ABSTRACT:

Looking Beyond Aggregate Markups: Profit-led Inflation Dynamics in Austria

Alexander Huber

Research Institute Economics of Inequality, Vienna University of Economics and Business

Vienna, Austria

The year 2022 brought with it an inflation surge of historic dimension with inflation rates reaching levels not seen since the 1970's and 1980's. Induced by supply shortages and accelerated by Russia's invasion of Ukraine, rapidly rising prices hit an economy that had just been recovering from the COVID-19 crisis. Apart from the obvious contributors to the inflation surge, the extent of firm profits' contribution is still at the heart of the debate within economics. However, there is no clear definition of profit (-led) inflation or what Weber and Wasner (2023) refer to as seller's inflation. While standard economic theory suggests that imperfect competition and industry concentration lead to higher profits, alternative explanations range from cyclical factors to greed.

Up to now, literature's focus has mainly been on the development of different measures of markups aggregated to different levels. This literature is centered around a contribution by De Loecker et al. (2020). In their study they follow the marginalist approach where the price is determined by a markup on marginal costs. The markup itself depends on the elasticity of demand or market concentration. Kaleckian theory has a broader understanding of the markup following the "structuralist approach". Nikiforos et al. (2024) argue for a markup not on marginal costs but normal costs which can be understood as average expected costs over a certain period of time. In this case the markup does not solely depend on the elasticity of demand but a combination of factors such as institutions, social norms, class struggle and structural characteristics. Taking a microeconomic perspective, Bijnens et al. (2023) find that in Belgium, 2022 price increases were driven by higher input costs rather than markups while larger firms adjusted their prices slower than smaller firms. A contrary perspective is provided by Weber and Wasner (2023) who find that firms used their market power to take advantage of consumers' lack of information to exert what they term "seller's inflation". Out of a Postkeynesian perspective, Lavoie (n.d.) argues that profit-led inflation is not a result of firm's "greed" but rather cyclical factors and rising import costs. Accordingly,

these led to an increase in the profit share by definition. Nikiforos et al. (2024) argue that even when markups are kept constant, firms can still expand their profits at the cost of real wages. Setterfield (2023) and Konzcal and Lusiani (n.d.) focus on market concentration during the COVID-recovery period and find that market power helped firms increase their markups.

The Austrian case is interesting for various reasons. Firstly, the country has been hit comparably hard by the inflation surge due to a range of factors including close ties to Russia in the energy sector. Secondly, Austria's counter inflation strategy was centered around compensation schemes rather than direct price interventions. This was accompanied by a record decrease of real wages in 2022. Thirdly, the majority of the existing literature uses data for listed companies, while I have the possibility to also include a large number of midsize firms.

In my study I focus on profit-led inflation dynamics in Austria. Using firm-level data for listed and non-listed companies, I compute markups following different approaches. I argue that the chosen weighting and aggregation schemes play an important role in the way the evolution of markups and profits can be interpreted. While results do not show broad-scale increases of markups, this does not automatically rule out profit-led inflation. In many cases the pass-through of higher input costs came in favor of real profits and at the cost of real wages.

References

Bijnens, G., Duprez, C., & Jonckheere, J. (2023). Have greed and rapidly rising wages triggered a profit-wage-price spiral? firm-level evidence for belgium. *Economics Letters*, *232*, 111342. DOI: https://doi.org/10.1016/j.econlet.2023.111342

De Loecker, J., Eeckhout, J., & Unger, G. (2020). The Rise of Market Power and the Macroeconomic Implications. *The Quarterly Journal of Economics*, *135*(2), 561-644. DOI: 10.1093/qje/qjz041

Konzcal, M., & Lusiani, N. (n.d.). Prices, Profits and Power: An Analysis of 2021 Firm-Level Markups. *Roosevelt Institute Brief*.

Lavoie, M. (n.d.). Some controversies in the causes of the post-pandemic inflation. *Monetary Policy Institute Blog*.

Nikiforos, M., Grothe, S., & Weber, J. D. (2024). Markups, profit shares, and cost-push-profit-led inflation. *Industrial and Corporate Change*, *33*(2), 342-362. DOI: 10.1093/icc/dtae003

Setterfield, M. (2023). Inflation and distribution during the post-covid recovery: a kaleckian approach. *Journal of Post Keynesian Economics*, *46*(4), 587–611. DOI: 10.1080/01603477.2023.2249431

Weber, I., & Wasner, E. (2023). Sellers' inflation, profits and conflict: why can large firms hike prices in an emergency? *Review of Keynesian Economics*, *11*, 183-213. DOI: 10.4337/roke.2023.02.05