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L20 brief addressing the cost-of-living crisis:

THE NEED TO RAISE WAGES

Introduction

Inflation – the generalised rate of increase of prices – is having abrupt consequences on household budgets, eroding the real value of wages, and contributing to workers' increased economic insecurity across the world. Today's high inflation levels are largely caused by a combination of corporate price gouging, supply chain disruptions, and the rising food and energy costs resulting from geopolitical tensions.

These trends need to be understood in the context of a long-term decline in wages compared to productivity and GDP-growth. The share of wages as compared to GDP has been declining over the last decades, a trend that has been acknowledged by G20 Labour Ministers.[1]

This paper reviews the current trend of inflation, its drivers, and its impact on real wages. The paper notably highlights that **wages are not driving current inflation trends**, which appear to be mostly influenced by increasing food and energy prices, supply chain disruptions, and, in many cases, the excessive profits generated by some companies that are profiteering from their dominant position in the current economic climate. The paper highlights **the important role of wage policies in protecting workers' purchasing power – especially minimum wage policies to safeguard the incomes of the lowest income earners,** who tend to be most affected by inflation increases – as well as **the role of social dialogue and collective bargaining in supporting workers to respond to inflationary shocks.** Finally, this paper demonstrates how **increasing the frequency of wage adjustments during inflationary periods can help to safeguard workers' livelihoods and can prevent shocks created by less regular, but more dramatic, wage adjustments.**

Inflation: How is it developing, and what is driving it?

Even prior to the pandemic, in a low interest rate environment, the lack of investment in diversifying production centres exacerbated supply chain disruptions and shortages. Many central banks undertook the traditional and blunt approach of sharply increasing interest rates, which generated negative expectations for businesses, and reduced access to credit for small and medium enterprises, which helped to trigger a further crisis in the financial and banking sectors.

According to the IMF, global inflation is expected to reach 6.6 % in 2023. While this is a slight decline from the 8.8% figure of 2022, it is still well above pre-pandemic (2017–19) levels of about 3.5 %.[2] The growth

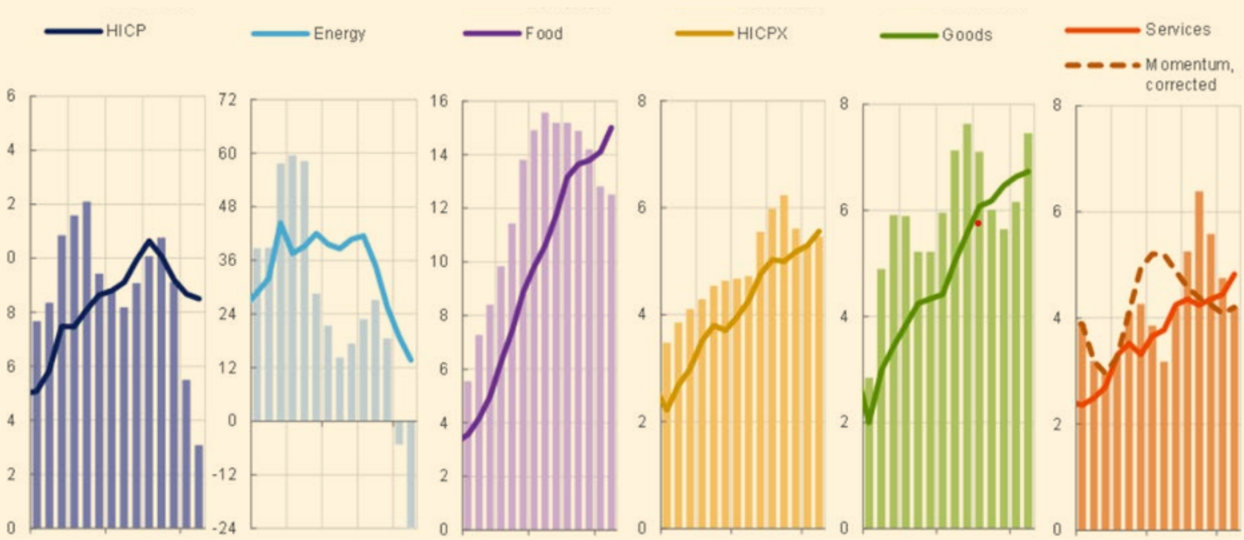
1 G20 (2018) Labour Ministers' Declaration: Fostering opportunities for an inclusive, fair and Sustainable Future of Work

2 IMF World Economic Outlook (January 2023).

of inflation is shared unevenly across countries. In Indonesia, for instance, inflation over the past year has reached over 5.5%, while in Turkey it has reached over 50% and in Argentina, over 100%.[3.]

As shown in the chart below for EU countries, **the cost of food has been rising far more rapidly than other items;** food costs have increased by over 15% in the last year alone.

CHART: INFLATION MOMENTUM IN THE EU (ANNUAL PERCENTAGE CHANGES; ANNUALISED PERCENTAGE CHANGES)



Source: European Central Bank based on Eurostat (February 2023) data

Notes: Momentum is defined as annualised 3 months on 3 months rates, seasonally adjusted data. HICPX: HICP excluding energy and food. The corrected momentum series on the right panel excludes the effects of the 9 euro ticket in Germany.

In addition, **major energy price increases in 2021 and 2022 – in part attributed to energy supply issues linked to Russia's invasion of Ukraine – has had huge consequences for the costs of household consumption,** as well as driving up the input costs for other goods and services, further contributing to inflation surges[4]

The rate of inflation, usually measured through changes in the consumer price index (CPI), is just one single number that provides a crude measure representing the overall changes in the cost of living within a country or region. However, **the different components within the consumer price index are not rising at the same rate and are affecting different income groups of the population differently.**

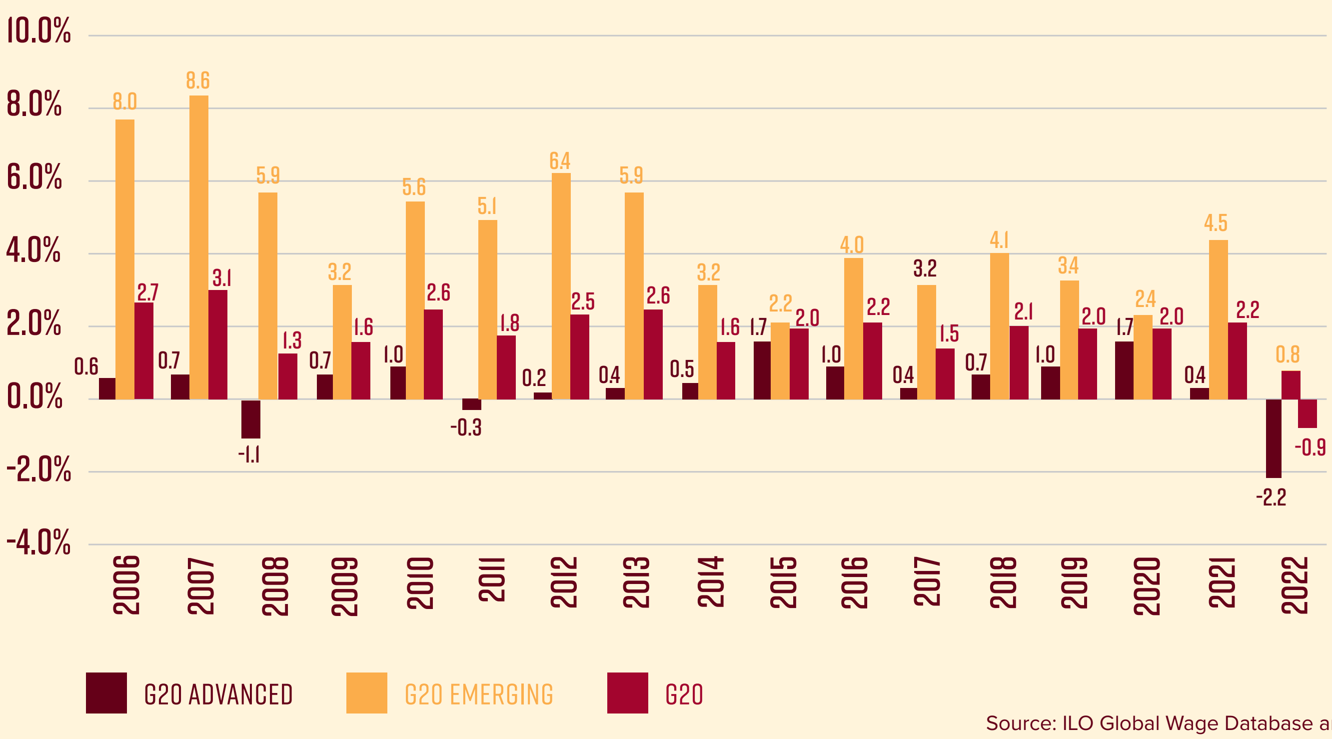
It is widely acknowledged that the drivers of inflation are not to be found in wage increases.[5] Despite an increase in total productivity, especially labour productivity, and global GDP growth over the last decade,[6] wages grew at a significantly slower pace. The gap between workers' wages and the overall growth of the economy widened, and the labour income share (LIS) worsened.

[3] See Bank Indonesia Data (2023); Turkiye Cumhuriyet Merkez Bankasi Data (2023); INDEC Data (2023), Argentina
[4] IMF (2023) World Economic Outlook
[5] IMF Blog, Wage-Price Spiral Risks Still Contained, Latest Data Suggests
[6] World Bank %GDP annual growth data

Real wages are rapidly declining

The IMF highlighted that, despite inflation having reached its highest rate in 40 years,[7] wages have not kept up with increasing prices, hence dramatically eroding their purchasing power. In 2022, average global monthly wages declined in real terms by 0.9%, and by 2.2% in advanced G20 economies.[8] This has contributed to the widest gap between labour productivity and real wages for over 20 years, and to the first negative global wage growth experience in the 21st Century.

CHART: ANNUAL AVERAGE GLOBAL REAL MONTHLY WAGES IN G20 COUNTRIES



Source: ILO Global Wage Database and ILO 2022 Global Wage Report

The absence of increases in labour incomes has generated a cost-of-living crisis. The impact has been greater on low-income households, who tend to spend a larger share of their incomes on essential goods and services. **Without appropriate measures to adjust wages, the current crisis and rising inflation will inevitably further increase inequalities, and will potentially endanger the post-pandemic economic recovery.**

[7] IMF (2022) World Economic Outlook
[8] ILO (2022) Global Wage Report

Protecting households from inflation: the role of adequate minimum wages and collective bargaining

Policies are urgently needed to avoid further erosion of workers' purchasing power and living standards. Increasing minimum wages to protect low-income earners is especially important to ease the effects of the cost-of living crisis. Low wage earners are particularly vulnerable to inflation; they tend to have less in savings that they can rely on when prices increase, and they tend to spend a large portion of their earnings on basic items such as food and energy, which can represent up to 40% of household expenditure.

In order to be effective and not deteriorate over time, minimum wages must take into account the cost of living and be regularly updated according to inflation and other economic developments, in line with ILO Convention 131 on Minimum Wage Fixing.[9] Making use of negotiated cost-of-living calculations that consider consumption patterns and the demographic composition of households can help to avoid underestimating the impact of prices on purchasing power. Scheduling regular adjustments of minimum wages can help to ensure their continued adequacy, as well as provide greater predictability to both employers and workers. Not all countries have mechanisms in place to regularly review and adjust minimum wage levels. In the United States, for instance, the federal minimum wage has remained unchanged since 2009. Most frequently, however, countries adjust their minimum wages once a year.[10] **In some countries, when inflation rises above a certain threshold, more frequent adjustments are automatically applied.** In France, for example, the minimum wage is automatically increased whenever price inflation exceeds two per cent within a given year.[11]

Strong tripartite social dialogue and collective bargaining on wages, across the wage distribution, can help to ensure that workers' real wages are protected. In Belgium, for instance, the regular indexation of salaries across all sectors, negotiated by social partners, has been shown to be helpful in cushioning the negative impacts of inflation on households, and there is no evidence that the impact of such indexation contributes to any wage-inflation spiral (Belgium has an average rate of inflation withinthe EU). More frequent and moderate wage adjustments can reduce social tensions and can also help to avoid sudden, large, nominal wage increases that spur overreaction by firms in relation to inflation. **Defining and updating a schedule for negotiations that allows for frequent wage adjustments through collective bargaining can therefore help to ensure that wages keep up with inflation and maintain workers' their purchasing power. This can also positively contribute to social and economic stability and ensure fair pay that allows workers to share gains in profits and productivity.**

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9 ILO Convention 131 and Recommendation 135 on Minimum Wage Fixing II.3
10 See ILO Minimum Wage Policy Guide Global Wage Report 2020-21 Wages in time of Covid
11 Ibid
12 FGTB-ABVV (2023) Belgian Wage Indexation - FAQ

Finally, additional measures can be considered to alleviate the impact of inflation on households, including subsidies, **progressive tax reforms** (which support increased social protection measures that cushion against price surges), as well as **windfall taxes** in the case of excessive profits on key goods such as energy.

A number of countries have already introduced windfall taxes on energy profits, including Austria, Bulgaria, the Czech Republic, Greece, the Netherlands, Romania and the United Kingdom, while other countries have signalled the intention of doing so.[13]

IN SUMMARY:

- **Wages are not causing the current inflation crisis; energy and food costs have been mainly driving the trend, along with supply chain disruptions and, in some cases, excessive profits.**
- **Negotiating wages that are adjusted to the rising inflation is more crucial than ever to ensure decent lives for workers and their families.**
- **Increasing minimum wages is especially important in order to avoid further shocks on the poorest households, who are most vulnerable to cost-of-living increases.**
- **More frequent and moderate wage adjustments can reduce social tensions and can also help to avoid large and sudden nominal wage increases, which can spur overreaction in relation to inflation.**
- **Collectively negotiated wage increases not only help to ensure the continued adequacy of wages in view of the cost-of-living crisis, but can positively contribute to social stability, ensure a fair share of profits and productivity gains for workers, and improve economic performance generally.**

THE L20 RECOMMENDS THAT G20 GOVERNMENTS:

- **Urgently review minimum wages, together with social partners, in order to ensure their adequacy in relation to the cost of living.**
- **Promote broad-based social dialogue and collective bargaining on wage increases, and encourage regular, frequent reviews of wages, especially during times of inflation.**
- **Consider additional measures that can help curb inflation, such as progressive tax reforms and windfall taxes for excessive profits on key goods such as energy.**

[13] IMF Notes (2022) Taxing Windfall Profits in the Energy Sector ; Reuters (December 2022) Factbox: Windfall tax mechanisms on energy companies across Europe