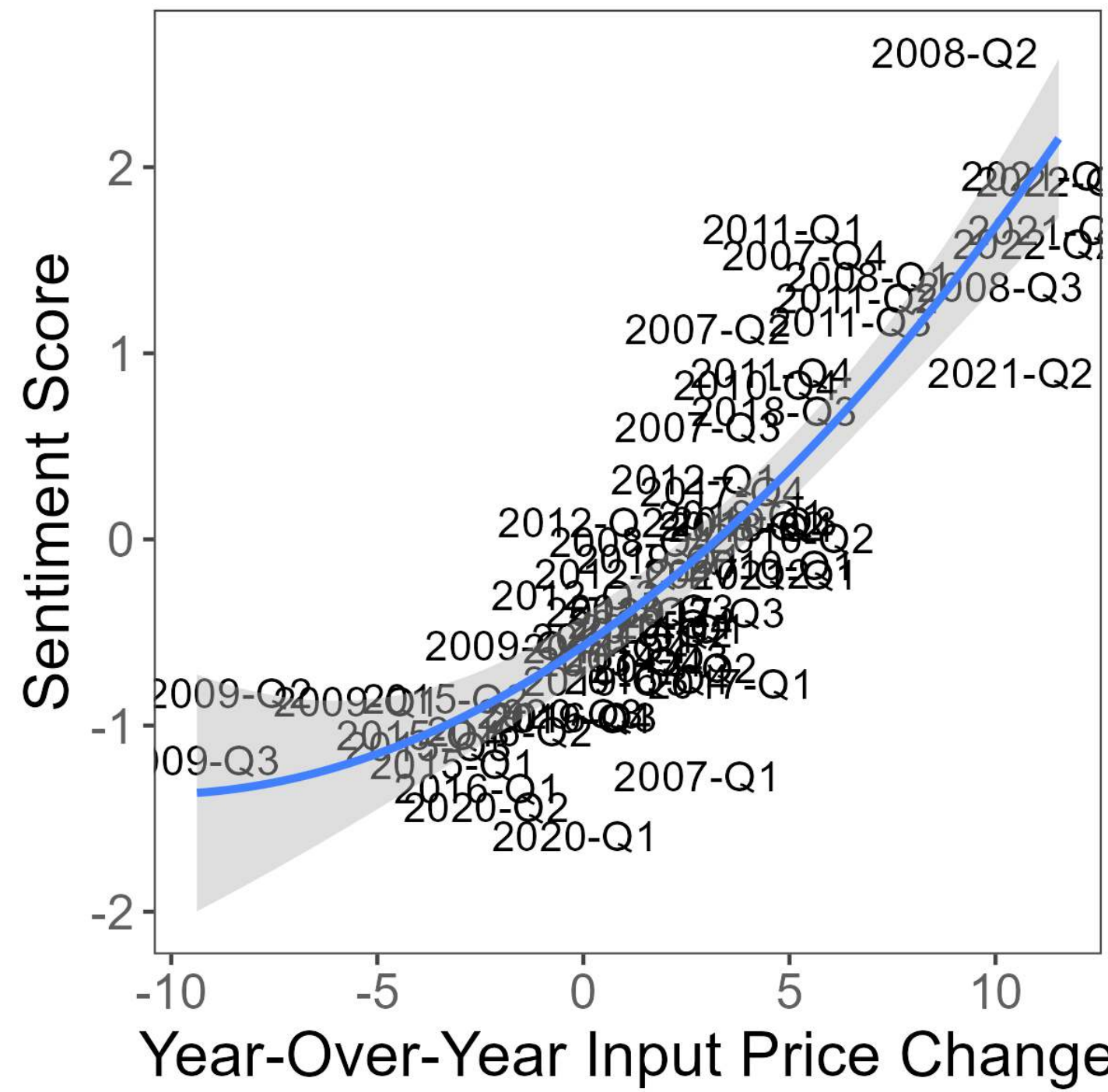
Stylised example of developments in profit indicators in response to an input cost shock

National accounts indicators	Initial period (T0)	Case 1		Case 2	
		Constant mark-up assumption		No constant mark-up assumption	
		T1	% change T0 to T1	T1	% change T0 to T1
Mark-up on total costs	20%	20%	0%	15%	-25%
Real units	100	100	0%	100	0%
Intermediate costs	6,000	10,000	67%	10,000	67%
Labour costs	6,000	6,000	0%	6,000	0%
Total costs = intermediate costs + labour costs	12,000	16,000	33%	16,000	33%
Profits	2,400	3,200	33%	2,400	0%
Nominal gross output = total costs + profits	14,400	19,200	33%	18,400	28%
Unit profits = profits / real units	24	32	33%	24	0%
Price = nominal gross output / real units	144	192	33%	184	28%
Profit share = profits / (profits + labour costs)	29%	35%	22%	29%	0%
Profit share = profits / nominal gross output	17%	17%	0%	13%	-22%

Source: ECB.

Note: In Case 1, the mark-up on total costs is assumed to remain constant; in Case 2, the calculation of the mark-up is based on an assumption that the price only reflects the additional input costs, not additional profits.

Cost shocks and sentiment



Preliminary finding: Large sector-wide cost increases make firms feel good about costs.



“Excuseflation” effects on demand elasticity

San Francisco

6:21 AM PT



VACCINE MANDATES & LAYOFFS

BUSINESS GROUP WARNS OF ‘CATASTROPHIC’ SUPPLY CHAIN DISRUPTIONS

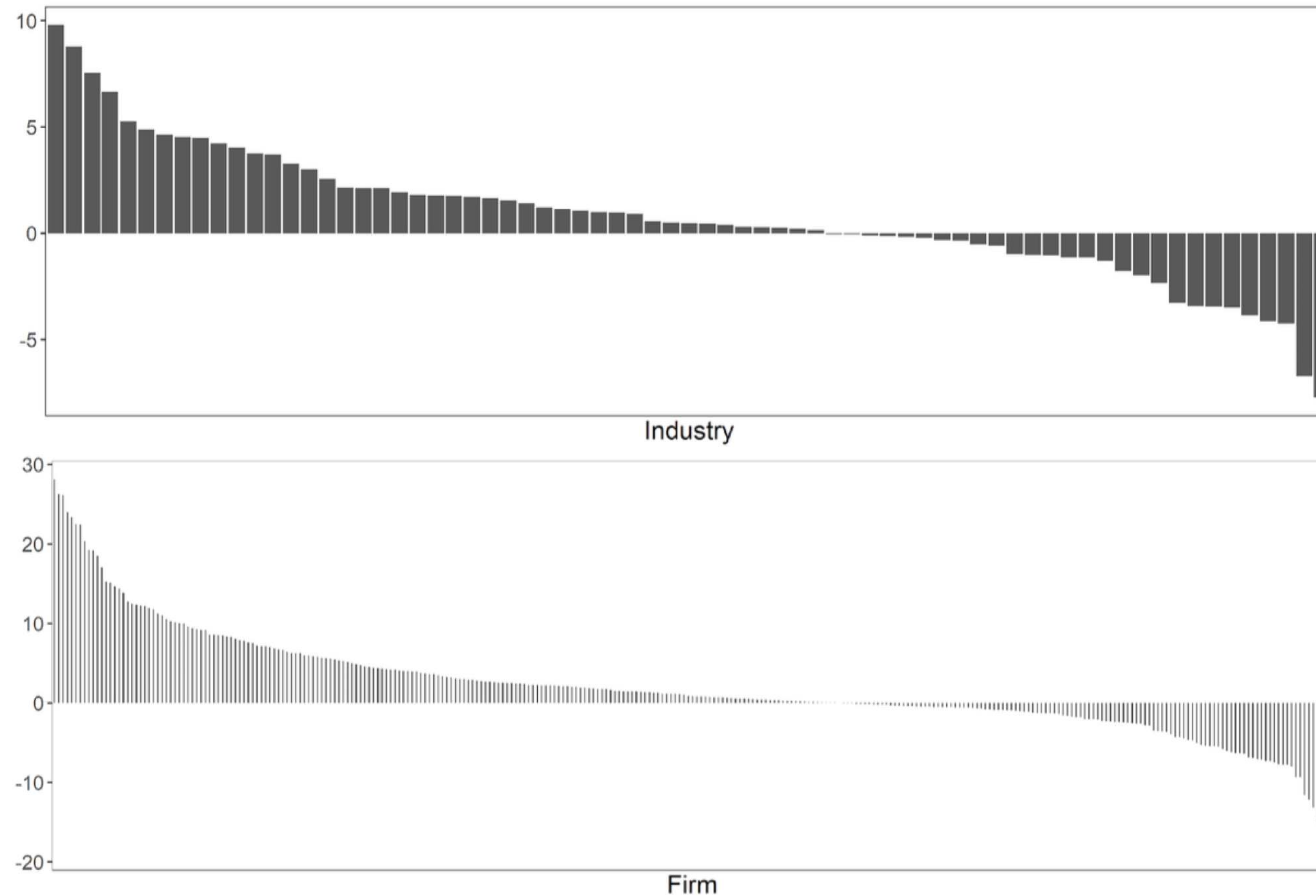
Eric Hoplin | President & CEO, Nat’l Assoc. of Wholesaler Distributors

SMERCONISH

Great inequality in changes in profit margins

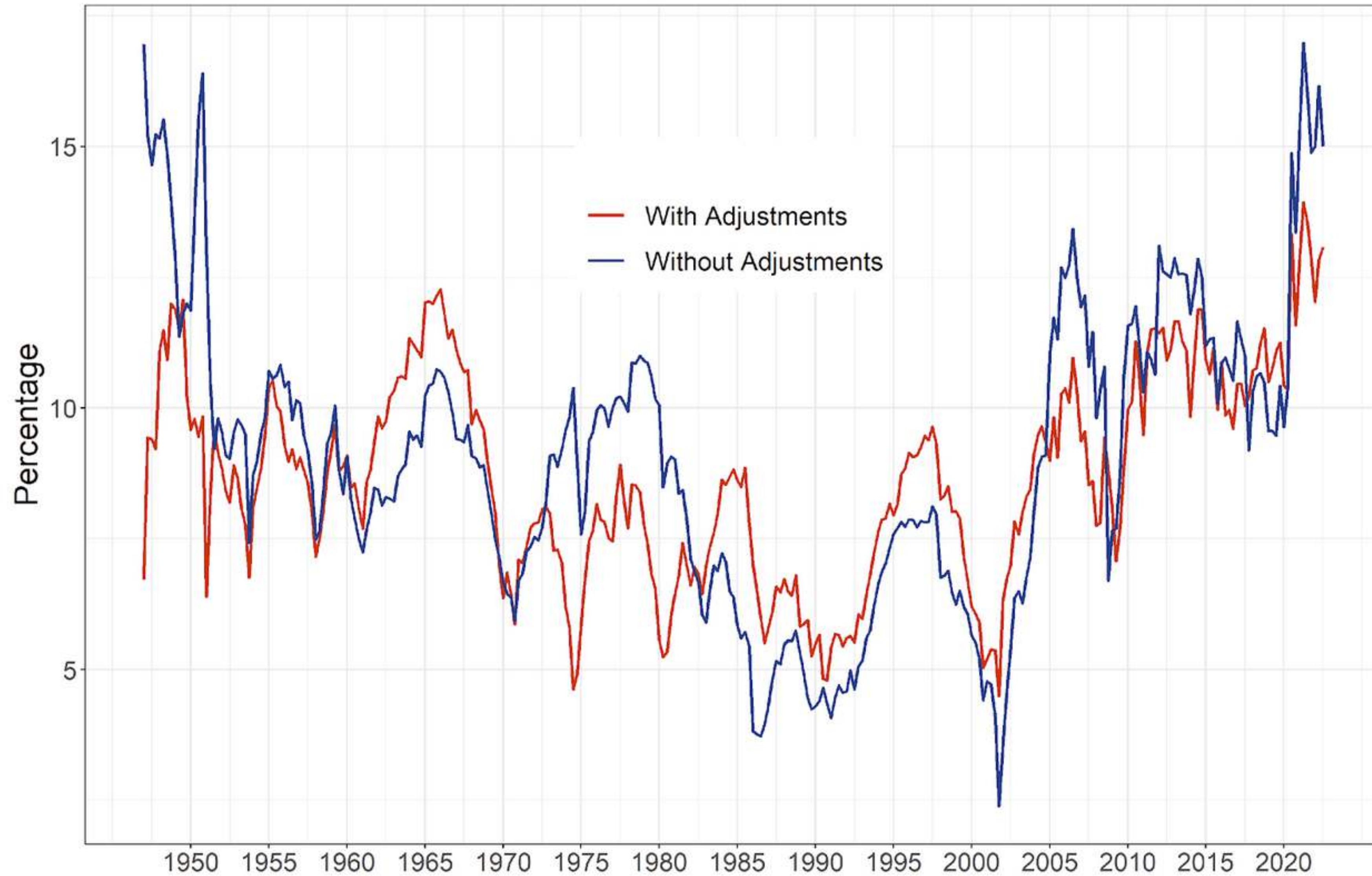
2021 compared
to 2017-19 average

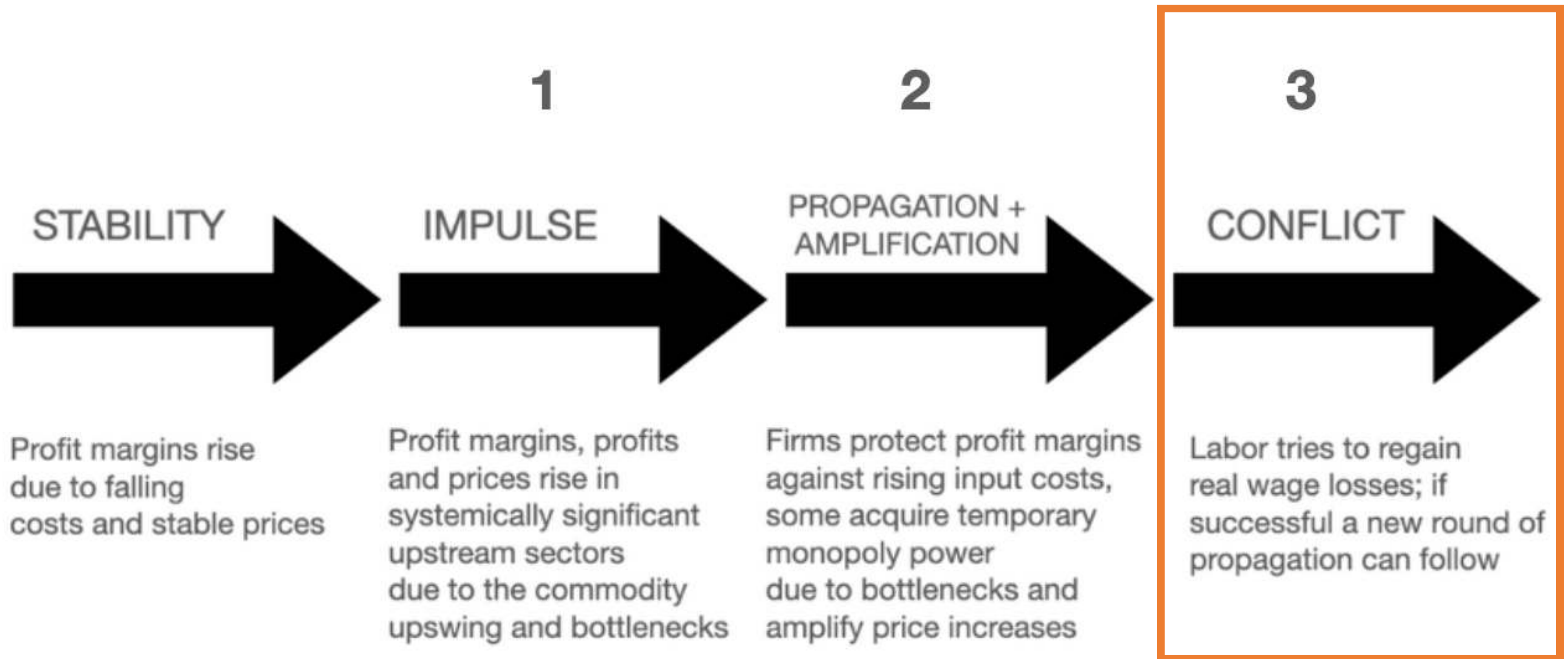
Figure 6: Distribution of changes in profit margins among industries and firms



The economy-wide margin explosion

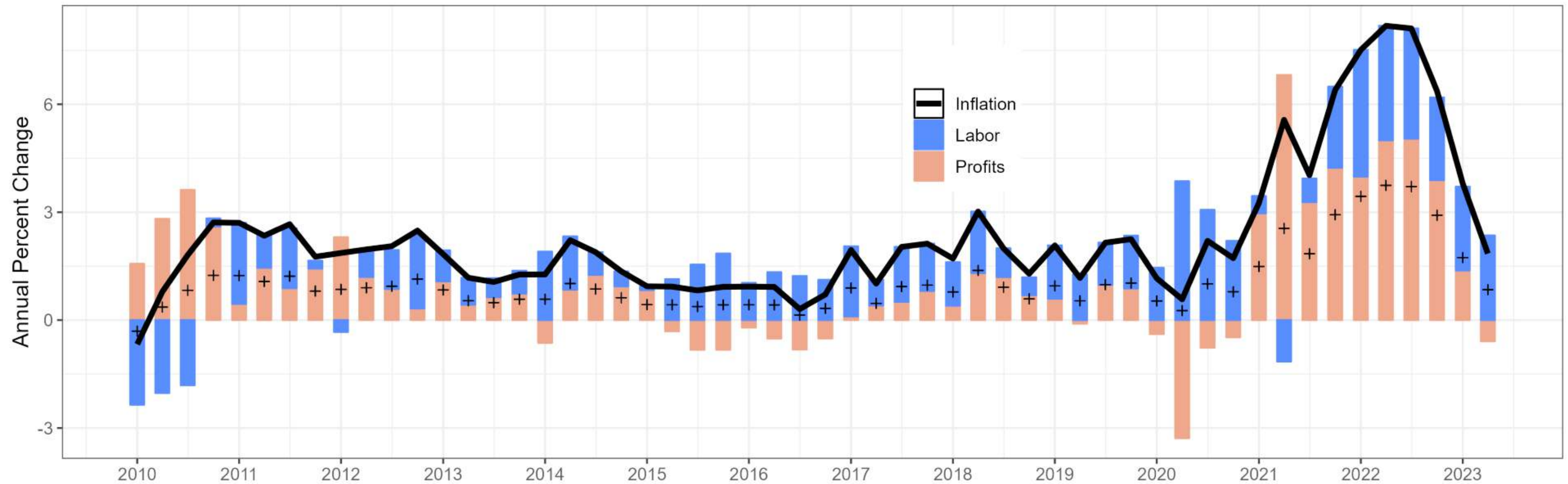
Figure 1: After-tax profit margins of non-financial corporate business





STAGES IN THE INFLATION PROCESS

Profits have captured the largest part of high inflation, wages catch up when inflation is falling.



Conclusion - Why the old stabilization paradigm fails the many

- Monetary and fiscal austerity is meant to “cool down the economy” and push down wages but wage increases are a consequence of sellers’ inflation and demand changed more in composition than in levels.
- Preventing wage catch-up cements the redistribution from the bottom to the top that sellers’ inflation brings about.
- Macroeconomic tightening kicks in when inflation is already generalized and comes at a high economic and political cost.

Conclusion - Why the old stabilization paradigm fails the many

- Credit tightening affects smaller firms more than larger ones and can increase corporate concentration and exacerbates the affordability crisis in housing, while generating yet another round of windfall profits for banks.
- Addressing climate change requires large scale investments and popular support. Both are undermined by austerity.
- Debt and exchange rate crises in the Global South are accepted as collateral damage of this “stabilization” paradigm.

Conclusion - Towards a new paradigm

- Corporations in systemically significant sectors are “too-essential-to-fail”. Cost shocks and supply constraints can limit competition and coordinate price hikes increasing profits. In other words, competition fails to control prices in in emergencies.
- More shock are coming in our times of overlapping emergencies. If the worst of times for most people, is the best of times for companies, economic resilience is out of reach.
- We need an inflation fighting toolbox that buffers against supply shocks in essential sectors, prevents price explosions and contains sellers’ inflation, while enabling a green transformation.

Conclusion - Towards a new paradigm

Some key instruments for a new toolbox:

Price monitoring and early warning systems for essentials (timing is of the essence!)

Virtual and physical buffer stocks for essentials to stabilize prices and to support a transformation

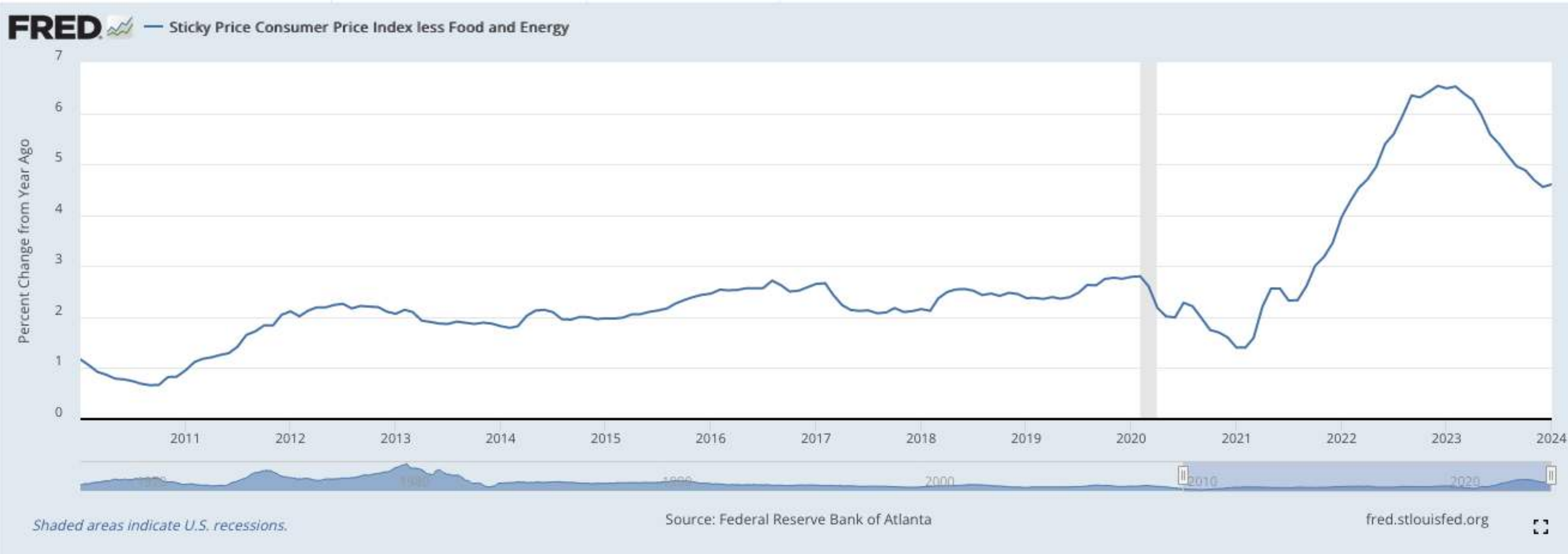
Emergency price caps to prevent price explosions in essentials

Windfall profit taxes and price gouging legislation

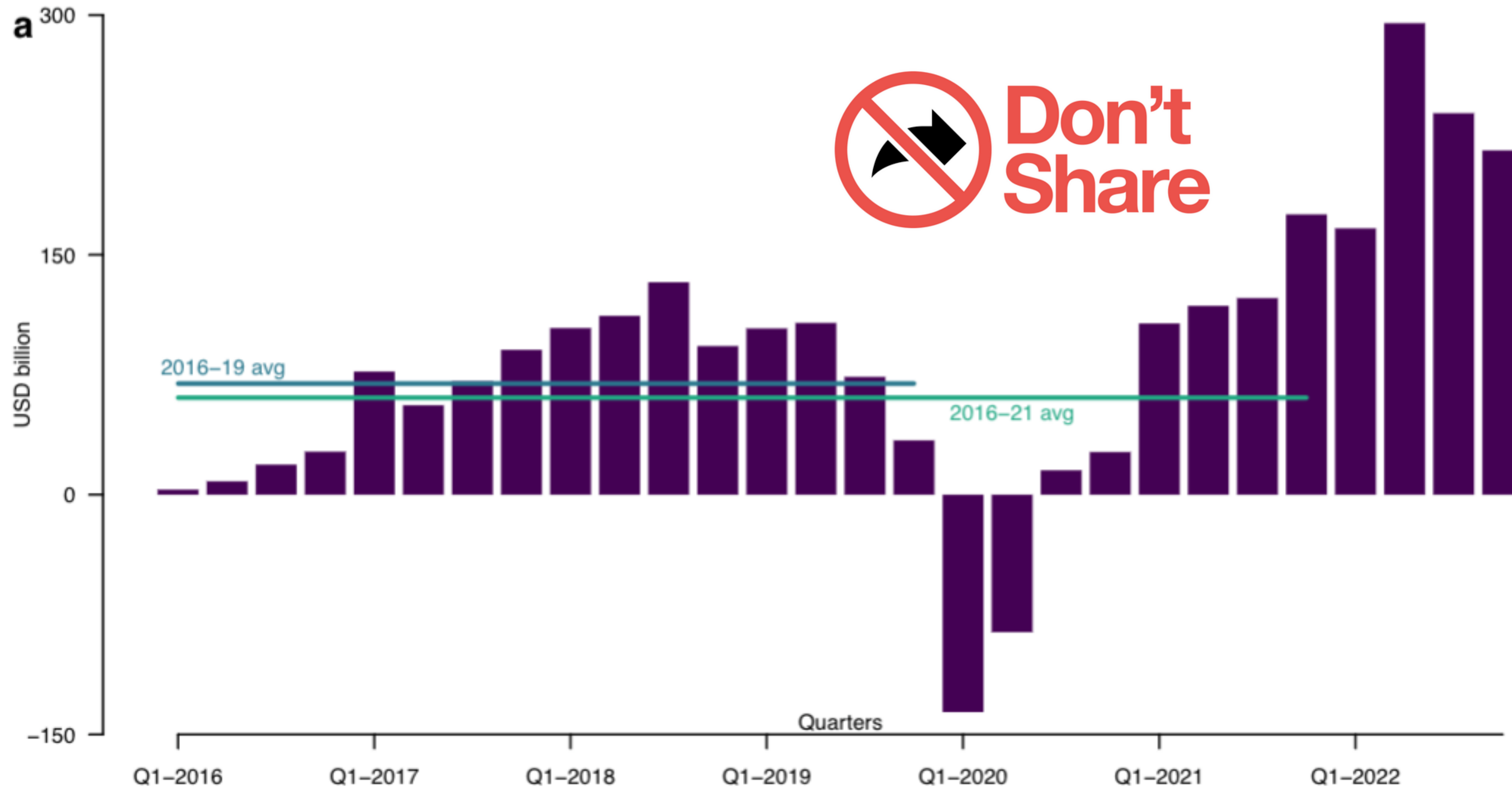
Strict regulation (de-financialization, anti-trust and resilience and transformation standards) for essentials

Public investments in resilience and transformation of essentials

Why did inflation return?

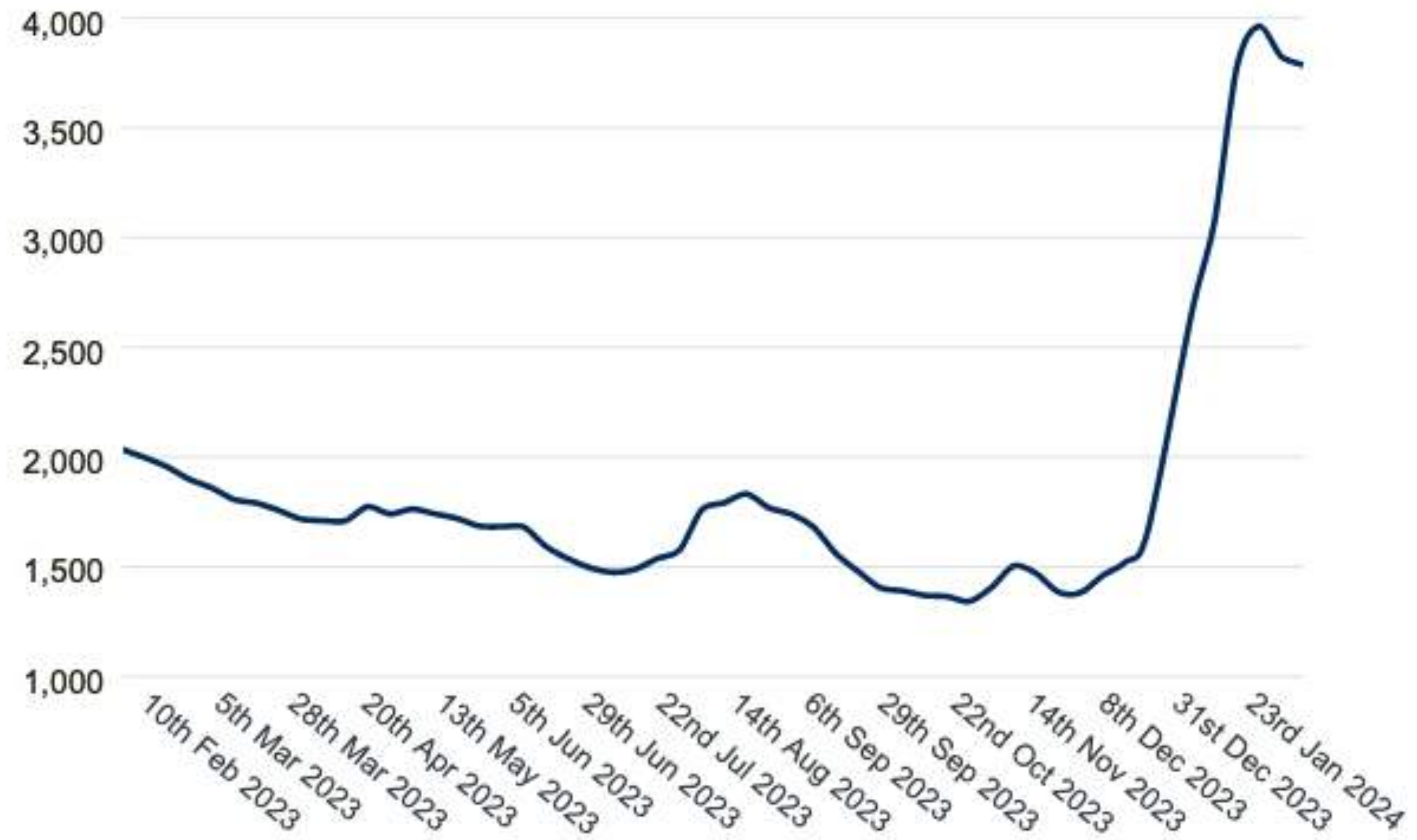


The example of fossil fuels

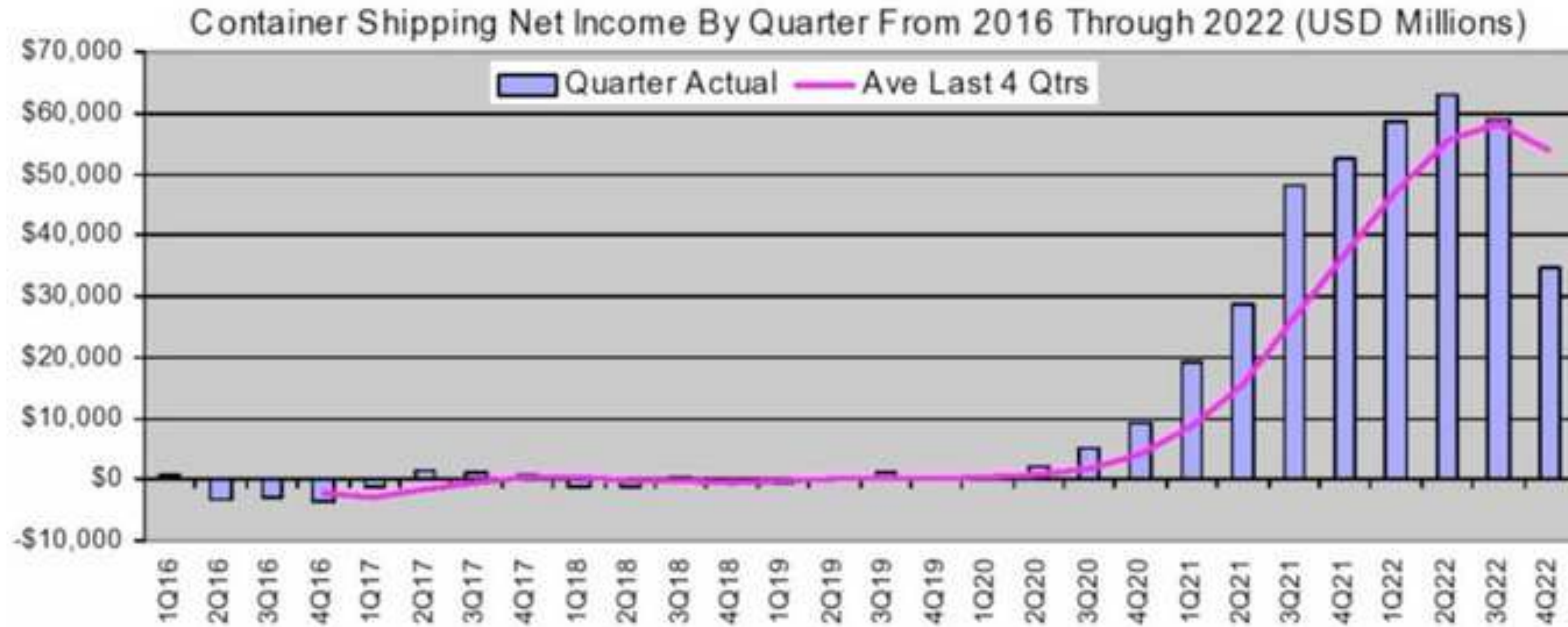


The example of shipping

Drewry World Container Index (WCI) - 08 Feb 24 (US\$/40ft)



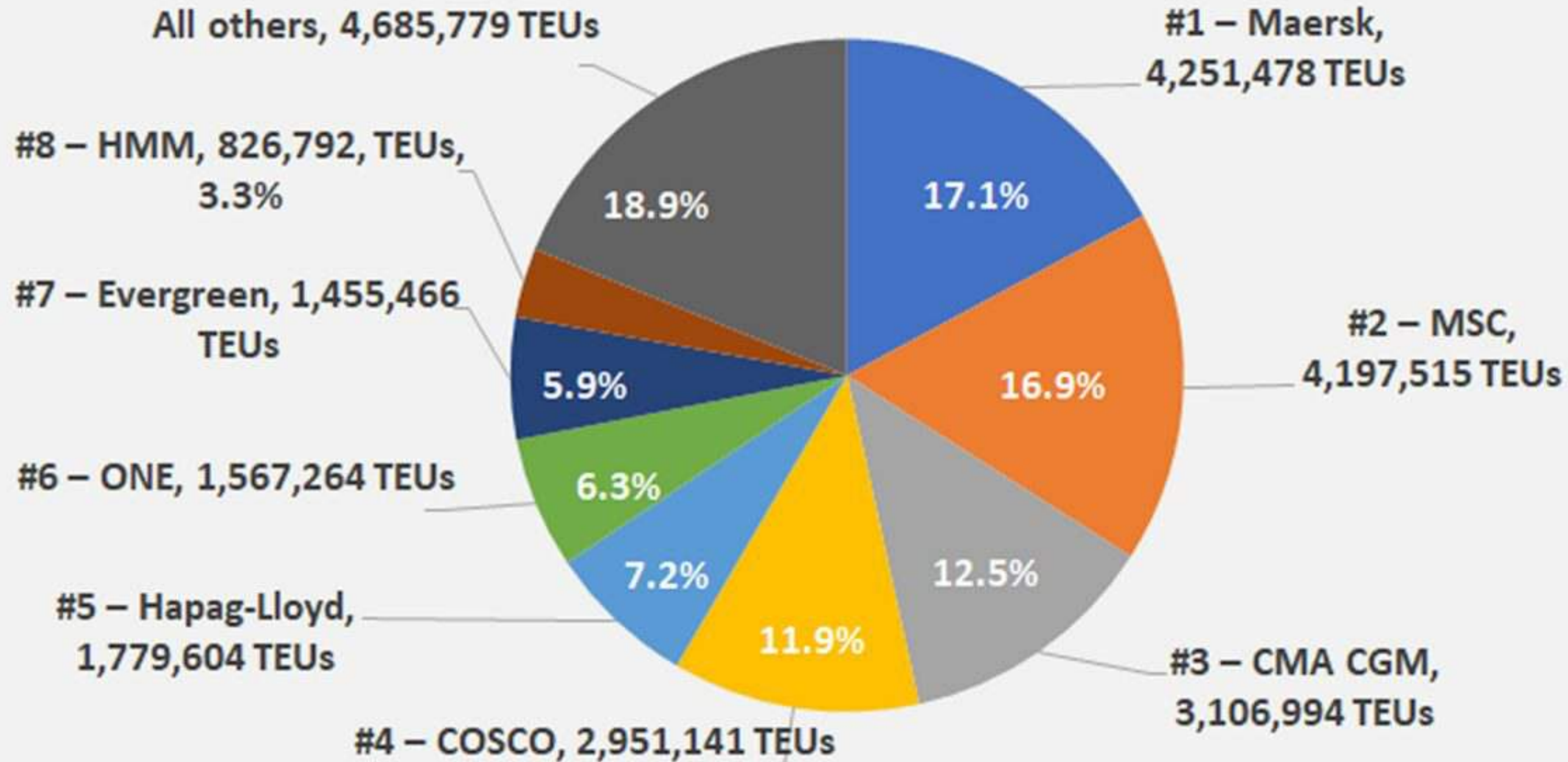
The example of shipping



Source: Freightwaves 2023

The example of shipping

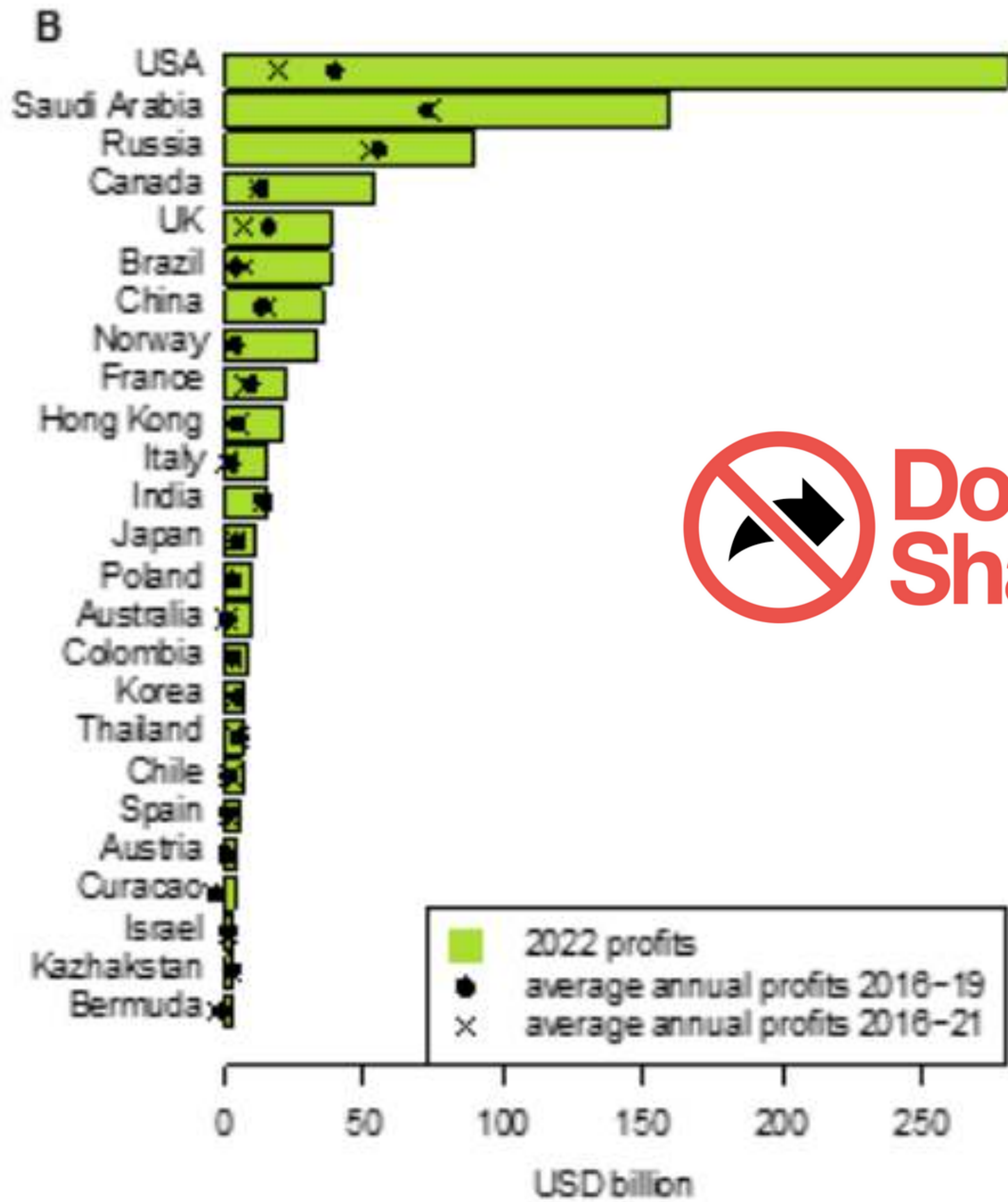
Top 8 carrier groups' share of global fleet = 81.1%



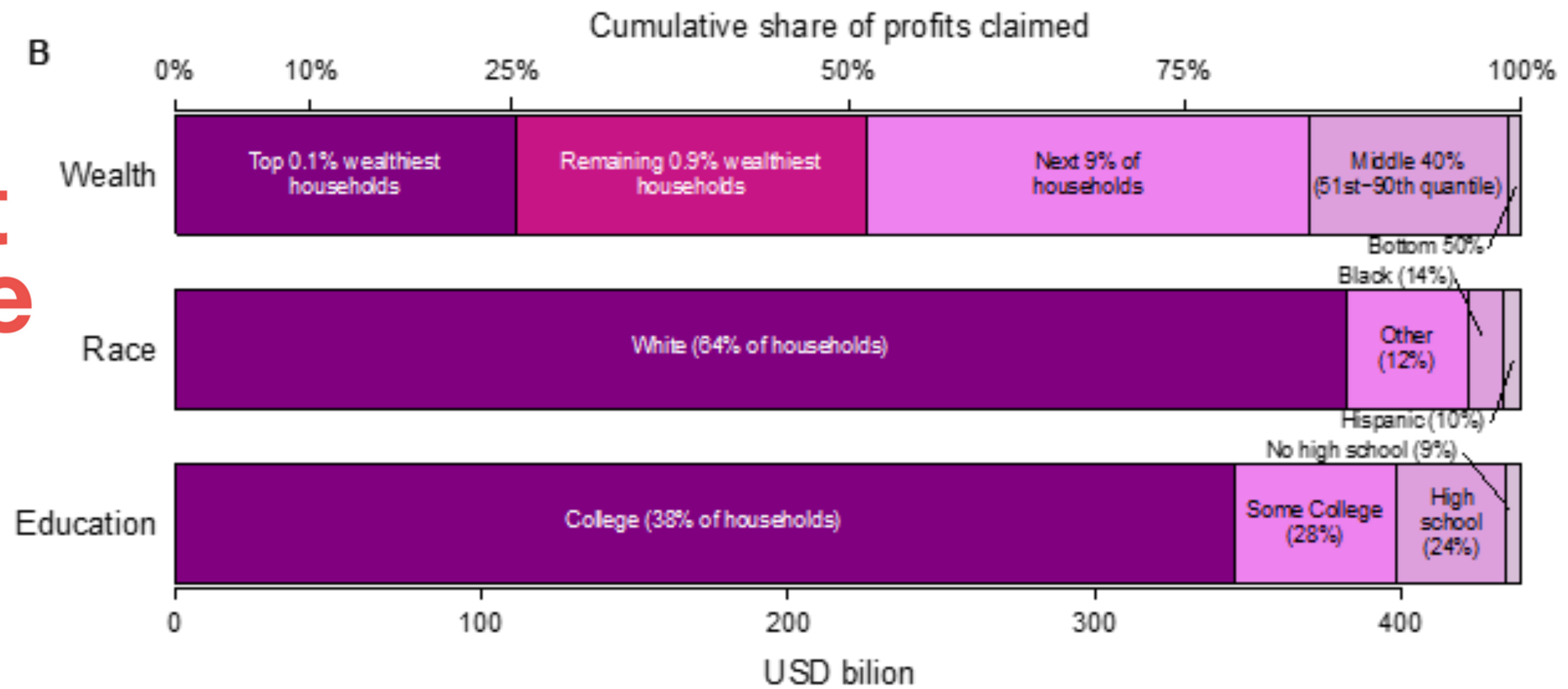
Two “unconventional” forms of corporate power

1. Systemically significant prices and structural corporate power
- 2. Pricing power in times of emergencies**
 - a) Shocks coordinate price hikes and reduce competition
 - b) Bottlenecks create temporary monopoly power

The example of fossil fuels



 **Don't Share**



Three groups of systemically significant sectors, three unconventional sources of corporate power

1. Essentials of human livelihoods

Housing, Food, Farms, Utilities, Petroleum and gas products

2. Essential production inputs

Petroleum and gas products, Oil and gas extraction, Chemical products

3. Essential infrastructure of commerce

Wholesale trade, transportation

The economy as circular flow - Input-Output

“Input-output analysis is a method of systematically quantifying the mutual interrelationships among the various sectors of a complex economic system.” (Leontief, 1985)

“The effect of an event at any one point is transmitted to the rest of the economy step by step via the chain of transactions that links the whole system together.” (Leontief, 1951)

“Far from being independent of each other, the cost-price structures of all the separate industries are nothing but links in a vast network which embraces the whole national economy.

...overall dependence among wage rates, profits earned, and taxes paid per unit of output in each of the many separate industries on the one hand and the prices of all different kinds of goods and services sold by these industries on the other.” (Leontief, 1947)

Two “unconventional” forms of corporate power

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