The consequences of inflation on wages, incomes and inequalities

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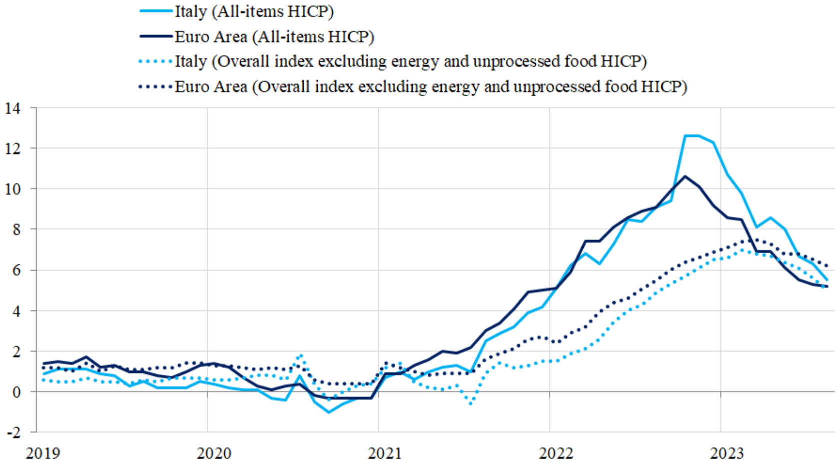
Outline

The rise of inflation

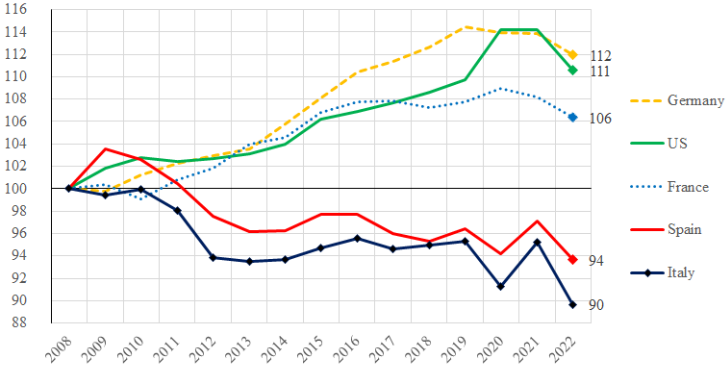
Figure: Inflation in Italy and in the Euro Area. Jan 2019-Aug 2023 (HICP, monthly data, annual rate of change)



Source: Eurostat, Harmonised Indices of Consumer Prices (HICP)

The fall of wages

Figure: Average real wage index in Italy, other European economies and the United States. Years 2008-2022 (Index, annual data, base 2008=100)



Source: Own elaboration on data Global Wage Report 2022-2023 - ILO estimates

- **A long term dynamics** (-12 p.p. 2008-2022 in Southern Italy real gross wages per employee)
- **Inflation**: hits hard in late 2021 and early 2022
- **In Q1 of 2023, real hourly wages are 6% lower than in Q1 of 2019**
- In the South, erosion of wage purchasing power even more intense: -8.4% (Q4/2019 and Q4/2022)

The deep roots of the labour crisis

- High rate of inactivity, wide gender and territorial gaps, low levels of education, growing spread of non-standard work (Cirillo, Lucchese, Pianta, 2022);

  → **Structural fragilities reflected in the levels and dynamics of real wages and incomes** (Franzini and Pianta, 2016)

- The fall in real wages in Italy has been 10 % over the past fifteen years, the worst dynamic among advanced economies;

  → **Path of development**

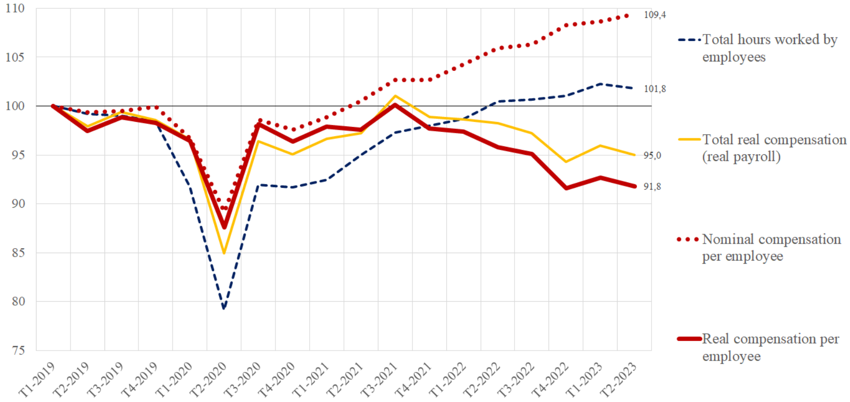
  "structural adjustments" and competitive strategies to safeguard profit margins based on "internal devaluation," i.e., a generalized reduction in real wages (De Cecco, 2012; Colacchio and Forges Davanzati, 2019)

  → **Low labour productivity growth**

  fragility of the few remaining large firms, weakening in the most technologically advanced productions, poor ability to create good jobs (Cirillo and Guarascio, 2015; Lucchese et al., 2016).

The effects of Covid and inflation on real wages

Figure: The dynamics of incomes and hours worked by employees in Italy. Years 2019-2022 (quarterly data, index numbers base T1-2019=100)



Source: Eurostat, National Accounts (Cirillo, Evangelista, Lucchese, 2023)

- **Drop in hours worked during the Covid crisis**

  → contraction of economic activities, consequent reduction in hours worked, factors responsible for the sharp drop in incomes (nominal and real);

- **Fall in wages more substantial for vulnerable social groups**

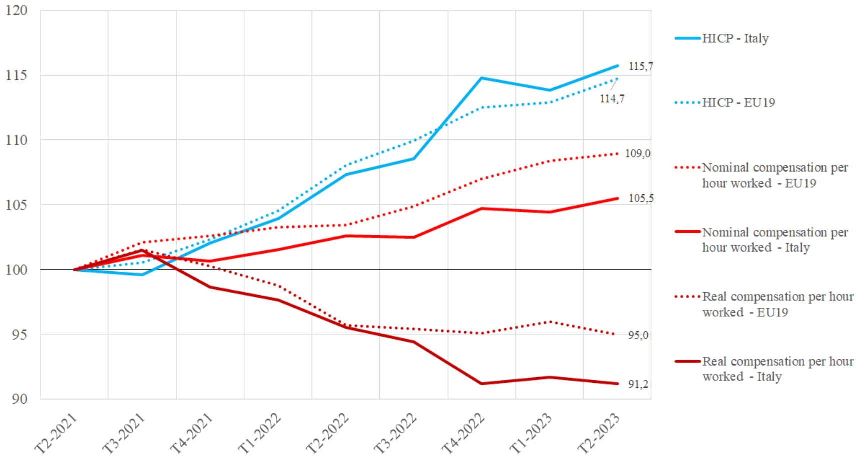
  → women, young people, migrants, low-skilled workers, employed in the sectors affected by restrictions (trade, transport, accommodation and catering, arts and cultural activities, and personal services), employed under temporary work arrangements (Carta and De Philippis, 2021; INAPP, 2021; Casarico and Lattanzio, 2022; OECD, 2022);

- **Increasing share of working poor**

  → Combination of job loss and reduction in hours worked during the pandemic increased the share of low-wage workers by almost one percentage point from 9.6 % in 2019 to 10.5 % in 2020 (ILO)

Inflation and wages across Europe

Figure: The dynamics of compensations and inflation in Italy and in the Euro Area. Years 2021-2022 (quarterly data, index numbers base T2-2021=100)



Fonte: Eurostat, National Accounts (Cirillo, Evangelista, Lucchese, 2023)

- Two main components responsible for the loss of purchasing power of real hourly incomes: (i) **price dynamics**; (ii) **nominal income trends**;
- The decline in real hourly incomes has been much more pronounced in Italy than in the average of the Euro area:

  $\rightarrow$ **lower ability of Italian nominal wages to keep up with inflation**

  $\rightarrow$ 31 contracts awaiting renewal at the end of June 2023, about 6.7 million employees (ISTAT)

  $\rightarrow$ **Faster inflation**: in the IV Q of 2022, CPI in Italy exceeded the European one by more than 2 %, further contributing to eroding the purchasing power of fixed income earners

Sources of inflation

- In the international debate, soaring inflation tends to be traced back, especially in Europe, to "supply-side factors" (Stiglitz and Regmi, 2023) - sources of price growth over the past two years:

  → (i) **bottlenecks and distortions** as a result of the pandemic in production capacity and international logistics with respect to the supply of raw materials and key components;

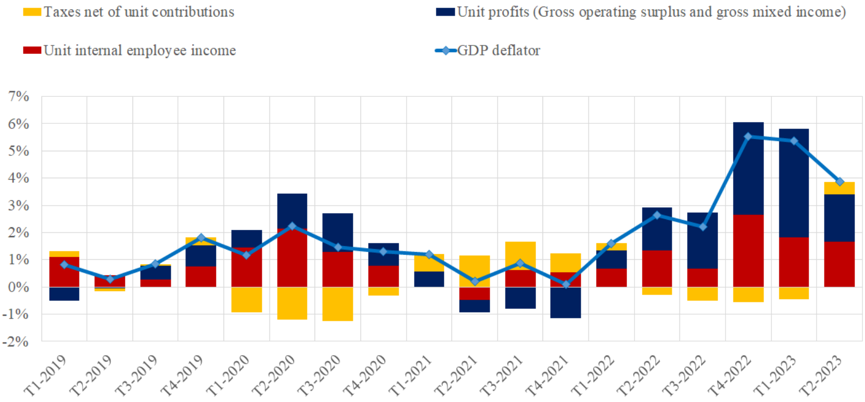
  → (ii) **steep rise in energy prices** (particularly gas), the result of the economic and geopolitical tensions related to the war conflict in Ukraine, and the consequent wave of speculation that has been triggered in energy product markets.

  → (iii) domestic source inflation resulting from firms' drive to raise price lists when they have enough market power to allow profit margins to widen.

- <u>Contribution:</u> Building on Italian National Accounts data, we explore the redistributive effects of the current inflationary phase (following Arce et al., 2023)

The distributional conflict

Figure: The "contribution" of wages, profits, taxes, and subsidies to inflation in Italy: decomposition of the GDP deflator "from the income side." Years 2019-2022 (raw quart. data, annual trend rates of change t/t-4)



Source: Eurostat, National Accounts (Cirillo, Evangelista, Lucchese, 2023)

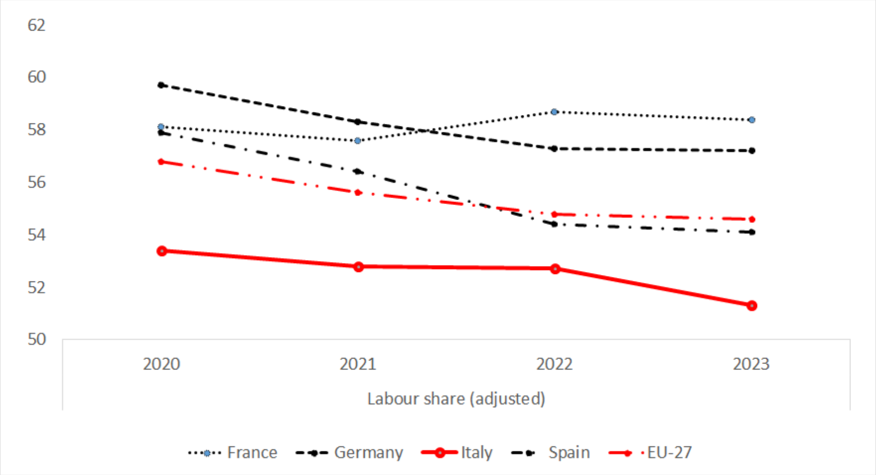
- The causes of this dynamics are most likely due to firms able to pass on cost increases to selling prices;
- The translation of rising production costs into prices, and the maintenance of high profit margins are easier where markets turn out to be less competitive and less demand price-elastic;
- In Italy, clear increase in profit margins in the energy sector, which has enjoyed the extraordinary increases in oil and gas prices

  → **controlling energy commodity prices**, which places a limit on speculation in international markets, and **taxing energy producers' extra-profits**: appropriate tools for addressing the "external" roots of inflation

  → to contain the "internal" dynamics of inflation, driven by rising profit margins, it would be important for market regulators to **monitor both prices and profits especially in sectors with high market power and less exposed to international competition.**

Functional distribution of income

Figure: Labour share in the European Union (%, 2020-2023)

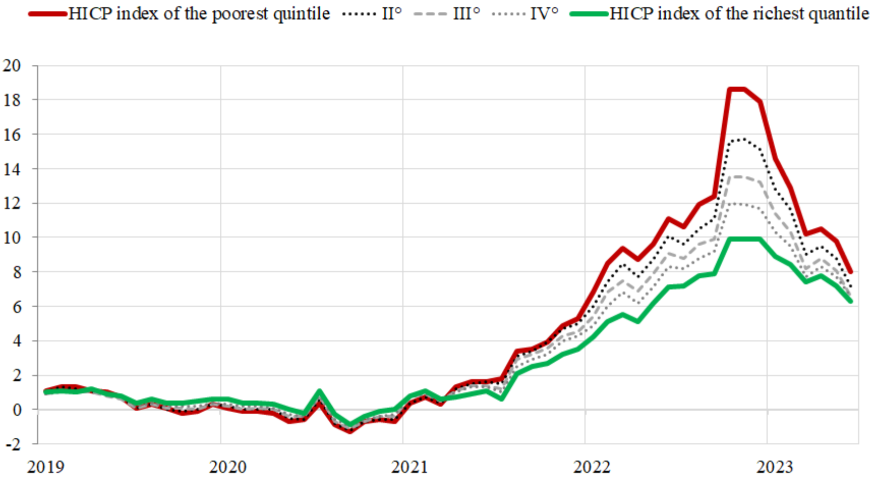


Source: European Commission, AMECO database (WSI Report)

Labour share (adjusted) = Compensation of employees per employee, in % of GDP per person employed (at current market prices, person concept, not adjusted for working time)

Inflation and income groups

Figure: Inflation in Italy by household expenditure class. Jan 2019-Jun 2023 (HICP Index; monthly data, percentage changes)



Source: Istat, Consumer Price Index

- **Uneven impact of inflation by social class and gender**:

  → 'poor households' allocate a significantly greater share of their income to the consumption of food and energy goods and are therefore more affected by inflation

  → In Q4 of 2022, inflation, as measured by the HICP index, increased by 18.4 % for the poorest quantile of households, while it increased by 9.9 % for the richest quantile

  → widening of gender inequality: increase in the prices of products and services of which women are the biggest consumers, concentration of women in sectors with low wages and where renegotiation of contracts is slower, costs of care, nursing, and social reproduction, a fall in real terms in public spending on health care and some basic services, transferred to women (Folbre, 2023)

- **Slow dynamics of contractual wages**:

  → Gap between the increase in the general price level and contractual wage growth peaked at 7.6 % in the IV quarter of 2022;

  → In Italy, since 2009, national collective bargaining has been regulated by a protocol concluded between TU and business associations: contract renewals are subject to a nominal wage adjustment system based on an inflation index that excludes imported energy goods (IPCA-NEI);

  → Not binding mechanism could allow for a recovery (*a posteriori*) of the purchasing power "lost" by workers due to actual inflation, but heterogeneous timing of contract renewals (service industries slower, ISTAT 2022)

- **Government policies in both Italy and Europe, compensation measures for families and businesses**

  → Overall able to offset about 70 % of the increased inequality in purchasing power (Gini index) that was produced by the effects of inflation (Curci et al., 2022).

Conclusions

- Pandemic and inflation aggravated wage gaps and reduced the purchasing power of labour incomes

  → in Italy the fall in real wages was particularly strong, result of a failure to adjust nominal wages to an inflation that grew more than elsewhere;

  → consequences of inflation hit the Italian labour market characterised by structural weaknesses, wide gaps and the worst wage trends observed in the last fifteen years.

- A progressive impoverishment of labour in Italy

  → long-standing phenomenon with deep structural roots, in Italy the fall in real wages has been particularly strong leading to an increase in the share of 'working poor' and of households that slipped below the absolute and relative poverty line

  → inflation has widened inequalities between social classes and within the world of work.

- Deterioration of functional income distribution

- Social polarization and insufficient public mitigation measures

  → quite efficient in reducing the short-term impact of inflation; but insufficient social protection system

Thank you

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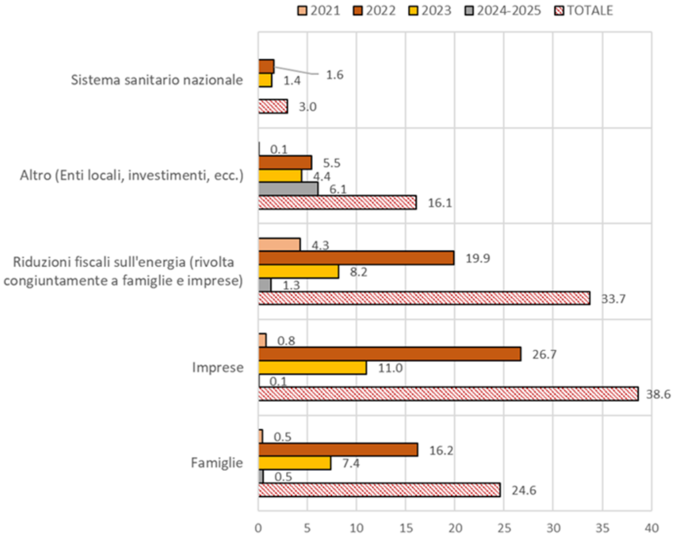
Appendix - Compensating measures

Figure: Italy, Govt expend. 2021-2025: 140 bn compensating for inflation



Source: UPB