# Setting minimum wages at times of accelerating inflation

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**Nothing more deceptive than an obvious fact…**

Arthur Conan Doyle, The Boscombe Valley Mystery
Sherlock Holmes Short Story

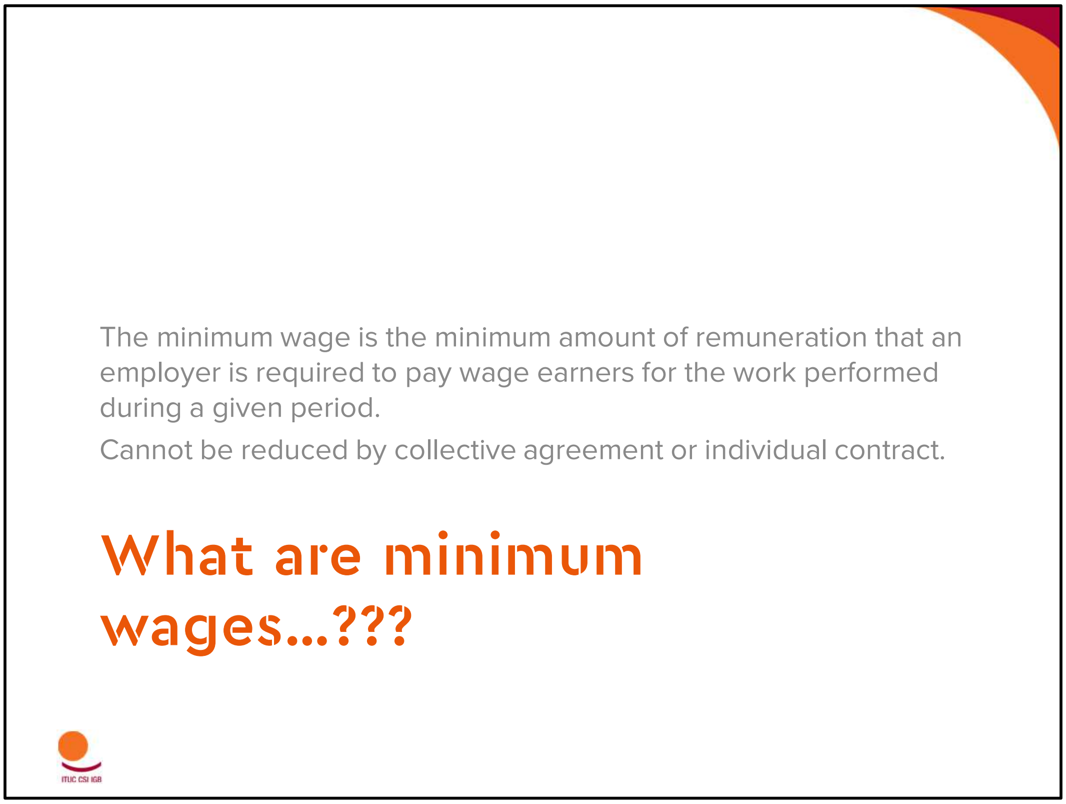
The emergence of the pandemic, that still goes on, naturalised in our life, has been surrounded by a number of other events that are affecting the return to normality.

There are several voices, from different ideological standpoints that are expressing concerns and warnings. However, many of those appeal some common places of conventional or canonical wisdom, that may lead to a new crisis of global dimensions, and as usual, the price will be paid by the most vulnerable sectors of society.

That is why, from the international labour movement, we must question the canonical wisdom that wages will drive inflation, which is put forward by some as an 'obvious fact'. As I will explain in my presentation, this hypothesis does not hold ground against the evidence. We must therefore be firm in refuting this theory and defending the interests of our affiliates, as well all those vulnerable sectors of the population, who would be most affected by the traditional prescriptions  to overcome inflation.

Beyond the obvious (1)

# Some concepts around the minimum wage




### Legal framework

The minimum wage constitutes one of the most fundamental institutions of the labour market. Since its first implementation in New Zealand in 1894, there are minimum wages in 90 percent of the 187 countries members of the International Labour Organization.

The minimum wage is mainly a legal concept that refers to the minimum amount of remuneration that employers must pay to workers during a certain period of time, statutory defined, in general by law or administrative order, depending on the institutional context of the country.

The legal weight of the concept is such, that the statutory minimum wage cannot be reduced by collective agreement -at any level- or individual contract.

## Objectives of the minimum wage

- It protects workers against unduly low pay.
- Ensures a just and equitable share of the fruits of progress to all
- Provides a minimum living wage to all who are employed and need such protection.
- Is a policy tool to overcome poverty and reduce inequality at many levels
- It has linking effects to the overall economy

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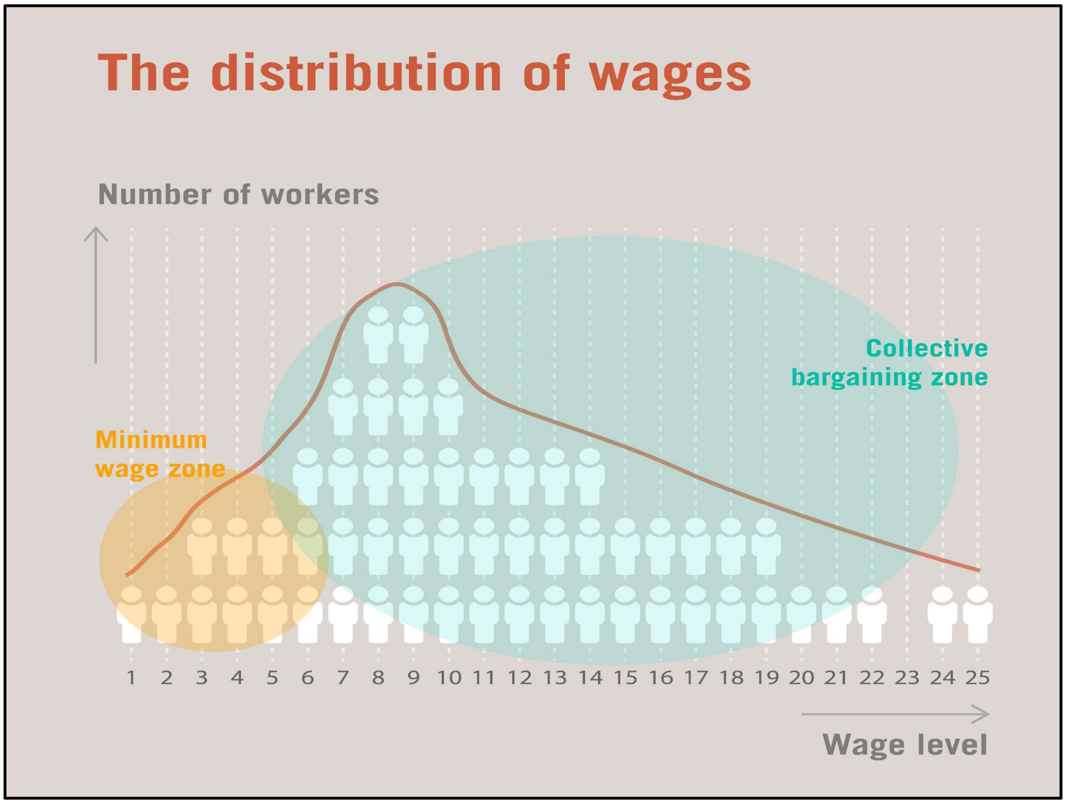
### Objectives of the minimum wage

Minimum wage is one of those instruments that – when correctly set and adjusted – is meant to compensate the asymmetry of power between workers and employers, hence, protect workers against unduly low pay.

Its adequate setting provides workers a minimum living wage to all those employed in need of such protection.

It is a crucial tool to eradicate poverty and reduce inequality at many levels and to make sure that the fruits of economic growth are shared and not solely appropriated by the employer. Minimum wage is linked to other sectors of the economy.

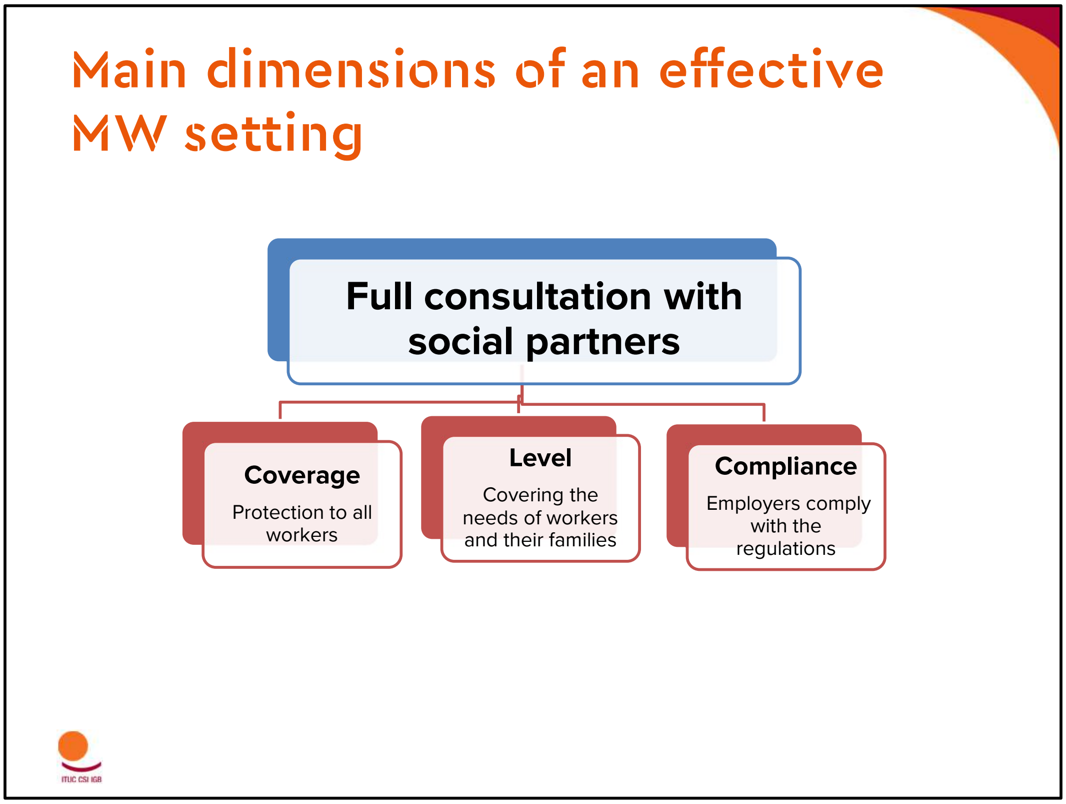



Who are the workers towards whom minimum wage aim?

In most modern societies, workers tend to be organized and negotiate wages collectively, in a dynamic process of unified demands, which proved to be the best way of achieving higher salaries, better working conditions, and a more sensible balance between work and personal life.

However, some workers  are not included in the overall context of collective bargaining and require such protection. These are the non-registered workers, those that perform work in non-standardized ways, or that basically, suffer for their lack of bargaining power.

In the graph, unionised workers and workers with negotiating capabilities are in the light blue area of collective bargaining, the orange area is the one where the minimum wage is the only instrument to provide them protection.




## The main dimension of the Minimum Wage effective setting

For us, organized workers, the context of social dialogue and tri-partite negotiations constitutes the cornerstone of the consultative process to define the level and the adjustment of the minimum wage.

However, it is crucial to note that there are three basic pillars on top of which the adequate minimum wage is based:

- **Coverage**, that must be to all workers, with exclusions kept to a minimum. It should include domestic workers, rural workers, seasonal workers, etc. and in the case that some are not in the general law of minimum wage, these sectors of those have especial clauses or collective agreements.
- **Level**: the minimum wage should be enough to fulfil the needs of workers and the families according to socially acceptable living standards.
- **Compliance**: the enforcement of the norm at the highest levels is the only way of guaranteeing that the minimum wage achieves the intended objectives.

## Elements to consider when determining the level and adjustment of the MW

- (a) the needs of workers and their families.
- (b) the general level of wages in the country.
- (c) the cost of living and changes therein.
- (d) social security benefits.
- (e) the relative living standards of other social groups.
- (f) economic factors, including the requirements of economic development, levels of productivity and the desirability of attaining and maintaining a high level of employment.

- **R135 - Minimum Wage Fixing Recommendation, 1970, Article 3**
- **Based on Convention 131 Article 3**

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### The International Labour Standards and Minimum Wages

The International Labour Organization has as its legal "backbone" the Conventions and Recommendations. In relation to the minimum wage Convention 131 and Resolution 135 of 1970 are the two instruments that define and recommend the elements to take into consideration for the determination of minimum wages.

The Convention 131 divides them in two big groups: i. social elements and ii. Economic elements.

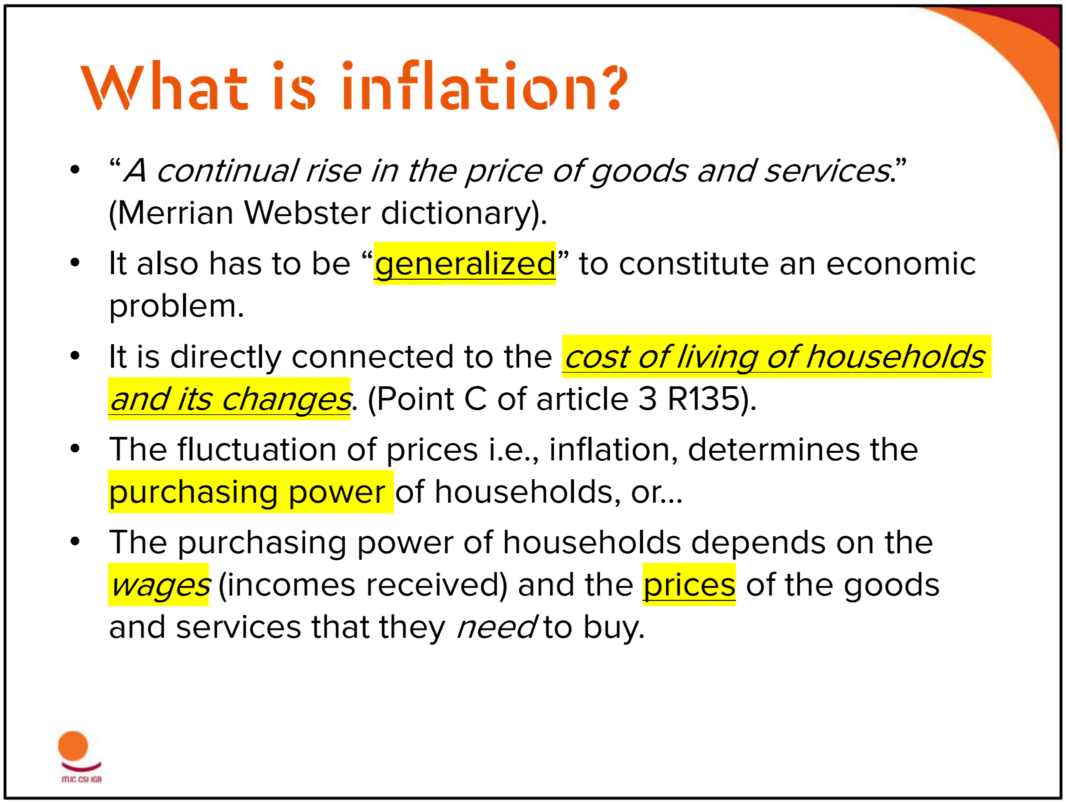
The cluster of the social elements is well-defined and simple to operationalize:

- The needs of workers and families, which are the minimum socially acceptable as a standard of living, and that require to be considered in a dynamic form, due to the changes in the patterns of consumption and needs satisfaction.
- The general level of wages, keeping a relationship with the remunerations received by other wage earners that are above the minimum wage level, and that move with their own sectoral or industry dynamic.
- The cost of living and its changes over time, expressing the need of adjustment of the minimum wage according to the variations in prices as well composition of the consumption by households.
- Social security benefits, as several social goods and services also constitute part of the expenditures of households, such as education, health, but also the minimum wage needs to have an equilibrium with the remunerations to passive workers that are receiving pensions and retirement benefits.
- Relative living standards of other social groups, which is a way of reducing and avoiding inequalities in the different countries.

The economic elements are much more general and difficult to operationalize. The needs of economic development, the levels of productivity and the desire of attaining high levels of employment -if not full employment- are somehow definitions of economic policy, and there are many paths or ways by which they can be achieved.

Beyond the obvious (2)

# What is inflation?




It is very important to define inflation in a more precise fashion. It is the generalized and continual rise of prices of goods and services.

It is explicitly mentioned in the Convention 131 as one of the elements to consider at the moment of setting and adjusting the minimum wage.

The purchasing power of wages is determined by two factors: the nominal wages, and the evolution of prices that constitutes the basket of consumption of workers and the households.

## Some concepts…

- Inflation
  - Prices increase
- Deflation
  - Prices decrease
- Recession
  - The economy is stagnated or contracting
- Stagflation
  - Inflation in a context of recession
- Headline inflation
  - A normative basket representative of all consumptions of good and services
- Core Inflation
  - A basket of good and services without food and energy

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There are a series of concepts that sometimes are used that need a more clear explanations.

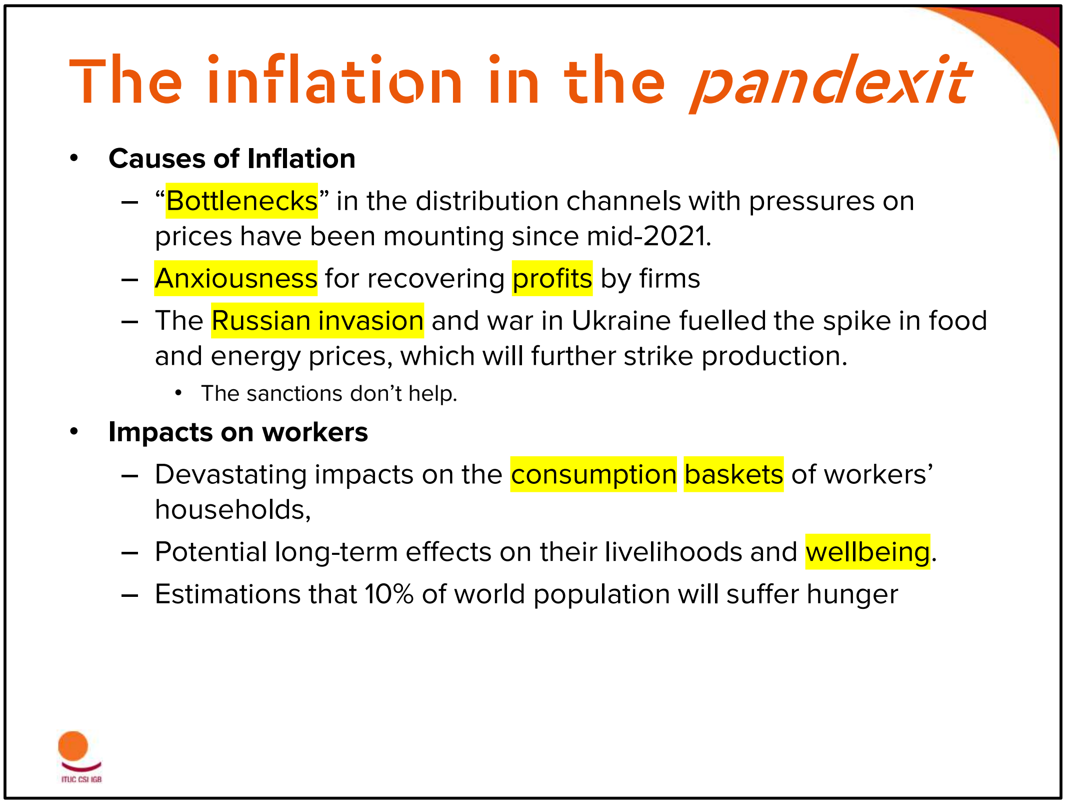
Inflation refers to price increases: generalized and continuous.

Deflation is the same process but with reverse direction. Prices go down.

Recession is the process when the economy is not growing or recessing, measured by its domestic product.

Stagflation is when the economy is in recession or not growing at the same time that prices go up in an inflationary process.

Inflation can be observed in different ways. The mainstream economists differentiate between the so called *"headline"* inflation, which is the determined basket of goods and services used to calculate the Consumer Price Index, and the *"core"* inflation, which is the same basket, but without the prices of food and energy. The reasons to make this distinction are the volatility of these prices, however the representativeness of the *core* inflation of the basket of goods and services of workers can be quite limited, as will be seen later.




*Why are we facing such a high inflation in the exit of the pandemic? Why inflation rates are today two or three times high than in the last 30 years?*

We could outline three major reasons:

The first one is the **bottlenecks** in the production of certain goods, as well the channels of distribution and logistics, that in a globalized world, disseminate in ripple and multiplying effects across the globe.

The second one is the **anxiousness** of many firms that in the process of reopening of the economies, are trying to restore and recover their profits rates to face some of the consequences of the closure of almost two years: debts, postponed investment, etc.

And to the already existing inflationary push, the **Russian invasion** to Ukraine affected the supply of food and energy to the world. It should be bared in mind that both countries are large suppliers of grains to the world, and that Russia is the main supplier of energy to Europe and fertilizers to the agriculture of many countries. Within this framework, the sanctions imposed, independently the political motivations and effects, tend to tighten more the supply.

All these have devastating impacts on the consumption baskets of worker's households. They face a challenge of fulfilling their basic needs, to the point that it is estimated that 10 percent of the world population may be brought into hunger or starvation.

These situations can lead to long term effects, even intergenerational, because many families will be forced to send other members, mainly young students, to the labour market, abandoning education, to improve the incomes of the household.

# Price-wages inflation?

- Inflationary context
  - This episode of high inflation is not the result of the "wage-led inflation".
  - Wages don't show a trend that would put additional pressure on costs of production. *(price-wage spiral)*
  - The myth of the "*great resignation*"
  - The myth of the "*skills mismatch*"

The supposed increased 'tightness' of the labour market after the pandemic is not materialising in higher wages.

Often, price-wages inflation has been used a pretext to avoid wage increases, even if prices are continuously on an upward trend.

However, there is no empirical evidence that wages cause inflation, as was explained before. On the contrary, governments tried to compensate the reduction of working time and wages during the pandemic, with movements of the minimum wages (MW) to trigger collective bargaining.

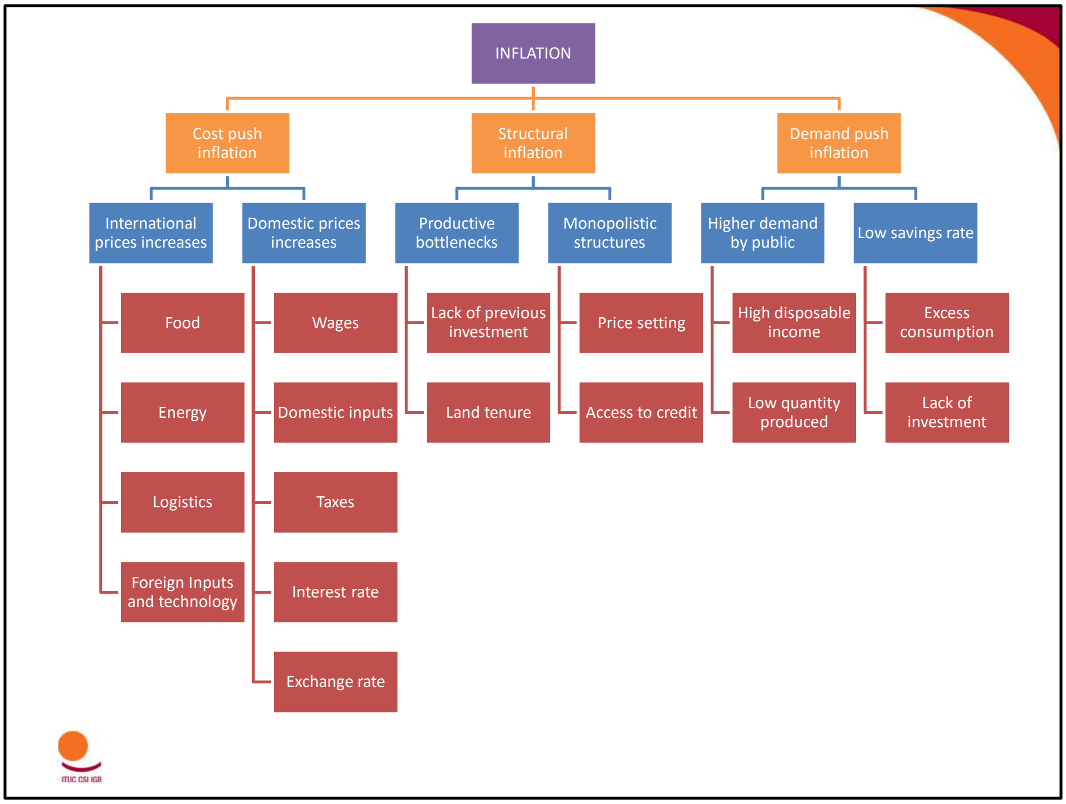
At the same time, when most restrictions related to the pandemic where levied, many workers did not go back to work, in the so-called *Great Resignation*, when the number of vacancies was higher than the people available to work. Instead, the reality is that without an improvement on wages, many workers preferred to wait for better offers than to return to the previous -badly paid- ones. That narrative has then been fainting after some weeks when the numbers showed that it was not the case.

Another storyline was around the *skills mismatch*, meaning that employers couldn't find the right workers for their productive needs. This was another attempt to blame workers and individuals about a corporate responsibility: the training of workers according to their needs. The expectation was instead that an already over-educated labour force, would adapt to the needs of firms and reduce their hiring costs.

In reality, the supposedly tightness of the labour markets after the pandemic, if happening, is not being materialized in the most clear indicator of a shortage, wages.


Economics is a *proto science* that, despite being among us for some centuries, still has a number of epistemological difficulties. Although some understand economics as a natural science which is able to explain so-called *"economic problems",* the different points of view, bring to the fore some irreconcilable positions.

The understanding of inflation and its remedies is perhaps one of the most prominent point of disagreement. The analysis of the causes of inflation leads to policy decisions that, as almost every economic alternative, have winners and losers, affecting people, households, enterprises, and the whole economy.




**Approaches to inflation**
There are three main "schools" or approaches to inflation, with names that are quite explicit and revealing of its causes:

- Cost-push inflation
- Demand-push inflation
- Structural inflation

**Cost-push inflation: Increasing of production costs push prices up**
This line of thought got stronger due to the many years of low inflation and stability that contextualised the globalisation process of the last 40 years. The explanation is quite standard: the prices of productive inputs push the cost of production, which triggers inflation. In principle, a price increase of a basic input would be a one-time event, but since this is not a synchronic process – different sectors suffer the inputs prices at different times, and transfer to their prices in different moments – the one-time effect may be extended for some time.

This set of prices includes the interest rate (or the cost of money), the exchange rate (the value of local currency in terms of foreign), or even wages and remunerations, each of them affecting the inflation rate. There are also other sources of cost-push inflation, for example taxes. When tax-rates are increased, or the taxing base is extended (including new activities, products, or agents) this can also drive prices up. But in this case it is a one-time effect. The cost-push inflation can also play a different role in country-specific situations. If we take as an example the case of countries that are net food importers (or importers of crucial inputs), a foreign price shock would have a clear impact on domestic prices. On the other hand, for exporting countries, the sudden increase of international prices or changes in the exchange rate can also push prices up, especially if the exportable products are internally consumed, "importing" the global inflation to the domestic prices.

It should be noted that cost-push inflation exists because there are firms that "defend" or "protect" their profits rate by increasing the prices of the goods and services they sell to the market. Ultimately, inflation is the result of constant rates of return by enterprises.

**Structural Inflation: there are structural causes in the economy that increases prices.**
Those that support the idea of a structural inflation highlight that some economies face structural characteristics and constraints that induce price-setting behaviours by firms, or that supply restrictions curb the reaction of production to demand pressures.

The main factors that define the structuralist approach to inflation are market structures with unregulated monopolies, monopsonies or other oligopolistic areas that push prices up. Similarly happens with land property concentrated in a few hands that adjusts production and prices in such a way that markets for food and primary goods do not function in a sensible way. This approach is the one that highlights the distributive conflict between classes -capitalists and proletarians- at the centre of the inflationary process.

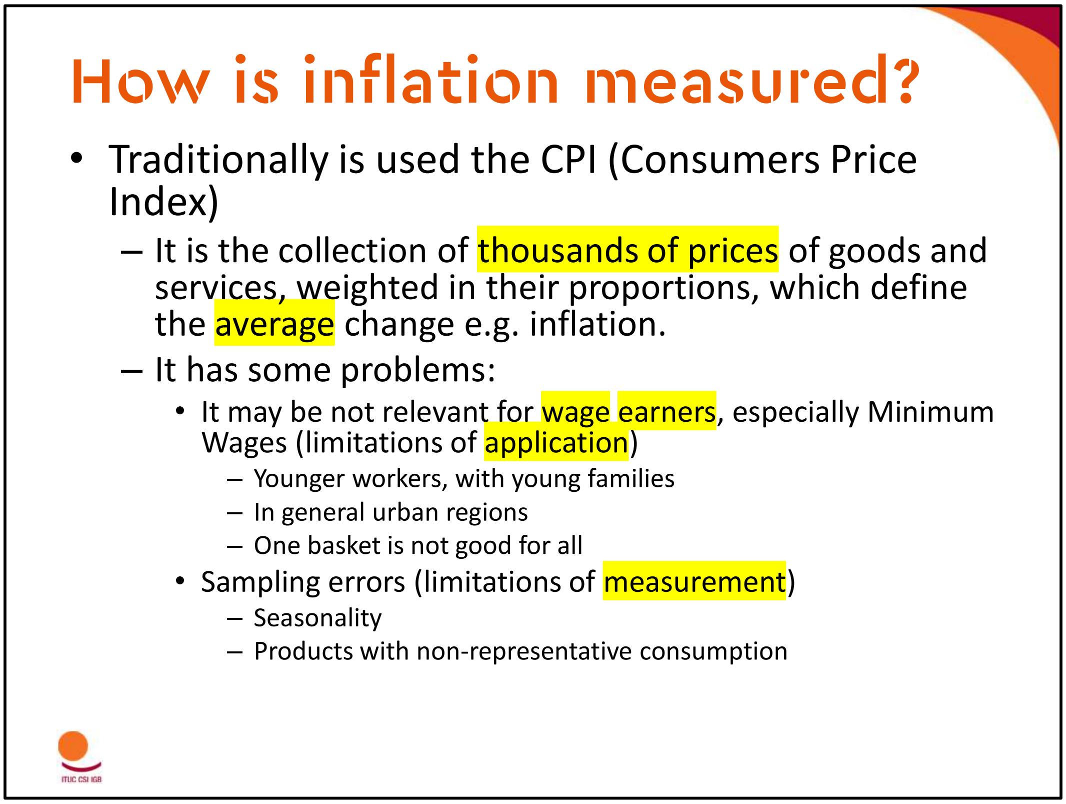
Other of the structural problems that may push up inflation is when the economy reaches full capacity of production and there is a lack of new investment to replace the depreciated one and build-up new potential output to face the demand, that is pushing up prices.

Lastly, and partially related to the previous point, is the access to credit that may also limit investment, but mainly to the working capital to purchase inputs, advance salaries, etc. This effect not only increases the cost of money (leading to cost-push inflation), but also limits the potential output or production.

**Demand push inflation: Excess demand of goods and services by the public push prices up.**
These are also called "monetarists" and the conclusions are based on the "*quantitative theory of money*". It has a quite simple, unsophisticated, and basic principle: The population demand more goods and services than those produced. If the economy produces 100 chickens and the Central Bank of that economy prints 100 coins, each chicken would be priced 1 coin. If the Central Bank decides to print 200 coins, but the economy still produces 100 chickens, then, the price of each chicken must be 2 coins. Therefore, the inflation would be 100 percent.

The monetarist approach has implications beyond the sheer control of the inflation and prices, expanding it basic understanding to other areas of the economic sphere such as the fiscal areas, policy interventions, income distribution, and trade. This simplistic assumption builds up the so called neo-classical theoretical build.

The equation $M \times V = P \times Q$ means that the quantity of money in the economy, multiplied by the velocity of circulation (the times where one monetary unit is exchanged) must be identical to the quantity of goods and services produced multiplied by the prices. The velocity of circulation is a very stable and structural (cultural) value, that barely changes overtime, also the quantity of goods and services produced.




The measurement of inflation is a crucial point for the discussion of inflation  in the negotiations of adequate living wages.

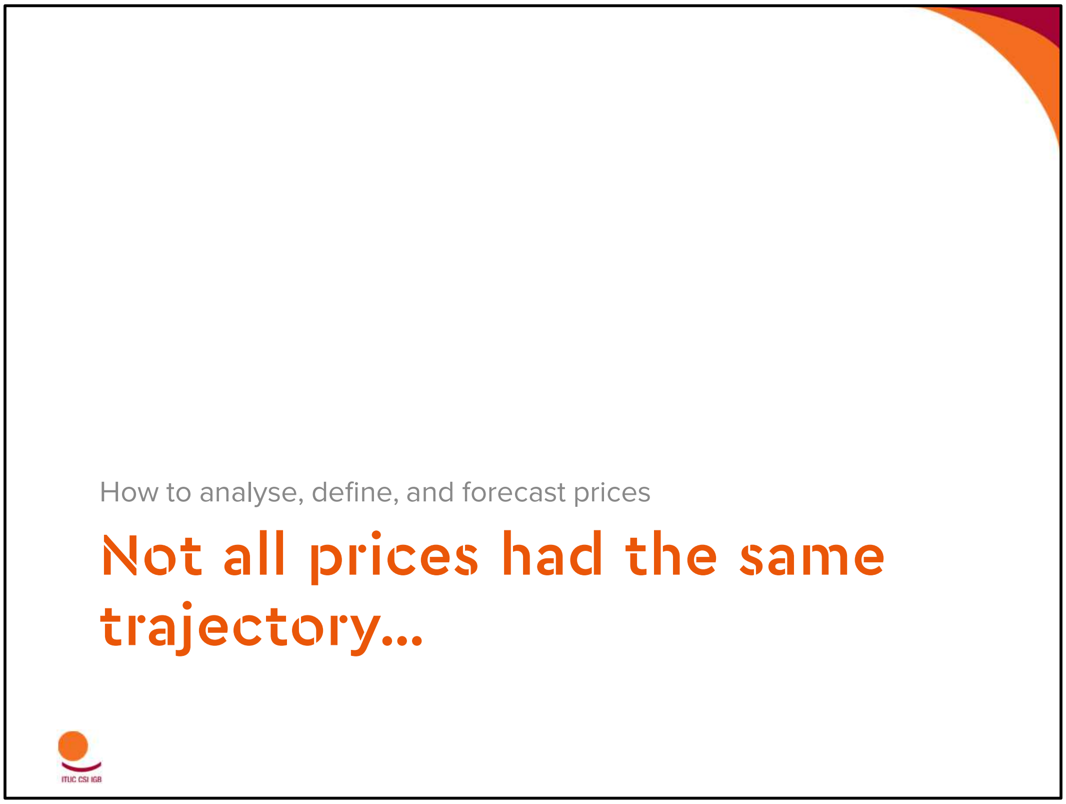
Usually, the Consumer Price Index (CPI) is considered, which is defined as the evolution over time of the the prices of a basket of goods and services. This is normally calculated over a period of time, monthly or annually.

Despite its widespread use, the CPI present some restrictions that have to be considered.

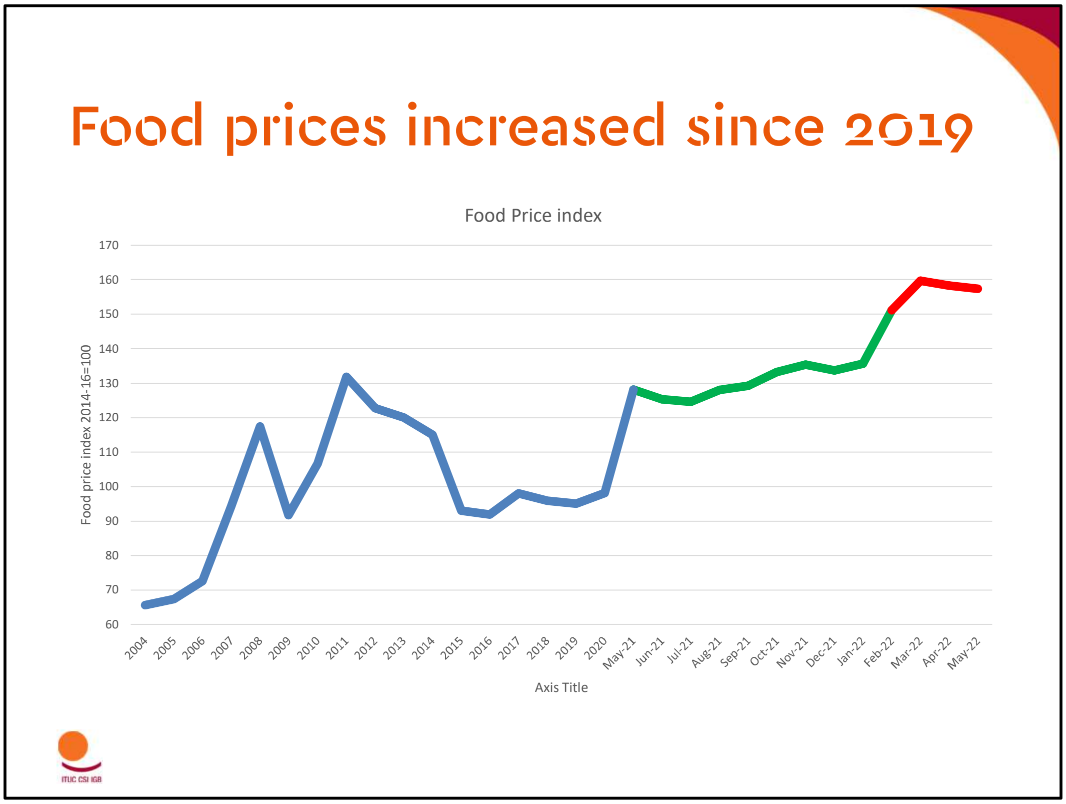
- Limitations of application that would make the index not relevant for some groups of the population, depending to their patterns of consumption. For example, younger workers (mainly concentrated around the minimum wage) usually tend to spend more than the average household for childcare or education.

- Limitations of measurement or sampling errors since the CPI may incorporate some products and services that are quite seasonal due to productive factors (agricultural products) or just the demand (holidays and vacations). There is also the issue of products that may not be representative of massive demand, but anyhow, they are included in the CPI. Also, the new technologies generate the demand of certain good and services, that are omitted in the original inclusion for the CPI.

It should be noted that the patterns of consumption are developed from complex expenditure surveys, which consider long periods of time to avoid seasonality or sudden price changes that generate substitution at household level. The right consideration of these surveys for the goal of wage negotiations is therefore a technical step that has to be mastered by Trade Unions to achieve the best results.




As mentioned before, the CPI is just one single number that aspires to represent the overall inflation rate in a country or region. When interrogated about the perception of inflation, individuals would bring different answers due to the variations on the patterns of consumption of the different households, which tend to differ from the composition of CPI and its average change.

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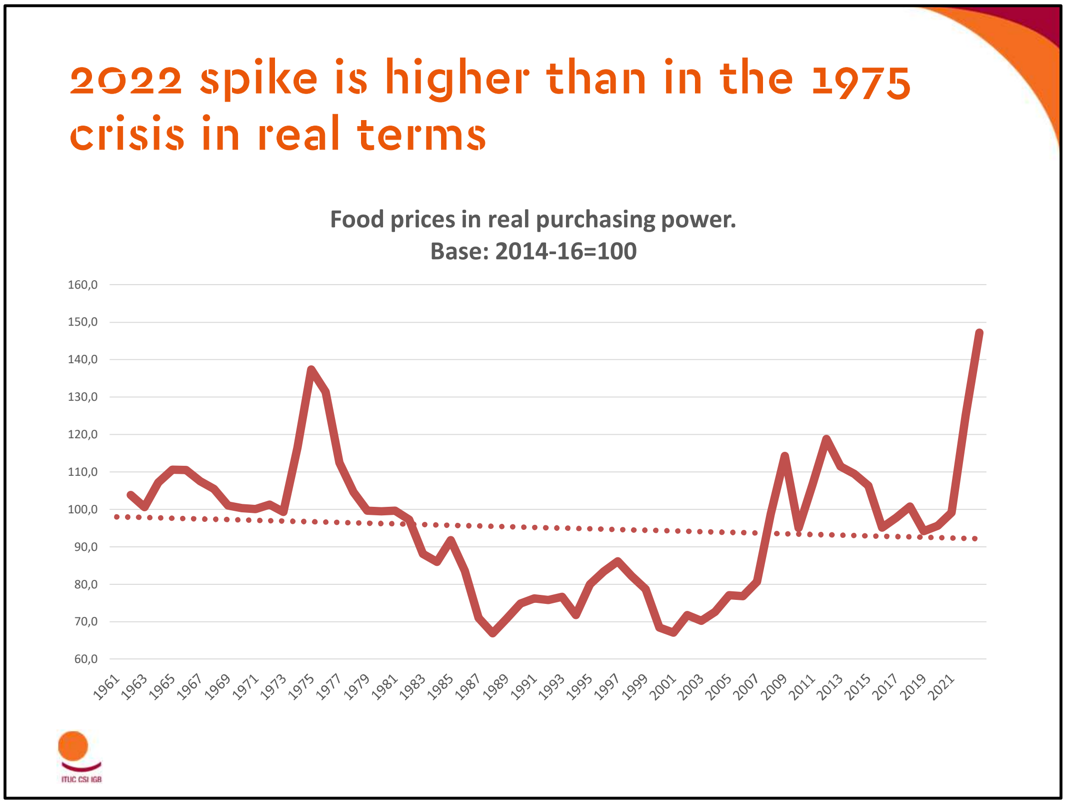
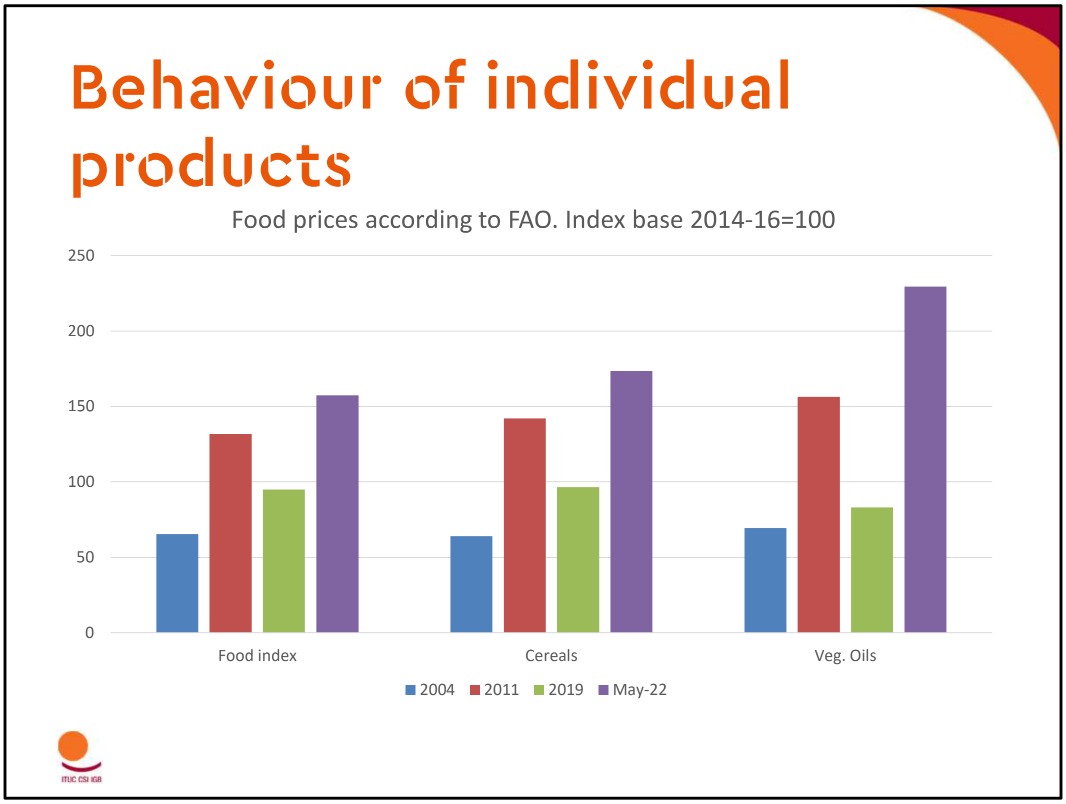



To have an idea of the magnitude of the food prices increase, the inflationary component in relation to the rest of goods and services, can be considered.

Using as base year the average of 2014-2016, the spikes can be analysed. The first large one was in 1973-75, with the sharp increase of energy prices which brought inflation worldwide for over a decade. Food prices were 40% higher than the base years.

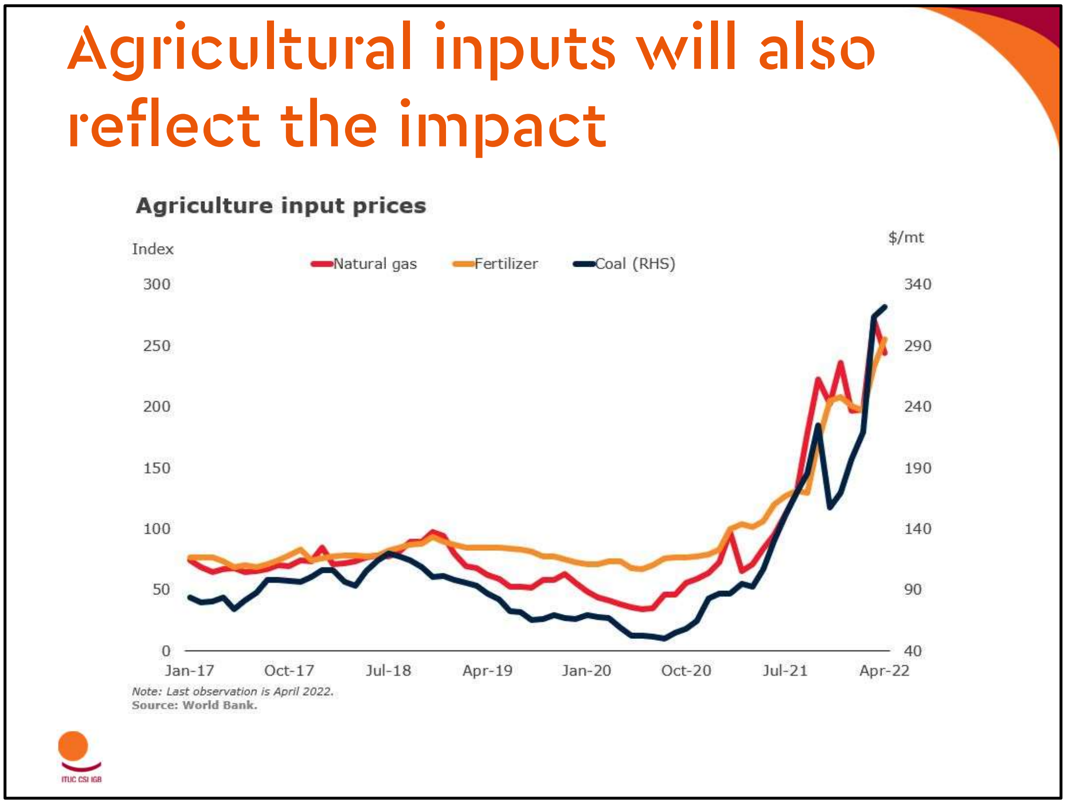
After that there is the increase of 2010, following the global financial crisis, when prices went up 20% in relation to the base.

Nowadays the real value of food is almost 50% higher than the average of 2014-2016, which is a significant increase in such a short period of time.




Even in the context of such increases evidence shows that not all prices increased at the same pace. The food index, that in May 2022 was over 50 percent more than the average 2014-2016, is short to represent the increase of almost 74 percent for cereals, and 230 percent for vegetable oils.

This behaviour enhances the need for calculating ad-hoc baskets that are representative of the consumption of workers.

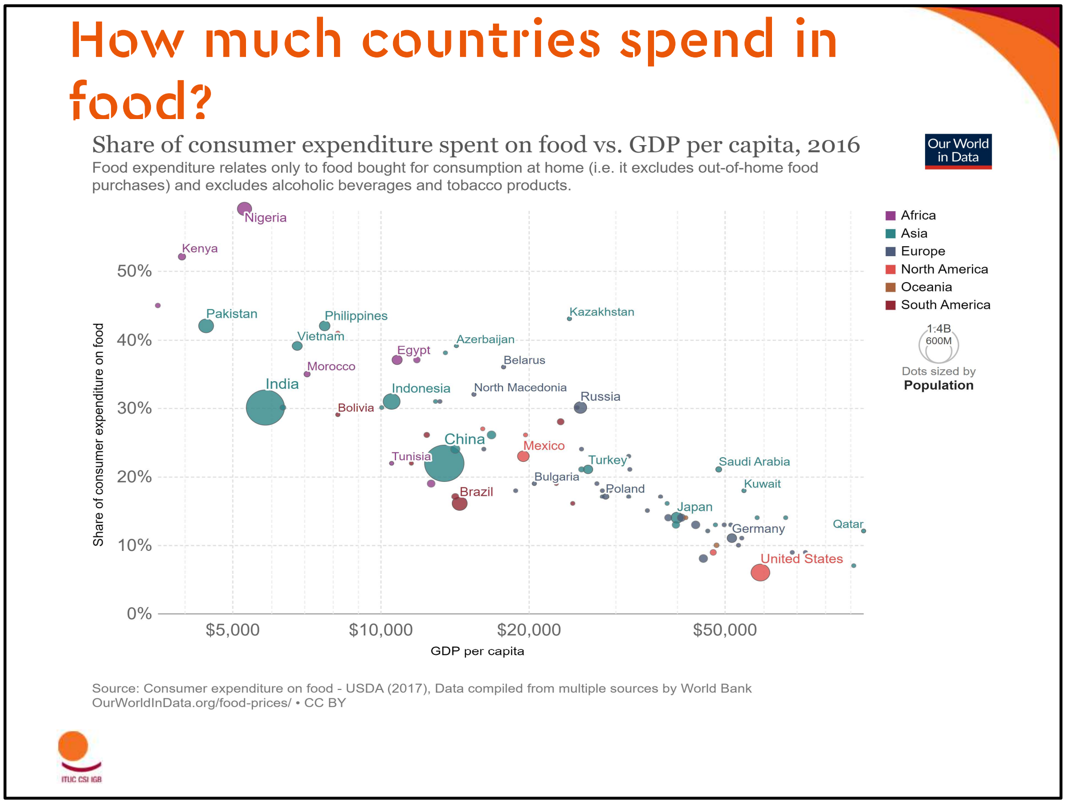



In addition, prices of crucial inputs for agriculture also registered a large increase, and it will aggravate the scene by extending inflationary reverberations even if the war comes to an end soon.

After the 2010 food prices spike, the FAO estimated that the ripple effects take almost one year to settle down again. In the meanwhile, adjustments in the incomes of the population are not only desirable, but also necessary  to avoid long-term effects on households.


As prices didn't move all the same at the same time, consumption and expenditure did not change equally among all countries.

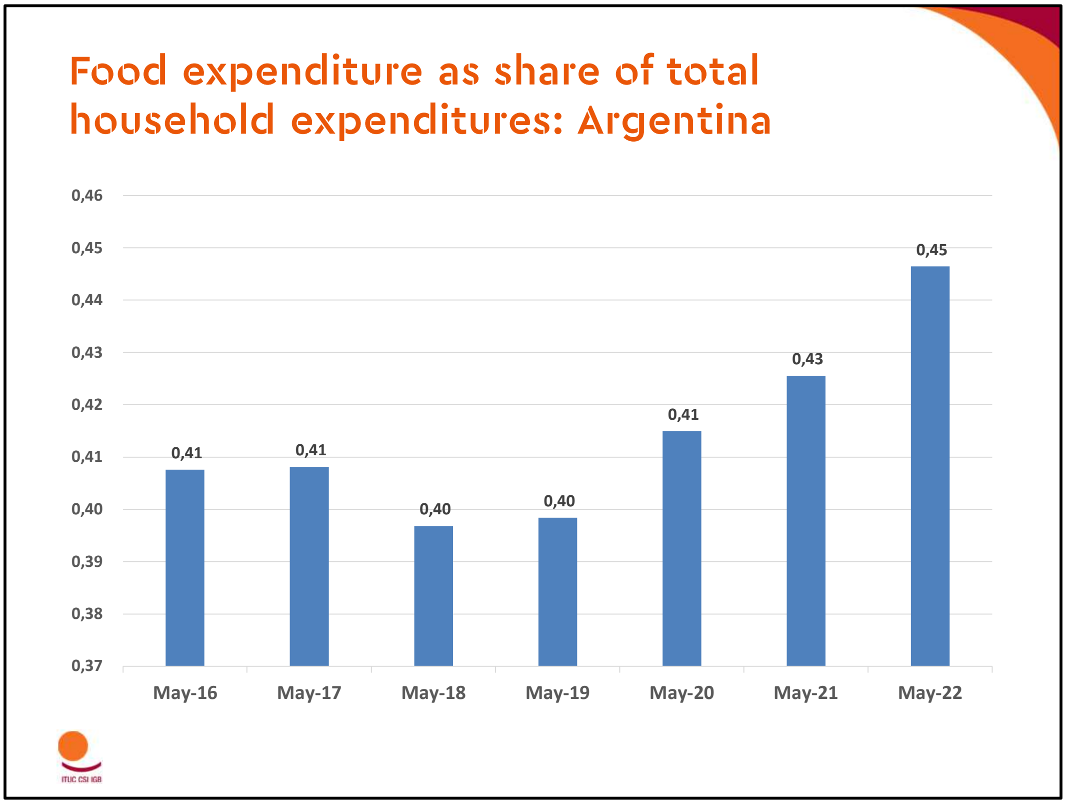
Furthermore, there are regional disparities that have to be considered, as well as different patterns of consumption of different classes and social groups that are determined by factors that transcend economics.




Food expenditure is one of the clearest examples. The share of income or expenditure dedicated to food is smaller as the income of the population expands.

In the graph, it is clear how the countries with higher GDP per capita spend a smaller proportion of it on food.

The main explanation is that higher income groups spend more in non-essential goods and services, even if in absolute terms food expenditure is higher. Food expenditure faces some “biological” limitations in relation to other items of the basket that have no superior boundary.




Similarly, food expenditure also can vary in time due to the fluctuations of prices and real incomes (purchasing power) of the population.

Here is an example of the share of household expenditure in Argentina dedicated to food, which shows a clear increase since the months before the COVID pandemic and spike of food prices.

Paradoxically, Argentina is a large exporter of cereals, which witnessed the price increases of 2022, but due to the transmission from international prices to domestic ones (Argentine's exports are the staple food in the country), the share of expenditure shows these changes.

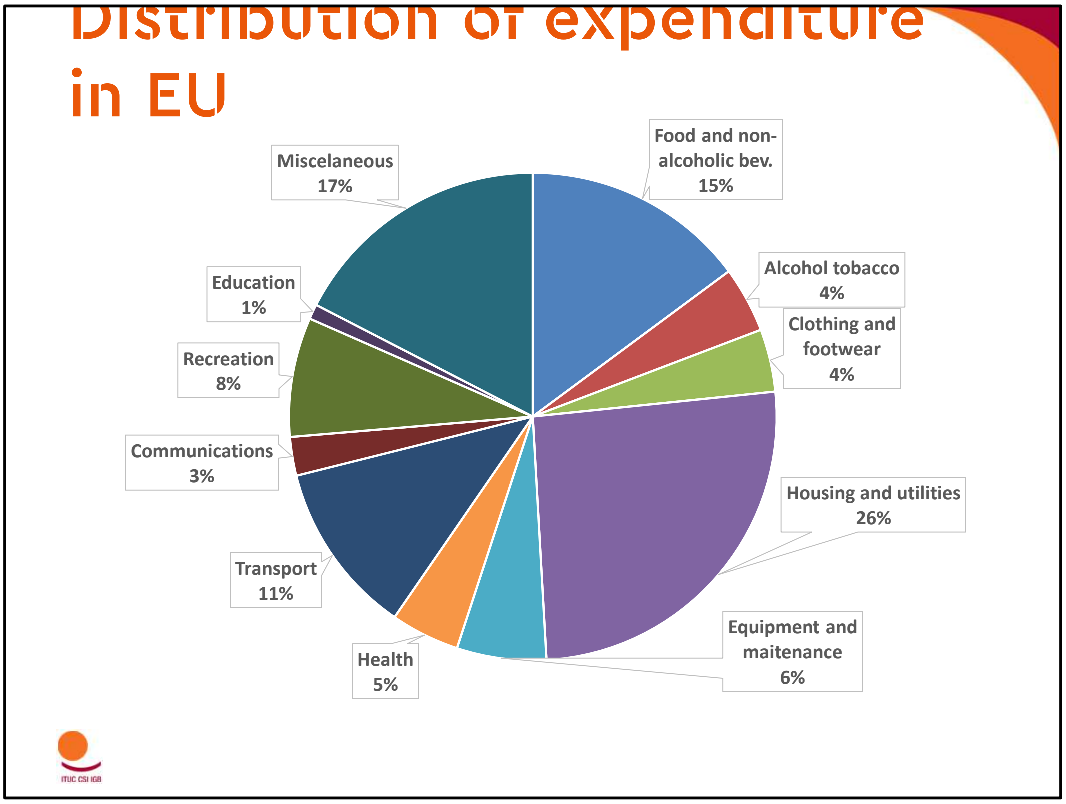
# Food is not only what is spent in the household…

| Group of goods and services of household expenditure | Nuclear no children | Nuclear with children |
|---|---|---|
| | Percentage | Percentage |
| **Food and non alcoholic beverages** | **21,2** | **22,8** |
| **Alcoholic beverages and tobacco** | **2,1** | **1,8** |
| **Clothing and footwear** | **5,9** | **7,1** |
| **Housing and utilities** | **15,6** | **13,1** |
| **Home equipement and maintenance** | **5,7** | **5,4** |
| **Health** | **9,3** | **5,5** |
| **Transport** | **14,8** | **15,1** |
| **Communications** | **5,1** | **5,1** |
| **Recreation and culture** | **8,0** | **9,0** |
| **Education** | **0,7** | **4,3** |
| **Restaurants and hotels** | **6,8** | **6,4** |
| **Miscellaneous** | **4,6** | **4,5** |
| Average expenditure in relation to the national HH expenditure | 99,7 | 114,0 |

INDEC Argentina. Expenditure survey 2018

Another significant point to consider is the demographics of households. Here, using the expenditure survey of 2018 for Argentina, the composition of expenditure of two different households can be compared: one nuclear with children and the other without children, both in relation to the average expenditure of the overall population.

The expenditure composition shows big differences in a number of items, with education, clothing and footwear, recreation and culture, showing the major differences in their specific weight.




In the case of the European Union the components of expenditures are summarized in the present graph, where it is clear how small the expenditure in food is (15%), in relation to housing and utilities (26%), or transport (11%), in relation to emerging and developing economies.

## Housing and shelter expenditure in different countries…

| Country | Percentage of total expenditure in shelter, housing, and maintenance |
|---|---|
| New Zealand | 25,7% |
| United Kingdom | 23,2% |
| Italy | 22,0% |
| Spain, Poland | 21,7% |
| Colombia | 20,5% |
| Germany | 20,0% |
| Netherlands, Portugal | 19,4% |
| Chile | 18,4% |
| United States | 18,3% |
| South Africa | 18,3% |
| Mexico | 17,8% |
| Costa Rica | 17,0% |
| South Korea | 14,7% |

Another item that shows big differences, not related to income but other political factors, is housing and shelter.

This depends significantly on the diverse policies of subsidizing or not housing, the availability of a mortgage market, the valuation of real estate, and the existence of public programs of massive housing.

These differences are quite clear, even among OECD countries, where the expenditure of housing and shelter varies from South Korea as the lowest with less than 15 percent of total expenditure, to New Zealand or the United Kingdom where the share approximates to one quarter of the total expenditure of the families. As it is clear, the relationship between the level of development of the countries and the share of income committed to housing have very little relationship.

## Child care is an important item in the basket of workers…

| Country | Percentage of total income<br>Family of four members<br>First income=Average wage<br>Second income=67% of average wage |
|---|---|
| United Kingdom | 29% |
| Netherlands | 18% |
| Japan | 10% |
| Spain, Greece | 9% |
| Austria, South Korea | 3% |
| Germany | 1% |
| Uruguay | 0,8% |

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The other item of the overall expenditure that is of high importance and very counterintuitive in relation to the level of development or income of the countries, is childcare.

In most countries workers with younger families are the main group receiving the minimum wage, and these households are the ones that need to spend money in childcare.

The OECD did a calculation of the share of the income that childcare absorbs from households with a simulation that considers that households have two income recipients, one at the level of the average wage found in the economy, and the second at two thirds of the average.

The amount spend in childcare varies from around 1 percent in Uruguay or Germany, to 18 percent in Netherlands or almost one third of the income in the United Kingdom.

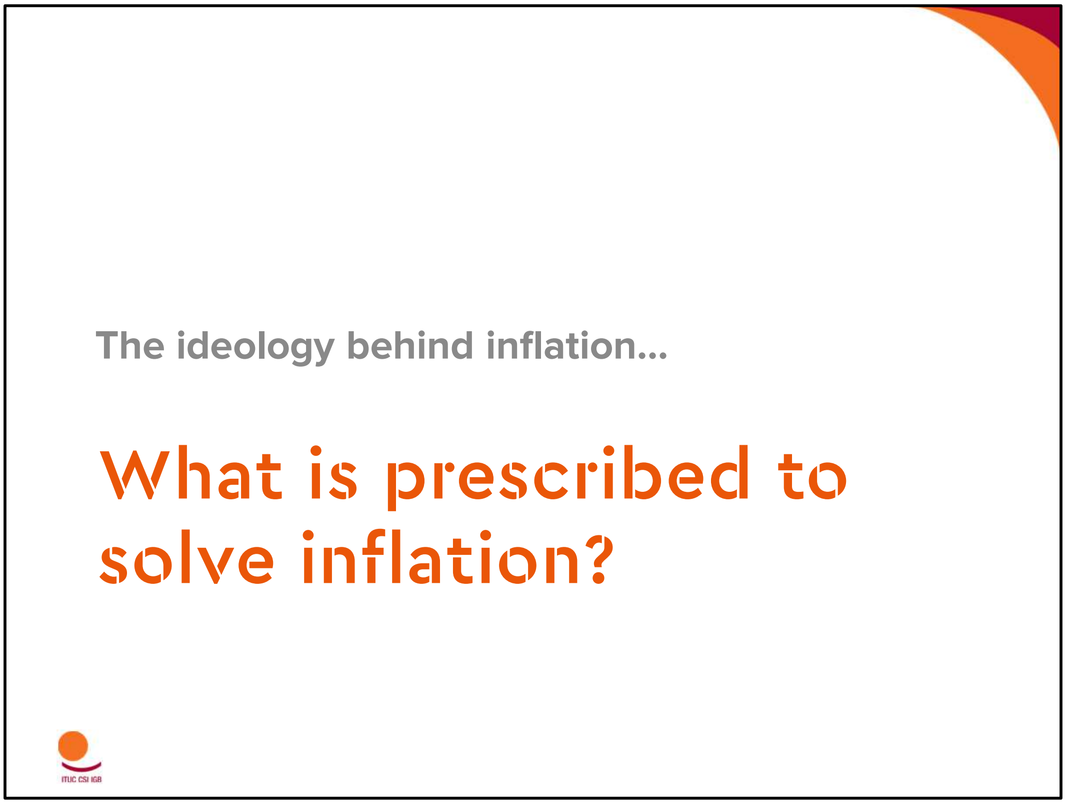
## Recommendation No. 1

- **Develop you own representative basket of goods and services and keep track of it monthly.**

This leads us to the first recommendation.

It is very important that the negotiations are evidence based, and that they discuss not only the average increases of prices e.g. CPI, but also how relevant these are for workers and their families.

This requires the construction of relevant and representative baskets of goods and services, and to keep track of the evolution of each of the prices that constitutes these baskets. Representative baskets can be a useful tool to be brought up in the rounds of negotiations with governments and employers' representatives.




The different approaches to understand inflation have direct links with the policy recommendations that they suggest.

These are not exempt of the ideological bias or the interest group that the supporters represent. Hence, the impact will depend on the different groups involved in the alternative solutions.

These days, supporters of the so-called “*price-wages spiral*”, state that “…*if prices can’t be controlled due to its complexity or the inability of the state to perform such task, wage repression is much easier”,*even though there is evidence that wages are not the causing inflation, nor the diffusers of its effect.

Unfortunately, the economic theory has been quite parsimonious in the defence of wages as the key factor for the wellbeing of the population.

**How to face inflation according the different approaches or schools of thought**

## Cost push inflation

- Control costs of production
  - Subsidise credit
  - Fix exchange rate, *crawling peg* under prices
  - *Repress wages*
  - Reduce taxes

## Demand pull inflation

- Reduce money supply
  - Increase interest rate
  - Stop printing money
  - Reduce fiscal expenditure

## Structural inflation

- Anti-trust legislation
- Promote investment in key areas
- Price controls (sometimes including wages)
- Open imports

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**The cost push approach**
This approach tries to act on the identified causes of the increase of the costs of production of goods and services. Since inflation, to be considered as such, must be a generalised increase of prices, there are a few items that can trigger it in the first place, and they are inputs which have a generalised use in the productive structure of the country. In general, they tend to be basic inputs for producing (such as energy, primary products, labour costs, taxes, or the exchange rate), or products of massive demand that face a shortage or price increase due to an external factor.

The instruments they apply tend to be more focussed on certain areas, and less generalised. However, they range from subsidies the productive sector in order to reduce the costs of production, targeting directly to the input that generates the costs hike, or other components of the chain such as credits, differential exchange rate, tax reduction, etc. to setting maximum prices, quotas to the international markets, or ad-valorem taxes on exports, to decouple the domestic from the international price. The implementation of price controls was a very common instrument in the second half of the XX century, but with the adherence to the Washington Consensus and the ideas of "setting prices right", was abandoned for some decades. The re-emergence of inflation in the actual context is bringing back the idea of setting some mechanisms of controls, which can be supported by the wide-spread of new technologies that could facilitate the process of controlling.

**The structuralist approaches**
For this school of thought, the identification of the bottlenecks in the productive process was central. The tools used for improving the production of certain crucial inputs relied in the targeted investment in those sectors that constituted constraints with the allocation of either public funds, or especial benefits for the investments in those areas. Of course, this approach has a lagging effect due to the time of maturity of these investments.

When the main factor was the oligopolistic characteristic of certain markets, the alternatives were a few: the "nice" one, which was the social dialogue to agree in mark-up limitations and price-freezing, and also the "not that nice" of opening markets to more competition, allowing investment in preferential conditions of foreign firms (to the country, or even from abroad), aiming to reduce the existing market power. In short, the idea is to stop the distributional conflict by bringing to the table -voluntarily or by more compulsory ways- the parties that would slowdown the process.

**The demand-push or monetarist approach.**

Monetarists face inflation as an problem of unsatisfied demand, and if it is demand for goods and services it is because the disposable income of the population is in excess to their production at the old price, and that is why prices jump. Within this framework, the reduction of the demand is achieved by reducing the monetary circulation in the economy - remember the simple equation they use- i.e., less money because of less money printing, higher interest rates that preserve the money as savings, and not in consumption. However, these do not seem to be enough, and the so called "austerity measures" come in place.

Austerity policies are also aiming to reduce circulation of money in the economy. Cuts on fiscal expenditure, frozen of pensions and reduction of social investments, and -as much as possible- wage repression on the public sector, are the tools that the economic orthodoxy always recommend to slow-down the price increases in the economy.

Those that belong to this school of thought have a single difference: There are some that support the "shock therapy" which is the massive implementation of all the considered measures at once; while others prefer a more "gradualist" approach, allowing for some "fine-tuning" in the implementation of the instruments. Experience world-wide have proven that this kind of program, even if sometimes succeed in reducing the inflation rate, entail significant economic, social, and political costs to the population of the countries that implement them.

**What is today's message around inflation?**
Conscious of the potential "tour-de-force" that occurs when households see their purchasing power eroded by the increase of prices, the mainstream media, multilateral organizations, and the orthodox economists, start to warn about the so called "price-wage spirals". These preventive discourses have as main objective the moderation of the aspirations of workers and their representatives in relation to wage adjustments, as well to put pressure on governments to avoid general measures, such as minimum wage adjustments or collective bargaining negotiations, that would culminate in wage increases.

The message is much more sophisticated than in the past. Nowadays, it turns around issues of apparent supply side constraint (tight labour markets, the "great resignation" with workers that choose more free time than work, not enough workers in the labour market, mismatch between the skills of the workers and the needs of enterprises, etc.), while suggesting solutions, that have little to do with the empirical evidence presented.

At the same time, the canonical wisdom presages chaotic consequences if austerity is not at the centre of the policy actions. And austerity only means reductions of fiscal expenditures, tight monetary policies of increasing interest rates, slowing down wage increases, etc. Obviously, nothing is said around profits, windfall capital gains, and other emerging signs of corporate greed that are present in the actual inflationary process.

**The silent process: climbs in interest rate and the cost of money**
Silently a process of increasing interest rates has begun all over the world. This is seen as the easiest, quickest, and with general impacts economy wide. The Swedish Central Bank states that *"A rise in interest rates also makes it more expensive for firms to finance investment. As a result, higher interest rates normally curtail investment. If consumption and investment fall, total demand also drops and there will be less activity in the economy. When activity is low, prices and wages usually rise at a more modest rate."* This blunt statement is very clear on the objectives of Central Bankers (i.e. Federal Reserve of US, Bank of England, etc.) when implementing interest rate hikes. The central bankers are central to economic policy, with overnight decisions that affect the whole country and beyond.

Theoretically, the increases of the interest rate, i.e. the cost of money, would induce people to save, rather than spend in goods and services, reducing the pressure on prices. Behind this very simple explanation, there are several other implications that transcend the financial sector, directly impacting the real economy.

The differences, in respect to the interest rate, between the monetarists and the cost-push inflation go beyond the diagnostic phase. For the monetarists, the increase of the interest rate would be a way of combating inflation because would induce savings, hence, lower the pressure of the demand. Conversely, for those that believe in the cost-push inflation, since the interest rate is a key component of the cost of production of goods and services, any increase in its rate, would immediately push prices up. As is clear, these two positions are irreconcilable.

The structural approach to inflation sets believes that high interest rate reduce the expansion of production in the short run, restricting access to working capital to firms that don't have enough sources of financing. Larger firms, with access to cheaper credit or larger amounts, will enhance their oligopolistic power, aggravating the situation.

Another of the structural conditions is when the economy has reached its full capacity, if the interest rate is increased or there are expectations of increases, the lack of investment, or the deterioration and obsolesce of the productive capacity of the country will not allow increase the quantity of goods and services supplied. It is true that this seems to be similar to the quantitative approach, but actually is based on a structural limitation to produce, and the remedy comes with a different pattern of finance economic growth in relation to the actual one.

**Implications of contractionary and austerity policies: Declining labour income share**
One of the main results of the implementation of contractive policies based on monetary principles is the direct impact on the labour income share, or the share of wages on total GDP. Contractionary instruments affect wages and/or employment almost immediately, both by expectations of economic slowdown, as well lack of resources to finance and to buy goods and services. The reduction of fiscal expenditure, the curtailing of money printing, as well as the increase of the interest rate, which impact on the demand for goods and services, directly affect the pace at which wages adjust to the past inflation, or, in the case that there is some sort of adjustment, the number of jobs created. These effects reduce the share of wages (wages times employment) over the GDP.

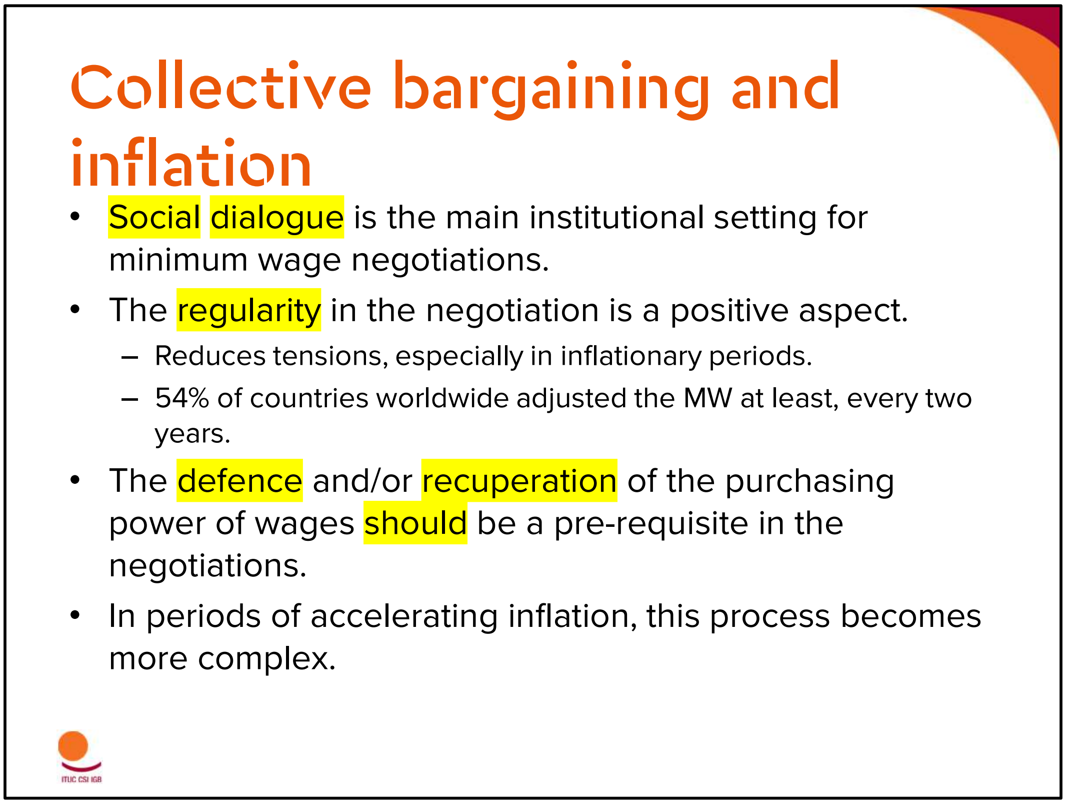
It is important to note that, despite a constant increase in the labour productivity in OECD countries since the beginning of the Century, average wages grew at a much lower pace.

The role of workers in times of inflation

# Collective bargaining, wages and inflation

Social dialogue is a key starting point for the negotiation of wages. In times of inflation and chaotic behaviour of prices, chances are that the policy recommendations will try “short-cuts” and simple but coarse solutions -such as the austerity mentioned in the previous pages- to stop it.

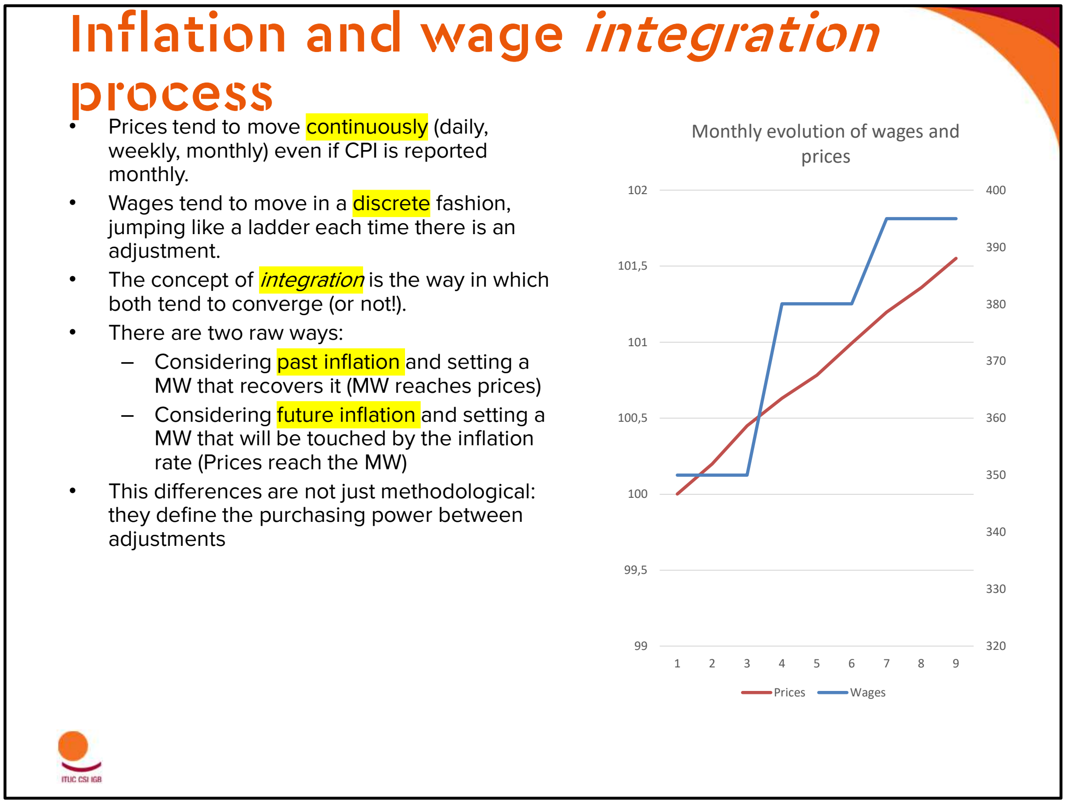
Collective bargaining and adequate minimum wages are the central factor to achieving a balanced objective, without harming the well-being of households.




Although social dialogue is quite relevant to preserve industrial relations within a framework of reasonable and manageable tension, in times of inflation its necessity mounts up.

Independent on the context, regular negotiations are very important since they would reduce pressure and tensions, that may lead to more difficult situations. A regular schedule of discussions, independent of the result, provides predictability to the system.

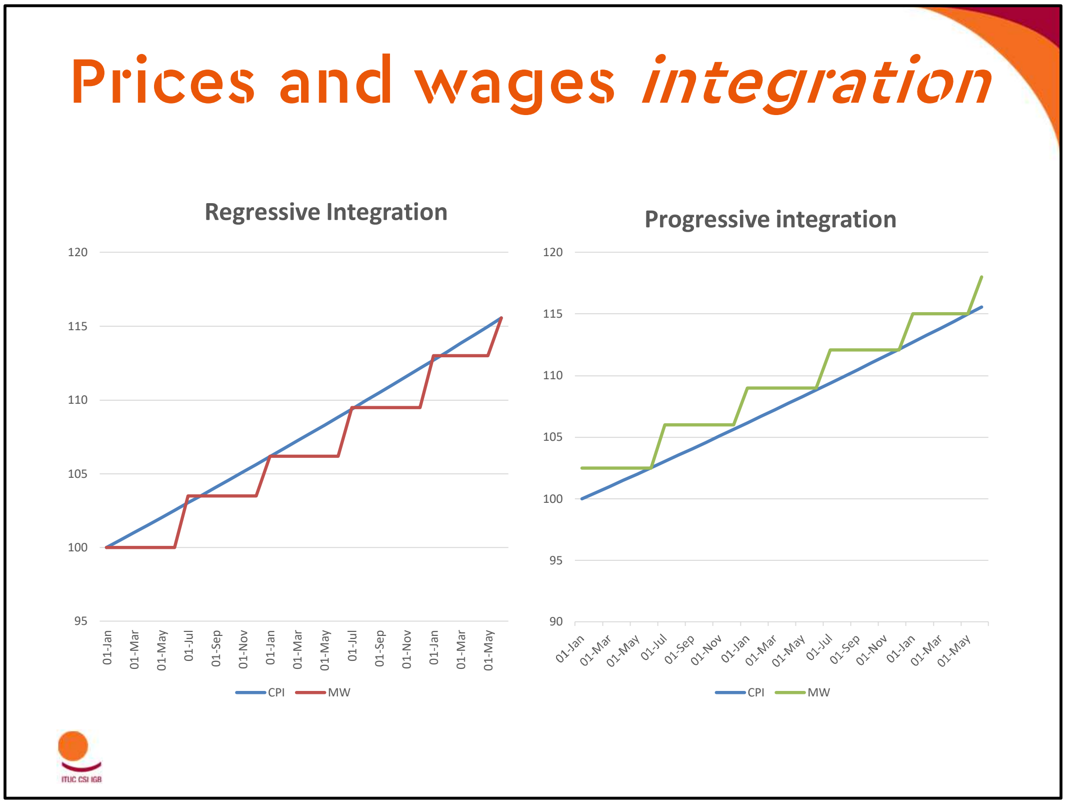
The **defence and recuperation of the purchasing power** of wages becomes a pre-requisite to any type of negotiations.




Prices and wages move at a different pace. While the latter jump every time there are negotiations or when the statutory minimum wage is adjusted, in general every year, but with a number of cases every biennium and a few two times per year, prices move continuously, with data published at the most, monthly.

The ways in which both wages and prices "integrate" to a same point can be taking into account the past inflation, or with prospects of the trajectory. These differences define the purchasing power between the adjustments.

The differences between both will be further analysed with country examples.




The process of integration of wages to prices can have two different extreme methods: the regressive integration in the left hand chart is when the wages in every adjustment recover the purchasing power, but the day after, they lose it.

In the case of progressive integration, wages foresee potential price increases, but at the end of the period, the prices reach the same level of the wage boosts.

However, reality is all over these alternatives. Wages may increase faster than prices, but also match them or lag drastically behind the CPI.

## The measurement according to the results

- Additionally to the two types of countries, they can be assessed according to the results

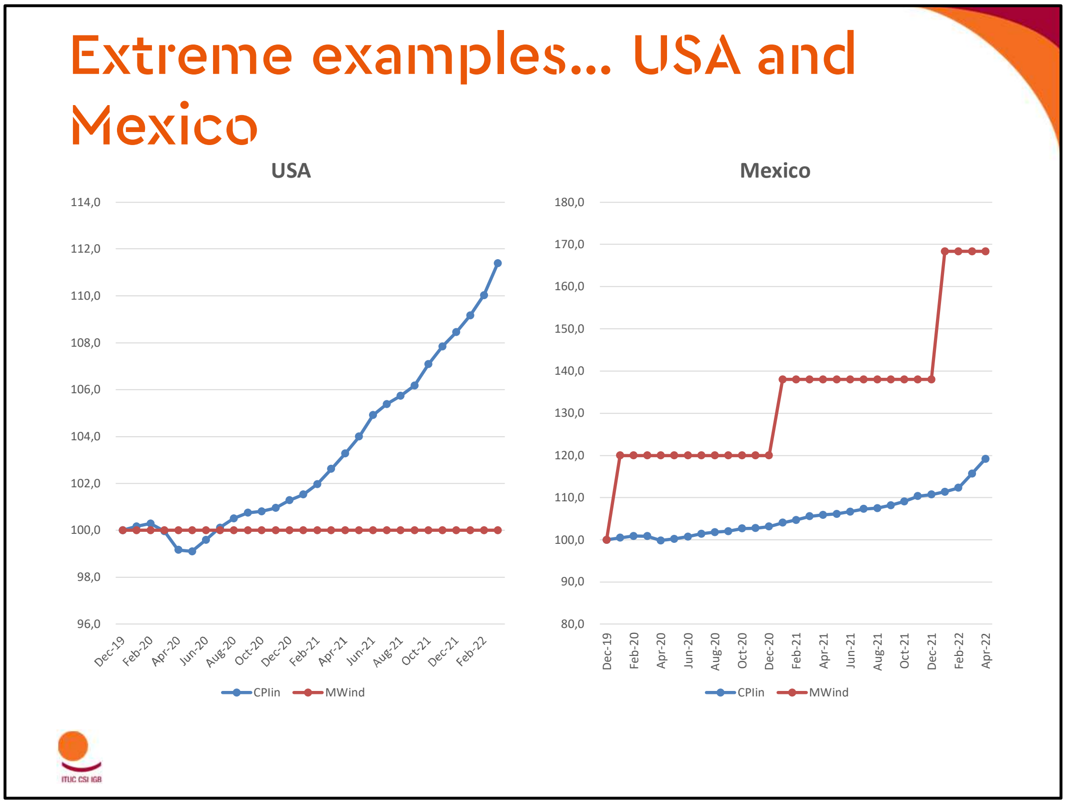
| Type of adjustment | Under inflation | Equal to inflation | Above inflation |
|---|---|---|---|
| Adjustment considering past inflation | Lost purchasing power | Same purchasing power | More purchasing power |
| Adjustment considering future inflation | Will loose purchasing power | Equal purchasing power | Will gain purchasing power |

Additionally to the two types of adjustment (progressive, regressive) presented, the assessment can be done in relation to the results that the adjutment has, and there are three alternatives:

- Under inflation, which is a loss of purchasing power
- Equal to inflation, maintaining the purchasing power
- Above the inflation or changes of the CPI, what would be that the purchasing power of wages increases.

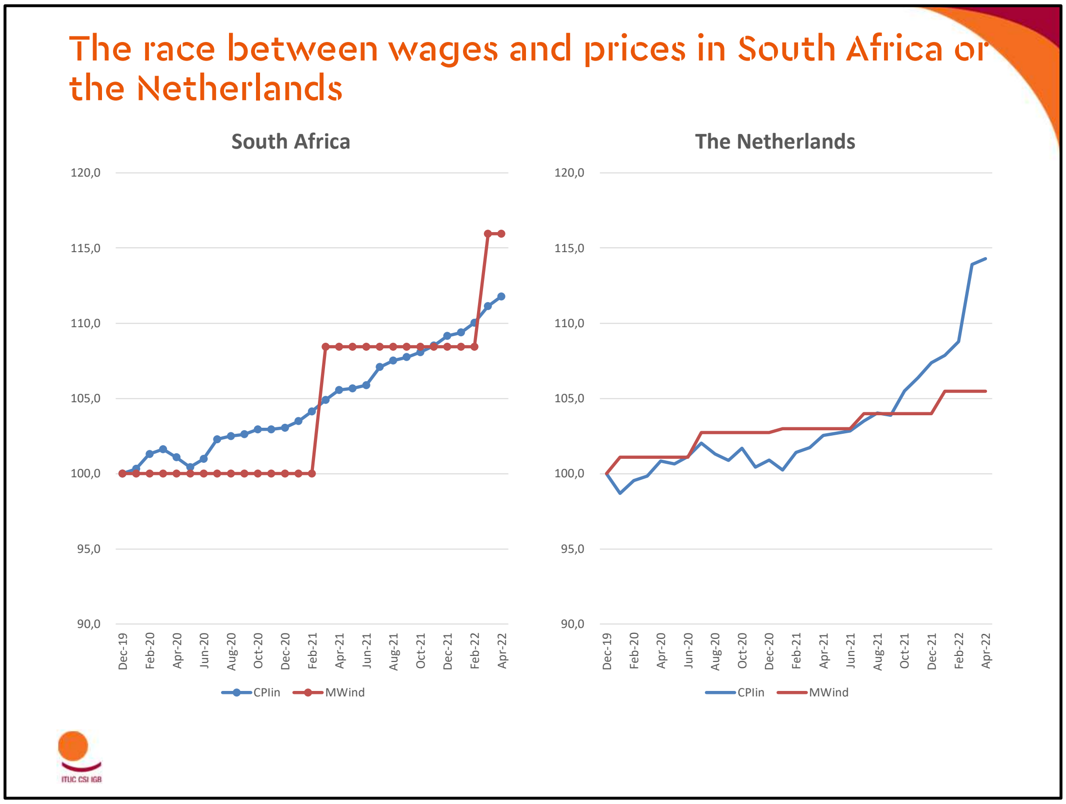

What has been happening since the beginning of the pandemic of wages in relation to prices is quite descriptive of labour market policies and collective bargaining of the different countries.

Using as starting point December 2019 (base 100), we compared the monthly evolution of minimum wages and CPI for countries of different regions.




In this chart, two opposite country cases are presented. In the United States of America, the Federal Minimum Wage has not been adjusted for a decade. Therefore, no change has occurred since the beginning of the pandemic (red line), and while prices declined during the first half of 2020, they then registered a constant upward trend.

In the case of Mexico, as soon as the pandemic started there was an increase of 20% that continued yearly until January 2022, showing an increase of the minimum wage's purchasing power of almost 50 percentage points.



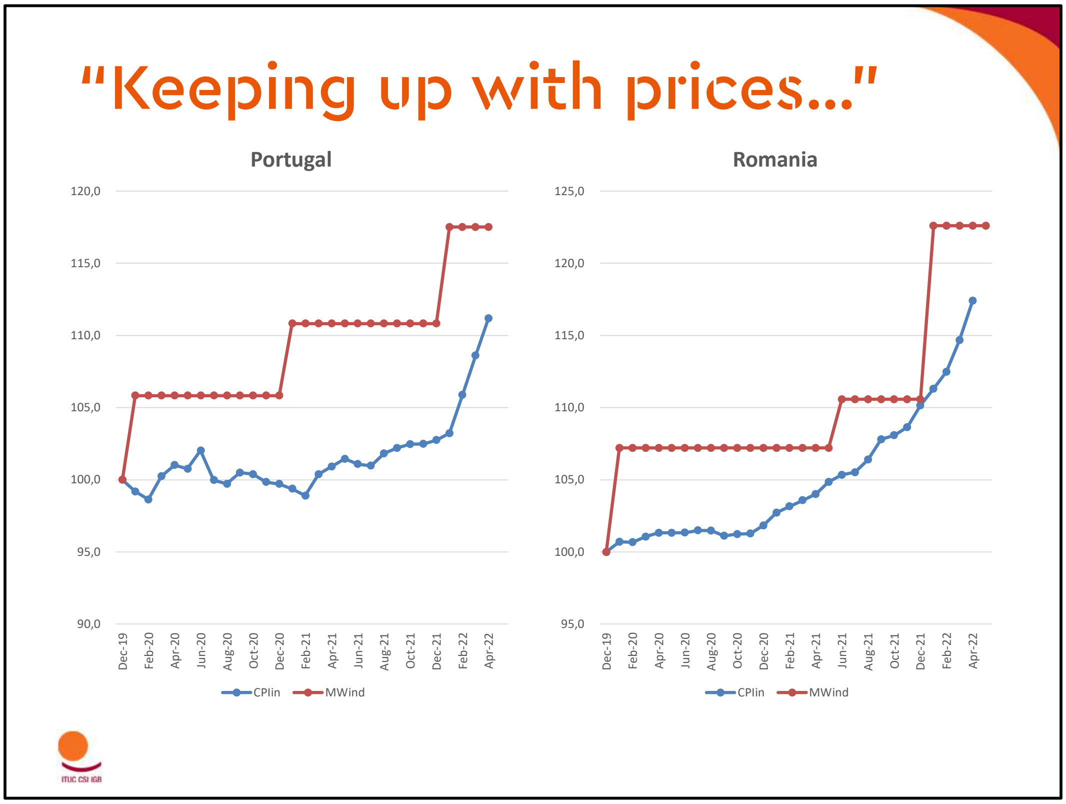

In the  Netherlands and France, minimum wage adjustments are related to what happen with remunerations to other workers in the collective agreements.

In both cases, the objective is to have the MW moving along with the wages of other relevant workers in the different sectors of the labour market.

In the case of Netherlands, the adjustments are the weighted average of all the collective agreements in the country, and are performed twice per year.

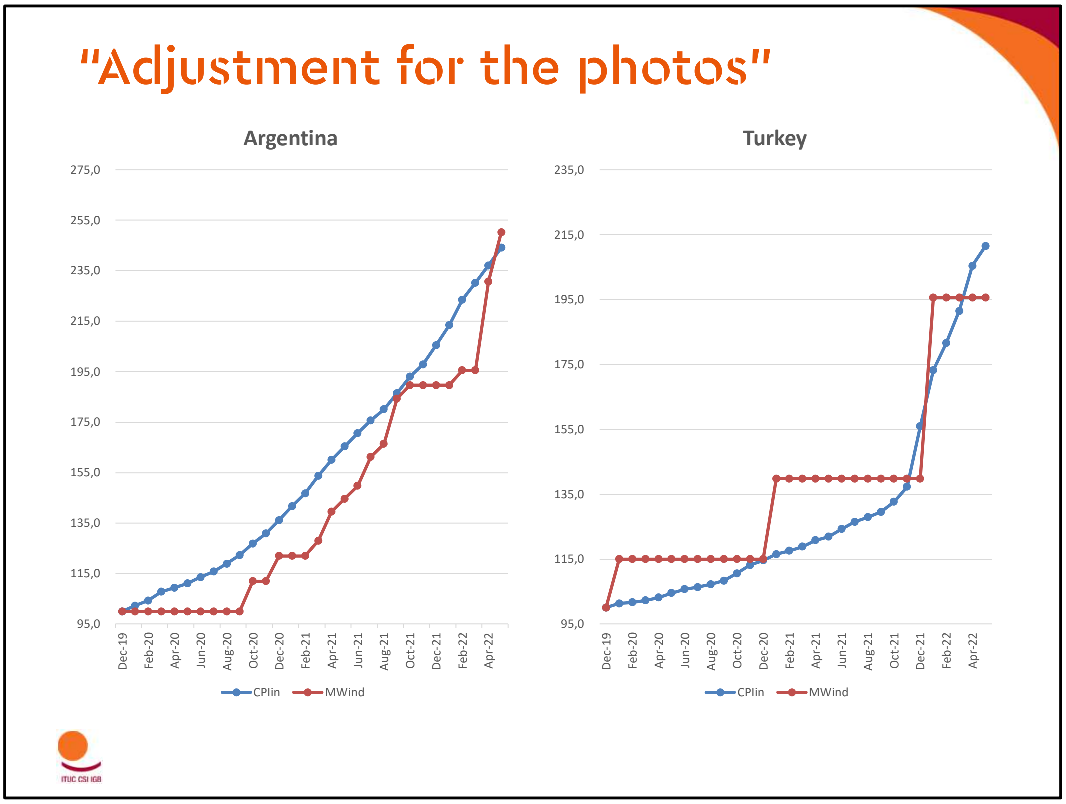
In France, the reference are the “blue collar” workers and the changes in the CPI.

The use of CPI as a component of the formula of adjustment makes the divergence between CPI and wages much lower. In the case of Netherlands the spike of CPI since 2021 is clearly reflected by more scarce increases in the rest of the wages.




In this case we have the example of two countries that tried that the MW would run faster than inflation. In the case of Portugal is a clear trend, however, the acceleration of inflation starting in the last quarter of 2021 seems to be recovering.

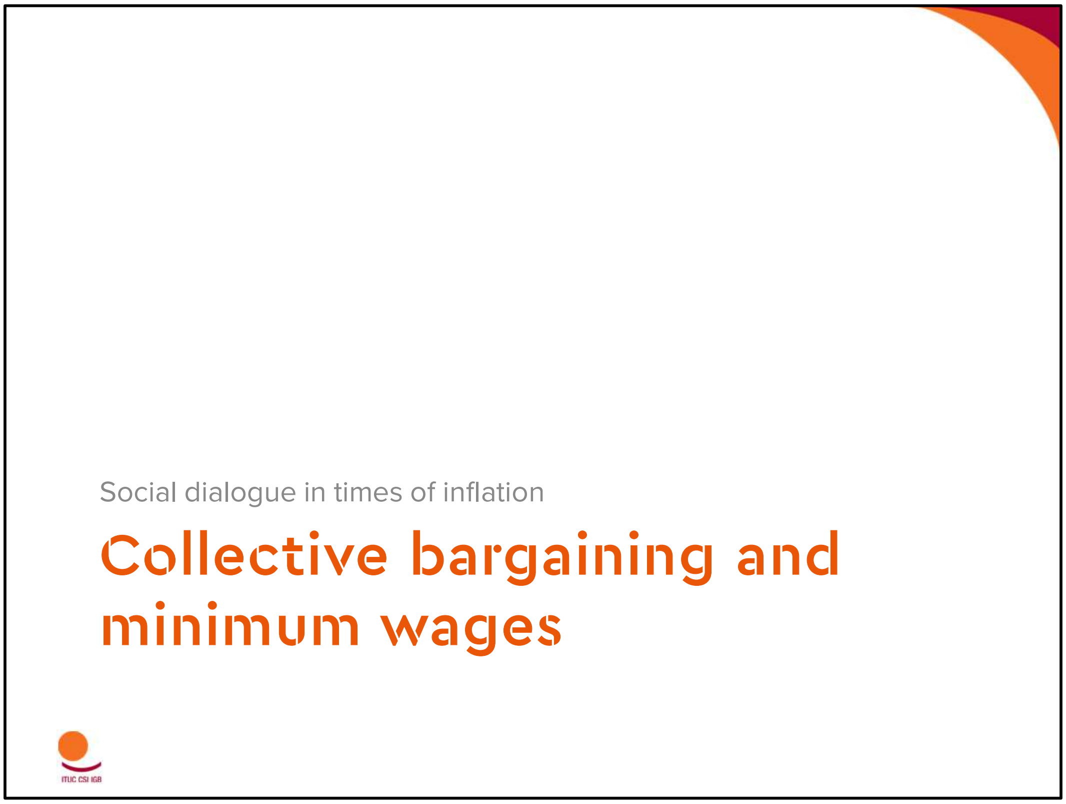
In the case of Romania, MW increased more rapidly than inflation until December 2021, when all the gains of previous periods, were eroded. Only the significant increase of 11 percent at the beginning of 2022 recovered it. It is important to see the trend that is developing with the CPI, that may surpass the MW in three or four months.




Some countries are a clear example of what we called "regressive integration", since they adjust only taking in consideration the past inflation, as in the cases of Argentina and Turkey.

The adjustment is announced by saying that all the eroded purchasing power was recovered (that is why is for the photo of the event of the communication), but the erosion starts the day after the adjustment, and continues until the next one.

Even in the case of Argentina, where the National Council of Productivity and Minimum Wage meets once per year, they define smaller adjustments to avoid both drastic jumps, and/or significant delays.




To conclude this workshop it can be said that social dialogue in times of inflation has enormous significance due to the broader implications of its conclusions. That is why collective bargaining and minimum wage setting has to be supported by evidence, preparation of the background documents and, especially, the training of the negotiators. These type of discussions, although require the political skills of all the comrades in the field, have a technical dimension that can't be omitted in the process of negotiations, but also in the communication and diffusion of the results achieved to the broader population.

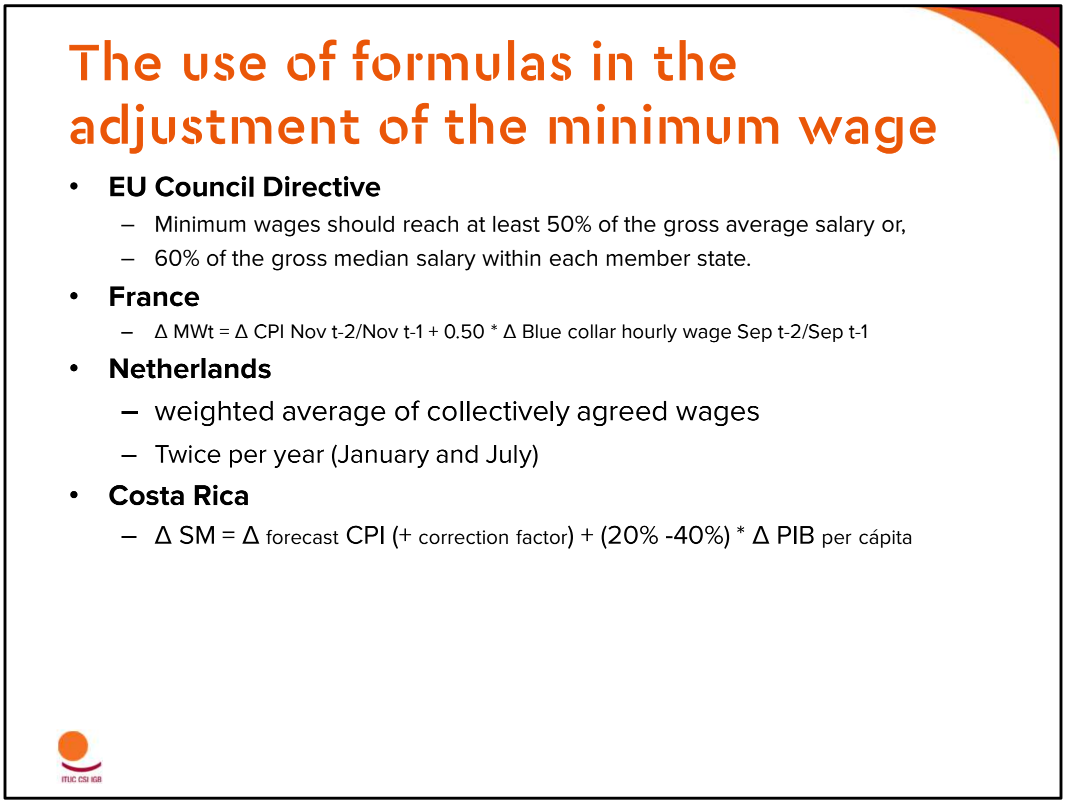
## The interactions between minimum wage adjustments and collective bargaining

- Minimum wage *follows* collective bargaining
  - Netherlands (weighted average of CB)
  - France (blue collar workers negotiations)
- The minimum wage can be used as a *trigger* to collective bargaining
  - Pushes from the bottom the wage distribution
  - Triggers negotiations
  - Latin American cases

Minimum wage adjustments may have different impacts and respond to diverse strategies in relation to collective bargaining.

In some countries, collective bargaining is the prevailing form of wages negotiations. This tends to happen in the sectors where unions are more dynamic and active. The minimum wage adjustments are used as a way of correcting the distance to the rest of the workers. This is what happen in France and Netherlands, where the MW is a function of what is happening to unionised workers.

In some other cases, negotiations are lagging. Governments use the MW to induce collective bargaining by pushing up the floor (the MW) and trigger negotiations, since workers above the MW will use it as a reference of adjustment, not only in terms of percentage of adjustment, also to re-establish previous wage differentials. This was a very common case in Latin America in the first decade of the 21st Century.




Even though all negotiations have in the back of their mind a number which is related to price increases of other elements, as suggested by the ILO C131 and R135, the use of the appropriated methodology is not a minor point. That is why in many countries the use of formulas for the determination of an adequate MW are in place.

One of the simpler ones, and recently suggested by the EU Council Directive of June 2022 suggests that the MW should reach at least 50 percent of the gross average salary, or 60 percent of the median salary of each of the member countries.

In the case of France, the MW is adjusted taking into account the CPI, but also 50 percent of the change of the hourly wage of the blue collar workers.

The Netherlands uses the weighted average of increases of all collectively agreed wages.

Costa Rica uses a forecasted (by the Central Bank) increase of CPI, and a share of the increases of GDP per capita between 20 and 40 percent according to the rate of real growth of the economy.

Brazil, before the regressive changes imposed by the last administration, used CPI and GDP to adjust minimum wages.

# The sophisticated formula of Malaysia

- $MW = \left[avg\left(\frac{PLI}{members} + median\ wage\right)\right] x \left[1 + (\frac{CPI+prod-U}{100})\right]$

- MW = Minimum Wages
- PLI = Poverty Line Income over number of household members
- Median wage= the value at 50% of the wages
- CPI = Consumer Price Index (% change)
- Prod = Productivity growth (%) GDP/number of workers
- UE = Real Unemployment Rate (%) = (Unemployment rate – 4%)

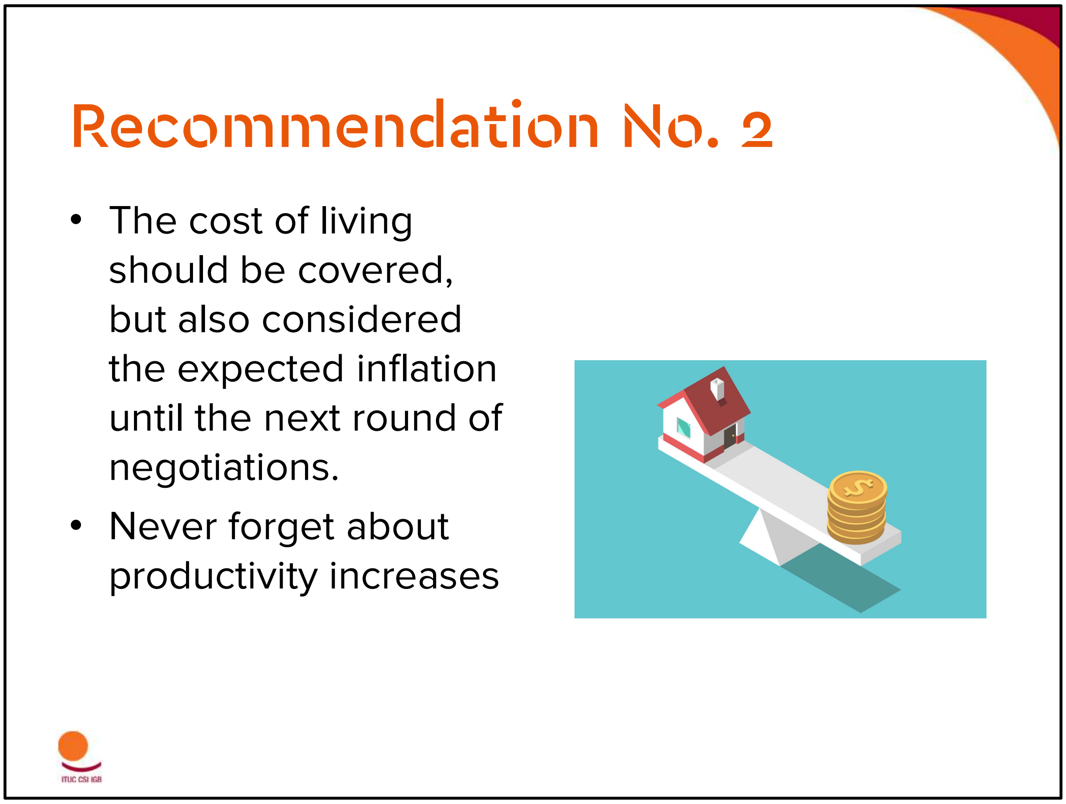
Malaysia's national long-term plan set the MW as the main measure to improve the livelihood of the bottom 40 percent of the population. They considered that the only way of reaching the category of high-income country would be by improving income distribution, and the MW offered the context for that.

Aiming at that objective, they ratified the ILO Convention 131 on Minimum Wage setting, and devised a quite ingenious formula that would consider the elements outlined in the Article 3 of the C131 and ILO Recommendation 135.

The level of the MW would result from the average between the per capita poverty line and the median wage. The supporting argument is that on the one hand the needs of workers and the families would be considered, while the median wage would show the capacity of enterprises to pay. If 50 percent of workers are paid an amount higher than the median, it means that most enterprises can afford that amount.

The adjustment would then be the result of applying the change of cost of living (inflation), and the productivity levels, measured through the change in the GDP per capita. If the unemployment rate is lower than 4% (considered as the "natural" rate of unemployment) the adjustment would be corrected by the same factor, understanding that there should be a long term number of replacement workers.

Independent on the creativity, the formula never was fully disclosed and implemented, because would imply much higher wages than the ones paid in the country.




The second recommendation for the process of negotiations

Although a prime goal is the recuperation of the purchasing power of wages, it should be kept in mind that prices will continue to increase, and that it is therefore necessary to have a clear understanding of the trends and evolutions that may happen. If future evolutions are not taken into consideration, the purchasing power will start to be eroded the day after the MW was set.

Equally crucial to take into account are the productivity changes happened during the period. In general, employers tend to ignore them and to only negotiate based on prices.

# Additional Recommendations…

- The erosion on the purchasing power of wages only can be compensated by the negotiation of new levels in wages, especially the minimum wages (MW) that have a light house effect, not only for the workers of the formal economy.
- Regular social dialogue helps to correct the lagging of remunerations in relation to inflation.
  - Rather than “gather pressures” is better to have a schedule of meetings
- In case of high inflation could be better to have agreements that either impose more frequent adjustments (negotiations) or even, trigger clauses.
  - It would even be necessary to advance the negotiations
- **ALERT:** The closer the MW to the living wage basket, the less tolerance to price changes.

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# The evidence based approach…

- Develop tools for evidence based analysis in order to generate knowledge that will serve the negotiations.
  - Have a clear picture of the relevance of the CPI in relation to the basket of workers, especially minimum wages
  - The recovery is central, but inflation still operate at the next day of the adjustment…
  - Follow up the evolution and prospects of prices of the relevant baskets
  - Follow up the share of wages on total costs of production
  - Keep an eye in the labour income share, or share of wages in GDP
  - SDG 8 is very handy for these discussions. Keep updated.
- It is important to have a long-term perspective (both backward but mainly forward) on how to negotiate wage increases.

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The <u>long</u> and the <u>short</u> run have something in common…

…they both <u>start</u> <u>today</u>!!!