Briefing Paper:

Profits and Inflation in Mining and Non-Mining Sectors

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Introduction and Summary

There is growing worldwide recognition of the leading role of high business profits in the acceleration of inflation experienced in most industrial countries since COVID lockdowns. Previous analysis of Australian data indicates that record-high business profits account for 69% of excess (above-target) inflation in economy-wide price levels from end-2019 (before the pandemic) through September 2022. Research in other countries has also found that widening profits, not wages, have been the dominant source of recent price pressures.

This report provides new detail on the distribution of those excess profits across different sectors in the Australian economy. By far the largest expansion of corporate profits was recorded in the mining sector, where gross corporate operating profits surged 89% between end-2019 (the last quarter before the pandemic) and end-2022. Those unprecedented profits resulted from enormous increases in prices charged to purchasers (including those in Australia) for petroleum, gas, and coal products. Those products were the biggest single cause of the initial acceleration of inflation after 2021.

Without the direct and indirect shock waves resulting from those higher fossil fuel and mineral prices (including knock-on cost increases for other sectors), Australian inflation would likely have stayed within the RBA's target range after COVID lockdowns ended, this avoiding the need for painful interest rate hikes.

However, the link between corporate profits and accelerating inflation is not limited to the mining sector alone. Less spectacular but significant increases in corporate profits are visible in many other sectors, too. Profits have risen rapidly in wholesale trade, manufacturing, transportation, and other strategic sectors. Businesses in those sectors could take advantage of supply chain disruptions, consumer desperation, and oligopolistic market power to jack up prices far beyond higher costs for their own input purchases.

Across non-mining private corporations as a whole, annualised profits have increased by $45 billion (above and beyond their own input costs, and not counting incremental profits resulting from expanded real output). Those excess profits have exacerbated inflation, and hence further motivated interest rate hikes imposed by the Reserve Bank.

Even small businesses have increased profits since the pandemic (also by over $45 billion per year) and boosted their share of national GDP. Workers are the only major factor of production to see their incomes fall behind inflation: average real wages have declined by over 5% since the pandemic (the steepest decline in real wages in Australian history),[1] and workers' share of national GDP has declined (by 2.3 percentage points since end-2019).

Business leaders,[2] recently echoed by RBA Governor Philip Lowe,[3] reject the notion that excess profits have contributed to recent inflation. They claim that record-high corporate profits are concentrated in the mining sector – and hence are somehow a 'special case' not relevant for inflation policy. This claim is doubly false. First, escalating profits in the mining sector were the dominant source of initial post-COVID inflation, and hence should be a top concern for monetary policy. Second, aggregate profits have also increased significantly in non-mining sectors, further adding to the cost of living crisis faced by Australian workers.

In early 2023, there were encouraging signs that current inflation had peaked, as supply chains strengthened, world energy prices retreated, and pent-up consumer demand dissipated. Those improvements will be accompanied by a moderation of corporate profits – further confirming the link between inflation and profit-taking.

However, a new inflationary threat is now presented by the OPEC+ cartel's April decision to curtail oil production and escalate world prices. Another round of energy price hikes will translate into further excess profits (especially but not exclusively in the mining sector), higher costs through domestic supply chains, and a further escalation of the cost of living crisis facing Australians. To prepare for, and more effectively counter, the potential renewal of profit-price inflation, policy-makers need to acknowledge the role of record profits in driving recent inflation – and develop alternative policy responses (such as price caps in strategic markets, excess profit taxes, and targeted fiscal support for working and low-income households) to manage current inflation in a fairer and more effective way. The knee-jerk assumption that inflation is produced by overheated labour markets, rising wages, and excess purchasing power among average consumers should be rejected in light of the clear evidence of profit-price inflation.

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[1] Greg Jericho, "The destruction of real wages will take a long time to recover," *Off the Charts* (Canberra: Australia Institute), 10 February 2023, https://australiainstitute.org.au/post/the-destruction-of-real-wages-will-take-a-long-time-to-recover/.

[2] For a critical review of these claims, see David Richardson, *Profit Share: Exploring Data on Profits in the Australian Economy* (Canberra: Australia Institute), August 2022, https://australiainstitute.org.au/wp-content/uploads/2022/08/P1283-Profit-share-is-rising-Web.pdf.

[3] Philip Lowe, "Monetary Policy, Demand and Supply," Address at the National Press Club, Reserve Bank of Australia, 4 April 2023, https://www.rba.gov.au/speeches/2023/sp-gov-2023-04-05.html.

Worldwide Evidence of Profit-Price Inflation

Scholars and researchers in several industrial countries have published new evidence that unusually high corporate profits have been both a cause and a consequence of the acceleration in inflation experienced in most jurisdictions since the re-opening of the world economy after initial COVID lockdowns. Examples of this research include:

- U.S. research has documented the rise of corporate profit margins in the U.S. economy to record highs since the pandemic, and explains how initial price hikes in "systemically significant upstream sectors" (such as energy, logistics, and transport) can spread into other sectors as a result of corporate concentration, pricing power, and supply bottlenecks.[4]
- U.K. research has found that average profit margins were 89% higher in the first half of 2022 compared to like-period in 2019, and this explains most of the rise in prices in several strategic sectors (including energy, transportation, supermarkets, and shipping).[5]
- New research from the European Central Bank has confirmed that unusually large profit margins account for at least half of recent consumer price inflation in the Euro zone: "Input costs are falling while retail prices are increasing and profits are also increasing."[6]
- In Canada, research has indicated that record profits in 15 specific sectors, most at strategic junctures in the overall supply chain, explain over 100% of the rise in economy-wide profits; those same sectors were the source of over half of post-COVID consumer price increases.[7]

In the Australian case, a February report from the Centre for Future Work[8] considered in detail the role of business profits in explaining recent inflation in Australia. That report disaggregated the increase in economy-wide prices (measured by the increase in the GDP deflator, as reported by the ABS) into its factor price components. It found that 69% of excess inflation between December 2019 (the last quarter before the onset of the pandemic) and September 2022 (latest data available at time of writing), over and above the RBA's 2.5% inflation target, was manifested in higher corporate profits in Australia. Just 18% of that excess inflation could be associated with higher unit labour costs (taking into account both wages and labour productivity). The remaining 13%

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[4] Isabella Weber and Evan Wasner, "Sellers' Inflation, Profits and Conflict: Why can Large Firms Hike Prices in an Emergency?", University of Massachusetts, Economics Department Working Paper Series, 2023, https://scholarworks.umass.edu/cgi/viewcontent.cgi?article=1348&context=econ_workingpaper.

[5] UNITE the Union, *Profiteering Across the Economy: It's Systemic* (London: UNITE the Union), March 2023, https://www.unitetheunion.org/media/5442/profiteering-across-the-economy-march-2023.pdf.

[6] European Central Bank, "Interview with The New York Times," 1 April 2023, https://www.ecb.europa.eu/press/inter/date/2023/html/ecb.in230401~ec65174af7.en.html.

[7] See Jim Stanford, *15 Super-Profitable Industries Fuel Canada's Inflation* (Vancouver: Centre for Future Work), November 2022, https://centreforfuturework.ca/wp-content/uploads/2022/12/Fifteen-SuperProfitable-Industries.pdf.

[8] See Jim Stanford, *Profit-Price Spiral: The Truth Behind Australia's Inflation* (Canberra: Centre for Future Work), 24 February 2023, https://futurework.org.au/report/profit-price-spiral-the-truth-behind-australias-inflation/.

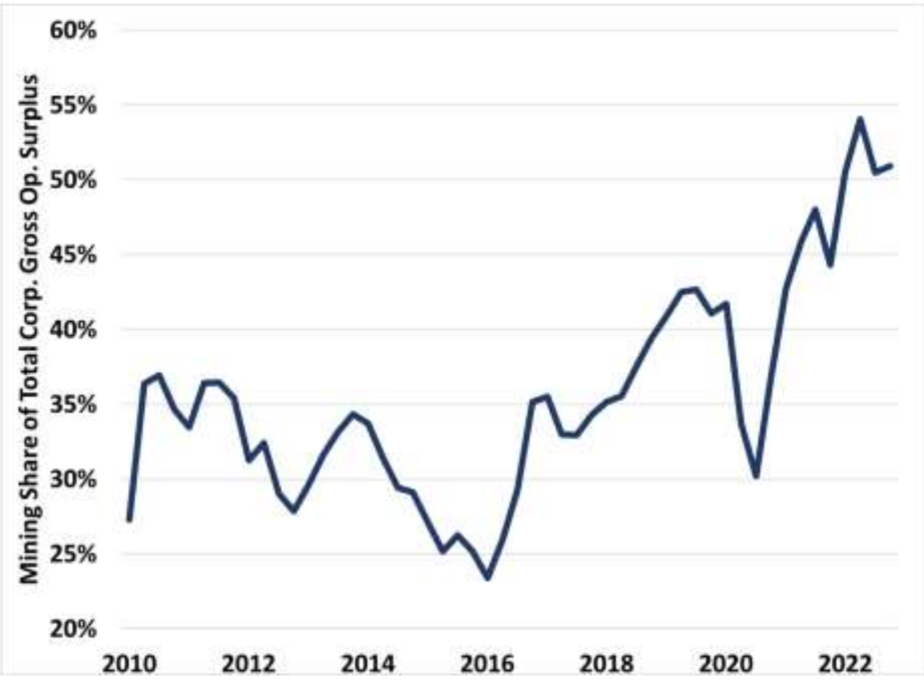
could be ascribed to other factors – largely higher profits for unincorporated small businesses.[9]

This report provides further detail on the sectoral composition of those excess profits in Australia, including both mining and non-mining industries. While the most dramatic (and inflationary) increases in profits were certainly concentrated in the mining sector (primarily as a result of skyrocketing prices for fossil fuel products), aggregate profitability has clearly improved in non-mining industries, as well – and rising profit margins in other industries (including wholesale trade, manufacturing, transportation, and others) has clearly exacerbated the inflationary pressures and the resulting cost of living crisis in Australia.

An Unprecedented Surge in Mining Profits

Australia's mining sector has generated unprecedented windfall profits in the past two years, as the result of dramatically higher prices for fossil fuel energy (petroleum, gas, and coal) and other minerals. The scale of these profits is enormous. According to ABS data, corporate gross operating profits in the mining sector totaled $295 billion in 2022, equal to 12% of national GDP.

Figure 1. Mining Profits as a Share of Total Profits, 2010-2022



Source: Authors, calculations from ABS Business Indicators Data, Table 11.

Corporate gross operating profits in mining grew 89% in the last three years, from end-2019 (last quarter before the pandemic) to end-2022. In fact, for the first time in 2022,

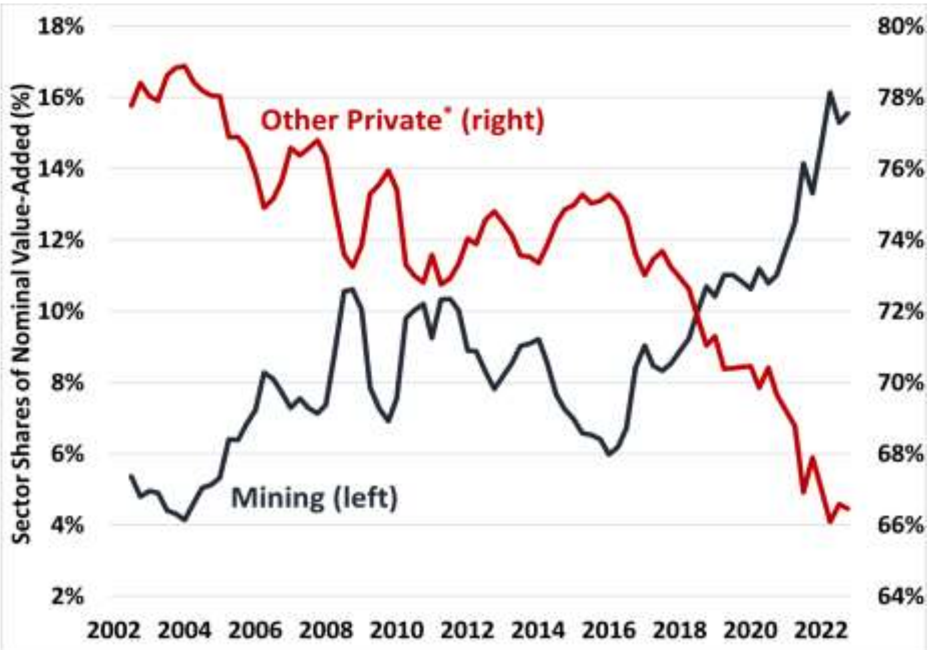
9 Internal RBA analysis, published through a freedom of information request, replicated the general methodology of this decomposition of GDP inflation into its factor components, and affirmed the conclusion that rising corporate profitability "is contributing significantly to GDP deflator growth." See Reserve Bank of Australia, "Freedom of Information Disclosure Log, RBAFOI-222337 Documents Released," 27 March 2023, https://www.rba.gov.au/information/foi/disclosure-log/rbafoi-222337.html.

mining profits accounted for *over half* of all corporate operating profits in the entire economy (making up 51.5% of profits for the year as a whole; see Figure 1). When analysts suggest that mining profits should be excluded from consideration of the role of profits in broader macroeconomic conditions (including inflation), they in effect are proposing to exclude *most* profits in Australia.

Changing Sectoral GDP Shares

The spectacular rise in mining prices and profits has caused a parallel rise in the share of the mining sector to nominal GDP. The broader mining sector has tripled its share of national nominal GDP since the turn of the century, reaching over 15% by 2022 (Figure 2). Just since the onset of the pandemic, the mining sector's nominal GDP share expanded by half: rising by 5 percentage points of total value-added. At the same time, the share of total GDP generated by other private-sector industries[10] has shrunk accordingly: down by about 10 percentage points of national GDP since the turn of the century, almost half of that since the pandemic.

Figure 2. Sectoral Share of Total Value-Added



Source: Authors' calculations from ABS National Accounts, Table 45.
** Excludes public administration and safety, education, and health care.*

The dramatic expansion in the share of nominal GDP arising from the mining sector is almost completely due to inflating prices, not growth in real output. As summarised in Table 1, there has been hardly any change in real value added from the mining sector in the last three years: real value added of the sector grew less than 1% in that time. In contrast, nominal value added shot up by 80% – and profits even faster. Growth in

[10] Figure 2 illustrates the share of nominal value-added arising from other mostly private-sector industries, excluding public administration, education, and health. The share of those three sectors, where public sector provision predominates, in total nominal GDP has been broadly stable in recent years, at around 18% of total value added.

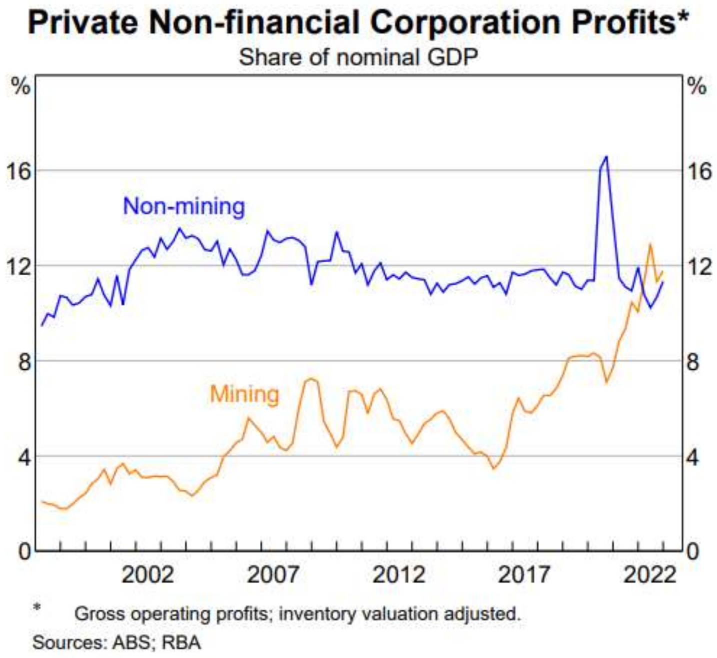
mining employment and nominal hourly wages has also been modest. Corporate gross operating profits now capture about four-fifths of all nominal value-added in the mining sector. That leave very little of the nominal output of the sector available to trickle down to mining workers: increases in aggregate labour compensation in the industry (resulting from both higher nominal wages and higher employment) account for just 4 cents our of each $1 increase in total mining value added since end-2019.[11] Moreover, a large share of the mining sector's operating profits is exported to foreign owners; this further dilutes the economic and social value to Australia from this sector's rapid escalation in nominal output.

Table 1 **Expansion of Mining Sector Since COVID Pandemic** **(% change, December 2019 to December 2022)**	
Growth in nominal value-added	80.2%
Growth in real value-added	0.9%
Growth in corporate gross operating surplus	89.4%
Growth in average wages[1]	6.7%
Growth in employment[2]	9.4%
Source: Authors' calculations from ABS National Accounts (Table 45), Australian Industry (Table 4), Detailed Labour Force (Table 4), and Wage Price Index (Table 5B) data. 1. Cumulative growth in wage price index, excluding bonuses. 2. Change from November 2019 to November 2022.	

The soaring contribution of the mining sector to nominal GDP, and corresponding decline in the share produced from other private sector industries, raises an important issue relevant to the discussion of profits and inflation. Some observers have argued that since the share of non-mining profits as a share of total GDP seems broadly stable, this verifies that there has been no surge in profitability in Australian business outside of the mining sector.[12] For example, the RBA recently published the following chart,[13] which seems to support the conclusion that the rise in profitability has been limited to the mining sector, and if anything profitability outside of mining has actually fallen (apart from a temporary spike in 2020 during the period of JobKeeper subsidies and other emergency COVID fiscal supports for business):

[11] Authors' calculations from ABS National Accounts Table 45.
[12] Examples are discussed and critiqued by Richardson, op. cit.
[13] See Reserve Bank of Australia, "Chart Pack: Graphs on the Australian Economy and Financial Markets," 5 April 2023, p.9, https://www.rba.gov.au/chart-pack/pdf/chart-pack.pdf?v=2023-04-08-14-53-08.

Figure 3. RBA Chart on Profits Relative to GDP



However, this measure of non-mining profitability is distorted by the fact that mining profits are *excluded* from the numerator (non-mining profit), but mining GDP (most of which is profit) is *included* in the denominator (national GDP). The falling share of non-mining private businesses in Australian nominal GDP (illustrated in Figure 2) artificially suppresses the apparent importance of non-mining profits.

To understand this measurement problem more clearly, consider that the share of non-mining profits in total GDP (as pictured by the RBA in Figure 3 above) can be expressed as the product of two other ratios: the share of non-mining profits (π) in non-mining GDP, and the share of non-mining GDP in total GDP.

$$\frac{Non\text{-}mining\ \pi}{Total\ GDP} = \frac{Non\text{-}mining\ \pi}{Non\text{-}mining\ GDP}\ x\ \frac{Non\text{-}mining\ GDP}{Total\ GDP}$$

As is clear from Figure 2, the last term on the right side of this equation (the share of non-mining business in total GDP) has declined by about 6% since the pandemic;[14] the relative importance of non-mining businesses has been squeezed by the rapid expansion in nominal output from the mining sector. For the ratio of non-mining profit to national GDP to remain constant, therefore, the first term on the right side of the equation must grow by an equivalent proportion. It is that first term (the ratio of non-mining profit to non-mining value added) that indicates the structure of income distribution within non-mining economic activity – not the ratio of non-mining profits to total GDP. Evidence presented below will confirm that by a range of different measures, the rise in profitability in non-mining industries has been significant and

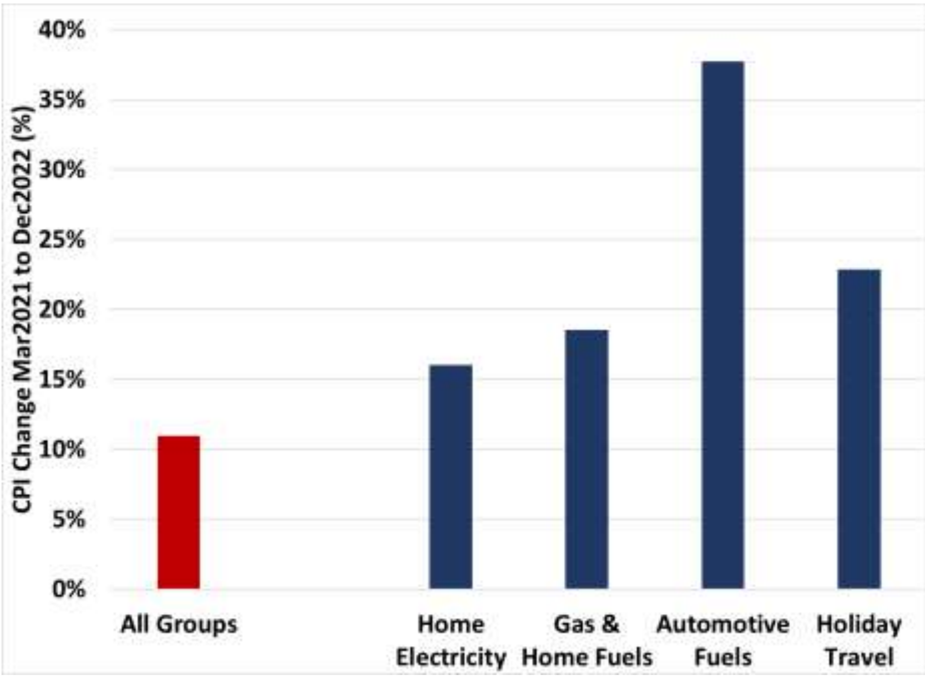
[14] The share of non-mining private industries (excluding public administration, education and health) in total sectoral nominal value added dropped from 70.4% in the December quarter of 2019 to 66.4% in December quarter of 2022.

widely shared. This results from the fact that prices for goods and services sold by those firms have increased faster than their own costs – even after paying for their (much more expensive) fossil fuel products and other minerals purchased from the mining sector.

Mining Sector Prices and Post-COVID Inflation

Energy-related products originating from the mining sector have made a critical contribution to the acceleration in inflation since the global economy began reopening after COVID lockdowns. This makes it all the more surprising that central bank officials could decide that mining profits (swollen by dramatic energy price increases) are somehow irrelevant to monetary policy and anti-inflation strategy.

Figure 4. Energy Products and Consumer Price Inflation, 2021-2022



Source: Authors' calculations from ABS Consumer Price Index, Table 7.

Energy products have made a disproportionate contribution to rising consumer prices in Australia throughout the post-COVID inflation episode. In the period since March 2021 (when aggregate consumer prices first began to accelerate after COVID lockdowns), inflation in consumer energy products (such as electricity, home heating, and automotive fuels) has been far worse than the overall rise in consumer prices (Figure 4). Automotive fuel prices have increased by a cumulative 38% since early 2021, more than three times faster than the overall CPI. Gas and home fuel prices have increased almost twice as fast as the overall CPI, and home electricity prices have risen 50% more than the overall CPI. Other consumer purchases with a large energy input coefficient (such as holiday travel) have also seen higher-than-average price increases. Given the significant share of those purchases in the overall bundle of consumer goods and services tracked by the CPI, the extreme inflation in energy costs has played a significant role in the overall acceleration of inflation.

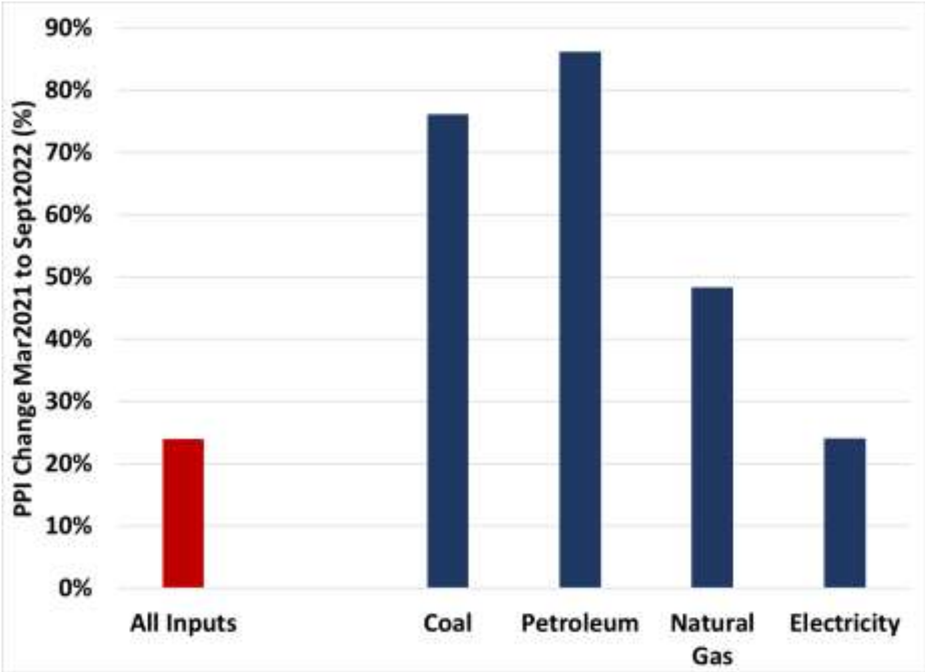
The disproportionate impact of mining products on inflation was especially dominant in the crucial initial acceleration of inflation after COVID lockdowns. Surging prices for petrol, in particular, were the leading edge in the initial take-off of inflation; hence they also contributed mightily to rising inflation expectations that so worries Reserve Bank officials (because expectations of inflation can broaden and reinforce inflationary pressures). In the first 12 months of significant post-COVID inflation (from March 2021 through March 2022), automotive fuel prices surged over 35%. Just that single item in the total CPI bundle single-handedly explained over one-fifth of the total rise in consumer prices in that period – and 37% of *excess* inflation (over and above the RBA's 2.5% target). Clearly, for monetary policy purposes, the mining sector cannot be treated as some kind of 'exception.' Its surging prices (and resulting profits) were the biggest single cause of accelerating inflation over the last two years.

Moreover, the direct impact of energy products in the overall consumer price index does not constitute the full impact of the mining sector's role in sparking post-COVID inflation. Most fossil fuel energy and other mining sector outputs are not consumed directly by consumers. Instead, they are used as inputs to the production of other goods and services, which in turn are purchased by consumers. Higher input costs paid by those industries will translate into higher prices at subsequent points in the supply chain (including, ultimately, final consumer prices for manufactures, housing, transportation, and services). The initial pulse of inflation resulting from fossil fuel price increases (and, to a lesser extent, other mineral products, such as iron ore) was thus transmitted through the whole economy, further boosting overall inflation.

This indirect impact is clearly visible in producer price indices constructed by the ABS to measure inflation in costs of inputs purchased by various industries. For example, Figure 5 illustrates the disproportionate increases in fossil fuel and related input costs paid by manufacturing companies in Australia during the post-COVID period. Figure 5 illustrates input cost inflation from March 2021 (the onset of post-COVID inflation) through September 2022.[15] Prices paid by manufacturers for coal and petroleum soared by 75-85% in that 18-month period. Prices for gas and electricity also rose much faster than other input prices. Therefore, it is clear that products sold by the mining sector have had a dramatic impact in overall cost pressures facing other industries. Those cost pressures eventually reach consumers in the form of higher prices for the myriad of other goods and services produced in the economy. The softening of mining sector prices in recent months (at least until the recent OPEC+ actions) has partially moderated those cost pressures – although that could change quickly, if OPEC+'s effort to curtail output and boost oil prices is successful.

[15] This period differs from the longer time period covered by the CPI data illustrated in Figure 4, because input costs for these products declined significantly in the last quarter of 2022, whereas consumer price inflation continued to accelerate through that quarter.

Figure 5. Energy Products and Manufacturers' Input Prices, 2021-2022



Source: Authors' calculations from ABS Producer Price Indexes, Table 13.

In sum, considering both the direct and indirect impacts of mining-sector prices in sparking and transmitting inflation through Australia's economy, it is clear that the impact of this sector's pricing and profit behaviour can hardly be discounted in analysing and responding to the surge in inflation since the pandemic. Together, the prices set by this sector have been the single biggest contributor to the surge in inflation over the last two years. They started chain reactions that have since spread into broader, persistent inflationary pressures. The surge in mining sector profits, which now constitute over half of corporate profits across the entire economy, is directly tied to those inflationary price increases. Without that initial surge in prices for outputs of the mining sector, it is quite possible overall inflation would have stayed within the RBA's broader target range (2-3%), hence avoiding the need for painful interest rate increases. It is thus not appropriate for Reserve Bank authorities to conclude that mining-sector profits somehow do not matter to the conduct of monetary policy in Australia.

No convincing justification has been provided by business lobbyists or the Reserve Bank in explaining why mining profits should be treated as a 'special case.' One rationale proposed is that mining prices and hence profits depend on prices that are determined in global markets.[16] In the case of petroleum and related products, for example, Australian energy policy currently allows producers to charge Australian consumers the same prices set in speculative global futures markets – even for petroleum produced and consumed within Australia. The sharp rise in world oil prices that followed the Russian invasion of Ukraine was thus quickly reflected in huge increases in prices for

[16] RBA Governor Lowe made this argument in his speech on 4 April.

petroleum products in Australia. That price spike led to unprecedented increases in profits for Australian oil and gas producers.

This link to world prices, however, is neither inherent nor inevitable: it reflects a policy decision to tie Australian energy prices to world markets. Nor is it unique to the mining sector: the prices of many other goods and services (including agricultural products, most manufactures, and many tradeable services) also depend directly on global market trends. The RBA can hardly suggest that profitability in these industries, too, is not relevant to understanding and combatting inflation. At any rate, regardless of how mineral prices are set, the clear reality is that rising fossil fuel prices and resulting record profits are inextricably linked. The consequences of this linkage for inflation, macroeconomic performance, and income distribution should be acknowledged and taken into account in the design of anti-inflation remedies.

Another possible argument is that mining prices are volatile, and hence current record profits are unlikely to be sustained in the long run. This is certainly true: speculative global futures markets always overreact to shocks in supply, expectations, and financial conditions. Indeed, within months the post-Ukraine-invasion spike in oil prices was starting to unwind (until the latest OPEC+ production cut, anyway). But this volatility, it seems, should make the relationship between mining profits and inflation even more germane for monetary policy. If price increases and super-profits in mining are indeed expected to be temporary, then monetary policy should be determined accordingly. Instead of attempting to suppress broader employment and economic conditions (through high interest rates), it would be more appropriate to target anti-inflation measures at the specific (and highly profitable) links between world energy markets, mining profits, and domestic inflation. Understanding this relationship is all the more important, if those initial price pressures are likely to be reversed – in which case, contractionary macroeconomic interventions are neither appropriate nor necessary.

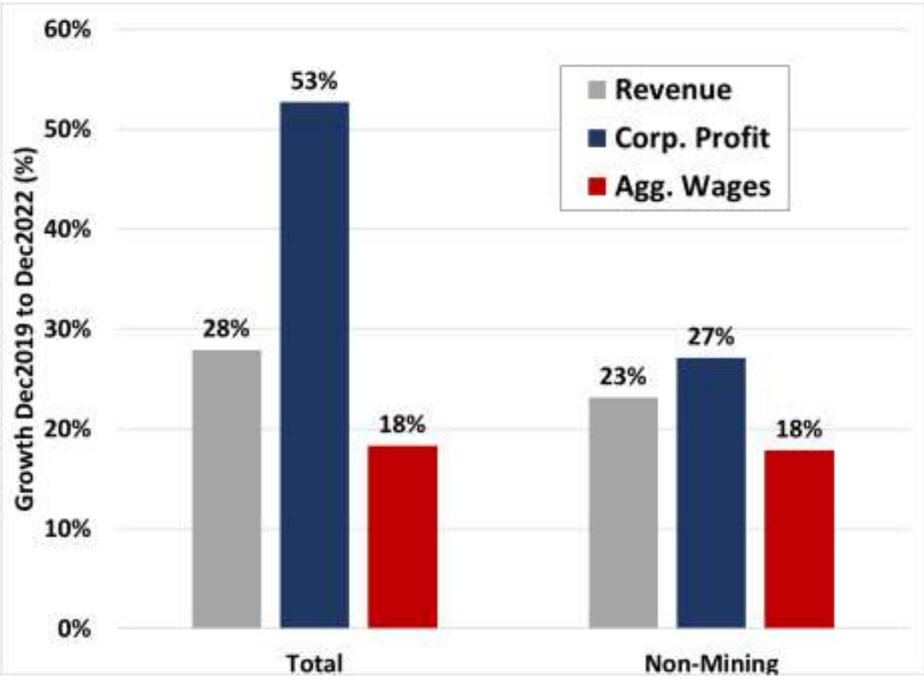
Robust Profits in Non-Mining Sectors

The expansion in mining profits since the COVID pandemic has been nothing short of spectacular, and has had strong and lasting reverberations on Australia's overall macroeconomic condition (including income distribution, inflation, and finance). However, profitability in other sectors of Australia's economy has also increased notably and disproportionately, over the same time period. While surging prices and profits in mining (particularly fossil fuels) are of particular concern in understanding and addressing inflation, the process of profit-price inflation in the broader economy cannot be ignored.

The ABS *Business Indicators* survey provides the most up-to-date information on revenues, profits, and wages on a sector-by-sector basis. The data is disaggregated into 15 sectors: mining and 14 others. It does not capture all corporate profits in the economy: it excludes three sectors where public-sector provision dominates overall output (education, health, and public administration). It also excludes agriculture (because of data availability and the importance of small business mixed income in that sector). Finally, its treatment of the financial sector is incomplete: it considers only revenues and factor incomes derived from provision of direct financial services (processing transactions, maintaining accounts, etc.), not the much bigger income and profit flows associated with deposits and borrowing.[17] For all these reasons, the *Business Indicators* data understates the total increase in business profits in Australia since 2019. Despite these limitations, this source confirms the breadth of profitability across Australia's economy – not just mining – since the pandemic.

Figure 6 illustrates the increase in overall corporate profits in Australia in the three years since the onset of the pandemic, compared to growth in firm revenue and payouts of aggregate labour compensation.[18] Overall corporate profits (measured here by gross operating surplus) surged 53% in three years, led by an 89% increase in mining profits. That was almost twice as fast as the growth in company revenues, and almost three times as fast as aggregate wage and salary payouts. Due to faster growth of profits than revenue and wages, overall corporate profits grew as a share of total Australian GDP: reaching 29% of GDP in 2022, the highest ever.[19]

Figure 6. Mining and Non-Mining Profits, December 2019 to December 2022



Source: Authors' calculations from ABS Business Indicators, Tables 6, 11 and 17.

[17] For this reason, financial services are excluded from the analysis below, which as a result understates the total scale and growth of profits in non-mining sectors. Data from the ABS *National Accounts* system (not strictly comparable to the *Business Indicators* data below) indicates total profits of financial corporations grew 13% in the 3 years ending in the December quarter of 2022, reaching a record annualised total of $110 billion (authors' calculations from ABS *National Accounts*, Table 7).

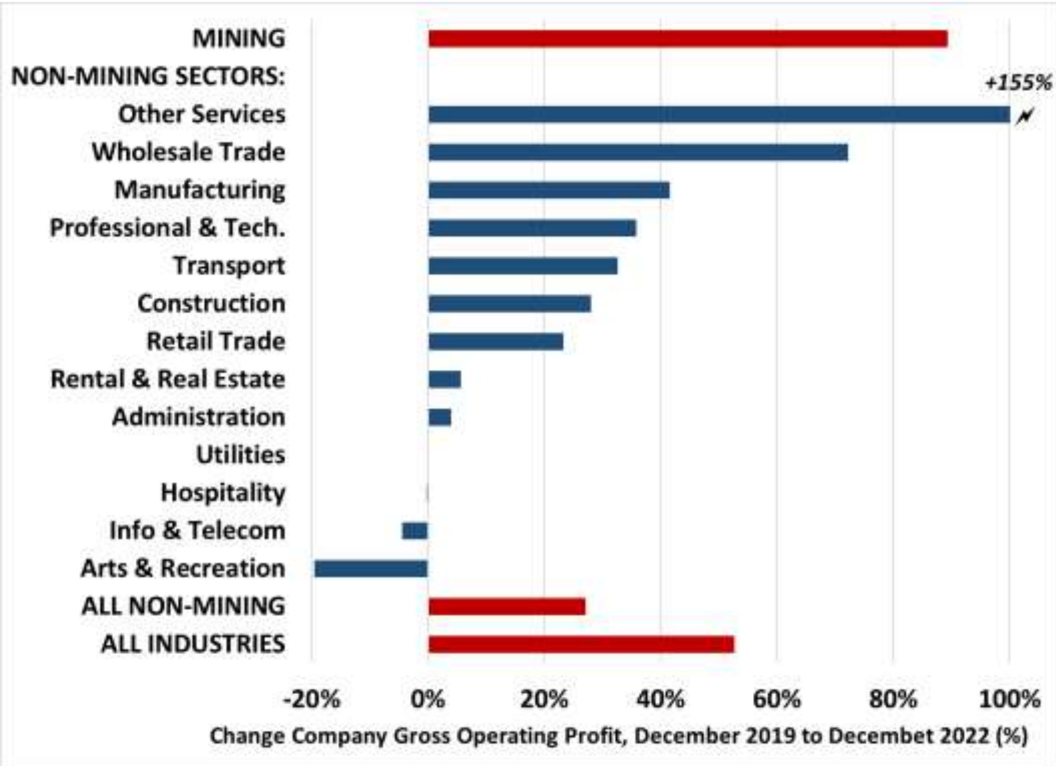
[18] Growth in aggregate labour compensation reflects both higher employment and higher nominal wages. Average hourly wages grew more slowly than aggregate labour compensation: rising just 7% cumulatively from December quarter 2019 to December quarter 2022 (authors' calculations from ABS *Wage Price Index*, Table 1).

[19] Authors' calculations from ABS *National Accounts*, Table 7.

However, even without the mining sector, the improvement in profitability in the rest of the private sector has been disproportionately strong. Profits across the other 14 sectors grew 27% over the same period – significantly faster than total revenues, and half-again faster than wages. As a result, profits in the non-mining sector have also increased as a share of non-mining revenue and non-mining GDP.[20]

This rise in the profitability of non-mining industries was sustained even after the phase-out of JobKeeper payments and other government subsidies to business during the initial COVID lockdowns. Those payments boosted profits (in both mining and non-mining sectors) substantially, but temporarily. Non-mining profits surged 38% between the March and September quarters of 2020, largely thanks to those subsidies. Profits then partially retreated when subsidies were phased out. However, even long after JobKeeper, profits in the non-mining economy remained well above pre-pandemic levels.

Figure 7. Corporate Profit Growth by Sector, December 2019 to December 2022



Source: Authors' calculations from ABS Business Indicators, Table 11.

Not all non-mining sectors have seen profits increase during this period, but most have. Figure 7 illustrates the change in profits in the three years ending with the December quarter of 2022, for 15 of the sectors tracked by the ABS data.[21] Sectors with profit

[20] According to ABS *National Accounts* data, nominal GDP in the same 14 non-mining sectors included above increased 17% in the same period, significantly slower than the increase in profits in those industries. By this measure, the ratio of non-mining profits to non-mining GDP (the first term on the right-hand side of the equation discussed above on p. 7) has increased by about 8.5% since the December quarter of 2019.

[21] Financial services are excluded from this graph since the ABS *Business Indicators* data, as discussed above, does not include profits from deposit and lending activities which constitute the bulk of total profits in banking.

increases that exceeded the overall average for non-mining industries include other services, wholesale trade, manufacturing, professional and technical services, and transportation. Most of these highly profitable sectors are also relatively large, which further pulls up average profitability across the non-mining portion of the economy.

Some non-mining sectors, however, have experienced flat or declining profitability since the pandemic. The hospitality and arts & recreation sectors were hit especially hard by the initial lockdowns, and have yet to fully recover. Utilities (which are mostly regulated, and hence not able to capitalise on supply pressures like other businesses) and the information and telecom sectors have also experienced relatively weak profits.[22]

This variability of profits across industries is consistent with international research indicating that initial inflationary surges were concentrated in sectors with particular market power and strategic linkages to the rest of the economy.[23] Companies in those sectors were able to exploit the unique combination of supply disruptions, consumer desperation, and energy price shocks to increase prices far beyond their own costs of production. This opportunism was most evident in the mining sector. But similar outcomes are visible in other strategically important sectors, including wholesale trade (which profited mightily after COVID lockdowns led to intense inventory shortages), manufacturing, and transportation.

Writ large, the surge in profits that has been both cause and consequence of post-COVID inflation has been particularly dramatic in the mining sector, but is clearly visible across many other industries. Since end-2019, businesses across the non-mining portion of Australia's economy have increased the prices they charge consumers above and beyond the costs of their own inputs (including fossil fuel products and other mining sector commodities) by a cumulative total of about $45 billion per year.[24] Those excessive price increases have contributed incrementally to inflation, and further skewed the distribution of income away from workers and toward businesses and their owners. The end result has been a broadening and reinforcement of inflationary pressures, a rapid decline in real incomes for workers, and a historic shift in national income distribution in favour of corporate profits.

Another robust but less timely source for data on profitability by sector is the ABS annual series on *Australian Industry*. This is published on a financial year basis, and the most recent release is for the 2020-21 financial year; hence it cannot yet capture the period in which corporate profits (and inflation) accelerated most rapidly. Nevertheless,

[22] Richardson reports that the growth of profits since December 2019 exceeds the growth of wages in the same period in all but 4 of the sectors tracked by the ABS data; see David Richardson, "It's not just mining: profits have increased by more than wages in almost all industries" (Canberra: Australia Institute), 23 March 2023, https://australiainstitute.org.au/post/business-groups-like-to-says-record-profits-are-all-due-to-the-mining-industry-but-in-11-of-the-15-private-sector-industries-profits-have-grown-faster-than-wages/.

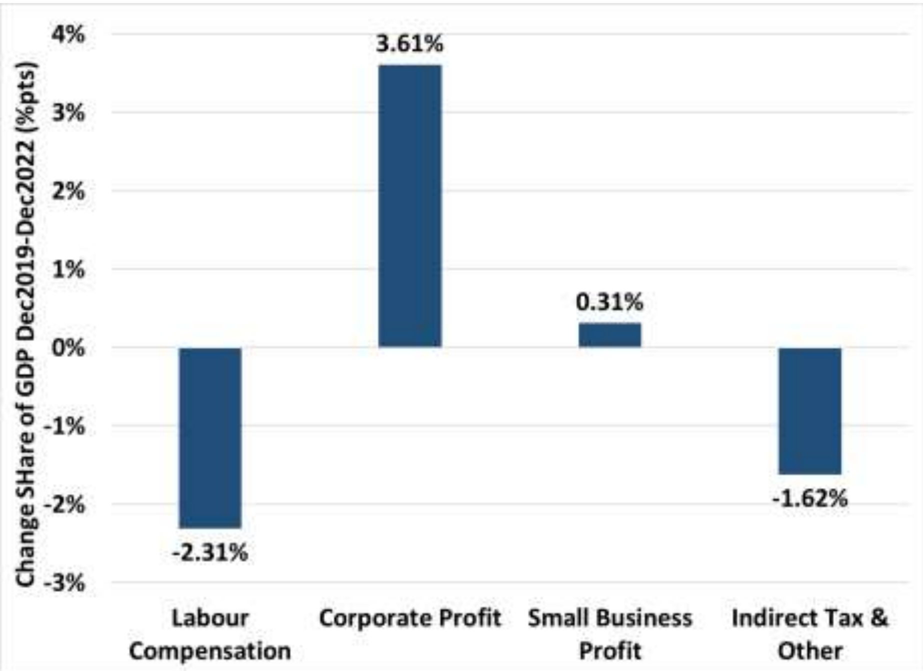
[23] See especially the work of Weber and Wasner, cited above.

[24] This estimate of excess profit-taking is adjusted for the increased volume of real output from the non-mining sphere of the economy: this is a source of higher profitability that is not inherently inflationary.

this data also confirms that the strong growth in profitability has been experienced across the broader economy, not solely in mining. *Australian Industry* reports various measures of profit, wages, value added, and other performance indicators for 18 sectors. Comparing 2020-21 to 2018-19 (the last full financial year before the pandemic), this data confirms that aggregate gross corporate earnings in non-mining sectors grew 18% over those two years, despite the continuing aftershocks from the pandemic still being experienced in 2020-21. Profits grew significantly faster than total revenues, value added, and labour costs during the same period.[25]

One final source of data confirming the robustness of business profits economy-wide is national accounts data on gross operating profits for unincorporated businesses (reported as 'mixed income'). In the three years from the December quarter of 2019 through December 2022, gross mixed income expanded by over 30% – much faster than nominal GDP, and almost twice as fast as aggregate wages. Even small businesses, therefore, have enjoyed expanded incomes as a share of national GDP – although their profits did not grow as dramatically as for corporations. As illustrated in Figure 8, labour is the only major factor of production to see its share of national GDP decline since the onset of the pandemic.[26]

Figure 8. Changes in Factor Shares of GDP, December 2019 to December 2022



Source: Authors' calculations from ABS National Accounts Table 7.

[25] Over the same two-year period ending 2020-21, total income in non-mining sectors grew 5%, nominal value added grew less than 2%, and labour costs grew 8%.
[26] The share of national GDP paid to wages, salaries, and other labour compensation (including superannuation contributions) declined by 2.331 percentage point in the three years ending in the December quarter of 2022.

Conclusion

A growing body of international research has confirmed the leading role of corporate profits in recent inflation in industrial countries, including Australia. This evidence has sparked concern and anger among the broader population. After all, since the outset of this inflationary episode, workers have been told they are the source of the problem: too many people are working (ie. labour markets are too tight), and they have too much money (ie. their aggregate purchasing power is excessive). This judgment has been invoked to support the painful monetary tightening which has been the main weapon wielded against post-COVID inflation: a record-fast escalation of interest rates has been imposed, with the explicit goal of slowing economic growth, weakening employment conditions, and suppressing wages. Yet even as they continue to pay record prices for basic necessities, workers have seen a litany of record-breaking profit reports from energy companies, supermarkets, airlines, banks, and other large corporations.

Workers have already paid once for the current inflation, through rapid erosion of their real wages. They are now being forced to pay again, through rising unemployment and further real wage cuts, in order to solve a problem they clearly did not cause. Therefore, public anger at record corporate profits is understandable and justified. Yet Australia's business leaders, now echoed by central bank officials, try to pretend those profits are normal, reasonable – and have nothing to do with the crisis in the cost of living experienced by millions of Australians.

It is not reasonable to pretend that Australia's mining sector – the centrepiece of national economic development strategy for decades, and now accounting for a large and growing share of nominal GDP, exports, and especially profits – can be excluded from consideration of macroeconomic phenomena like inflation. Fossil fuel products (produced by the mining sector) were the single largest contributor to the initial surge in post-COVID inflation. Those price increases have been associated with an unprecedented surge in profits in the mining sector. And higher fossil fuel prices have since cascaded throughout the national economy, spurring knock-on price increases in downstream sectors and broadening inflationary pressures.

Moreover, the claim that profits in other parts of the economy are only 'normal', and thus not relevant to understanding inflation and controlling it, is also false. According to several statistical indicators, profits in non-mining sectors have also grown faster than non-mining revenues, value-added, and wages. Even unincorporated small businesses have enjoyed growth in profits significantly faster than the overall growth of the economy. Wages, in contrast, have lagged well behind prices, output, and profits. Workers are the only major factor of production to suffer a decline in their share of national output and income.

It is important for policy-makers to be honest about the impact of business profits on recent inflation. Attempts to dismiss the role of excess profits is a dereliction of duty on the part of monetary policy makers. They should consider all the factors that have boosted inflation in the last two years – not just those that fit predetermined assumptions about the central importance of wages and labour costs. A broader, evidence-based analysis of the causes and consequences of inflation (including income redistribution from workers to corporations throughout this inflationary episode) would inform more effective and fair remedies to the current crisis in the cost of living.[27]

Looking forward, a better understanding of the role of profits in current inflation will also be vital to projecting future trends in inflation, interest rates, and economic growth. By early 2023 it was clear that inflation had begun to moderate – not because of higher interest rates (which have not yet had visible impact on most CPI components), but because of a reversal of the unique factors which allowed businesses to raise prices (and profits) so dramatically in the first place. World fossil fuel prices retreated through much of 2022, many supply chain and logistical constraints were resolved, shipping costs declined dramatically, and pent-up consumer demand after the lockdowns was dissipating. These positive developments will help reduce inflationary pressures; they will also be accompanied by an equally welcome moderation in corporate profits. As the ability of companies to exploit consumers (taking advantage of supply shortages and consumer desperation) abates, then company profits will start to return to pre-pandemic norms, and inflation will slow. On both the way up and the way down, therefore, the link between profits and inflation is clear.

However, more recently a new and worrisome scenario has emerged. In early April the OPEC+ cartel decided to once again restrict oil production (reducing production quotas by a combined total of 1.16 million barrels per day), with the intent of boosting oil and related energy prices.[28] If higher world oil and gas prices are allowed once again to fully flow into Australian energy prices (and subsequent downstream supply chains), then the painful experience of 2021 and 2022 could well repeat itself. Another spike in fossil fuel prices (bearing no relationship to the cost of production in Australia) will cause both a new surge in inflation, and a further climb in corporate profits in Australia (largely, but not exclusively, in the mining sector). Higher domestic interest rates will have little value in preventing this resurgence of profit-price inflation. Therefore, to understand these risks, and prepare for a more balanced and effective anti-inflation strategy, the role of business profits in post-COVID inflation must be honestly acknowledged – and effectively countered.

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[27] A menu of alternative policy responses to inflation that would more effectively target the true causes of higher prices, and share the burden of inflation reduction more fairly, is provided in Australian Council of Trade Unions, *An Economy that Works for People* (Melbourne: ACTU), August 2022, https://www.actu.org.au/media/1450094/actu-job-summit-papers-macroeconomics-10-august-2022.pdf.
[28] Mathew Martin and Grant Smith, "OPEC+ makes surprise oil cut in new inflation risk," *Australian Financial Review*, 3 April 2023.