What’s behind North America’s tepid inflation numbers? Labour peace

By Jordan Brennan
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Economic commentators have been puzzling over North America’s persistently weak inflation. Conventional economic theory posits that tightening labour markets should lead to higher levels of inflation, as employers bid up wages in an effort to attract and retain workers.

So why haven’t we seen an increase in inflationary pressure?

One reason the social sciences tend to trail the natural sciences in terms of predictive power is the absence of laboratories. While natural scientists can isolate and manipulate variables in a manner that better enables them to pinpoint causal force, social scientists typically lack this capacity.

On rare occasion, however, history itself produces a quasi-laboratory. The Great Inflation between 1965 and 1982 saw Canadian and U.S. price levels rise by some 225 per cent and 200 per cent, respectively. Vigorous debate ensued among economists about the underlying causes.

Four explanatory variables dominated the dispute:

- First, the OPEC oil cartel’s restriction of exports to the West, which pumped up energy prices fivefold;
- Second, U.S. budgetary deficits, which increased to prosecute the dual war on poverty and Vietnam;
- Third, the earnings margins of oligopolistic corporations;
- Fourth, the wage gains racked up by militant labour unions.

History has recently run a controlled experiment of sorts, allowing the first three explanatory variables to manifest themselves, while suppressing the fourth.

Since the turn of the century, oil prices rose fivefold, the U.S. government injected nearly $900-billion into financial markets, Western governments ran massive budgetary deficits and the markup of large North American firms swelled to historical highs.

The result? Central bankers are worried about disinflation and the spectre of deflation. The missing element appears to be wage growth, which has remained low despite the fact that unemployment rates have been heading south for nearly a decade.

Given that wages and salaries comprise more than half of GDP, changes in the overall price level are very sensitive to changes in employee compensation. However, there is no necessary relationship between low unemployment (“labour scarcity”) and accelerating wage growth (“labour price”).

Strike activity, or the threat thereof, is a type of non-market force that gives workers the bargaining power to bid up wages. And while “trade union power” may fit uncomfortably into the pantheon of explanatory variables, its significance cannot be ignored.

The statistical relationship between strike activity and wage growth is three to four times stronger than the relationship between unemployment and wage growth, depending on the periodization. And changes in CPI inflation are tightly synchronized with the rate of wage growth.

Over the past century, Canada and the United States witnessed three major strike waves, with peaks coming shortly after the First and Second World Wars and, in the case of the third strike

wave, in the mid-1970s. Wage growth and inflation underwent three similarly timed waves.

Strike activity in both Canada and the United States has been trending downward since the 1970s and is currently at a postwar low. It should come as no surprise, then, that wage growth and inflation have been so modest.

If soaring commodity prices, sizable budgetary deficits and roaring corporate profitability together cannot generate significant price pressure, then wage growth becomes the default variable.

The absence of strong trade unions wielding the strike weapon, in conjunction with the growth of precarious forms of work, automation and offshoring, are bound to suppress wage growth for the foreseeable future.

North Americans may see a generation of weak inflation and low interest rates. If this is true, then the only inflation we are likely to see is that of asset values, namely the stock and housing markets, which will further exacerbate economic stratification.

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