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Policy options and responses to the cost-of-living crisis

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This report highlights how the various crises of the past three years have interacted to affect both wage growth and labour market outcomes for wage employees worldwide. At a time when WHO has announced that the end of the COVID-19 pandemic is in sight,[1] the growing impact of a widespread and severe inflationary crisis, together with a global slowdown in economic growth, driven in part by the war in Ukraine and the global energy crisis, is pushing real wage growth into negative figures in most countries and regions. Indeed, it is the first time since the ILO started presenting wage trends through the *Global Wage Report* that global wage growth is negative – this with a data series that goes back to 2006 and thus covers a period that includes the most significant economic crises of the twenty-first century so far.

1 On 14 September 2022, the WHO Director-General announced that the end of the COVID-19 pandemic was in sight, presenting the most optimistic outlook yet on the two-year-long health crisis, which has killed nearly 7 million people worldwide.

Before the pandemic, slow wage growth across countries and regions was often highlighted as a concern and there was much discussion of possible ways of increasing wage growth to help sustain domestic demand and reduce inequalities (IMF 2017; ILO 2018; OECD 2016). The COVID-19 crisis triggered an unprecedented response by countries around the world as they sought to support workers and incomes and save labour markets from collapse. However, the difference in the capacities of advanced, emerging market and developing economies to respond to the crisis has exacerbated global income inequality, which has increased to levels last seen in 2008–10, thereby partly reversing the decline achieved in the past two decades (Adarov 2022).

Poverty has also been on the rise. Although global poverty more recently resumed its downward trend, between 75 million and 95 million people were pushed into extreme poverty during the COVID-19 crisis (Gerszon-Mahler et al. 2022). The negative wage growth reported for 2022, which has been fuelled by the fast rise in inflation, is likely to lead to further increases in within-country inequality, not only because inflation hits low-income households the hardest (Bulíř 2001; Benson 2021; Orchard 2022) but also because inflation-vulnerable households are likelier to have lost more in terms of wage employment and total wage bill in the harshest phases of the crisis. Policies are clearly required to put a brake on rising inflation, but consideration should also be given to the way in which such policies impact on households across the income scale. More than ever, it is necessary to support wage workers and their families through the provision of adequate wages. The purpose of this final chapter is to provide an overview of policy options and responses to the current cost-of-living crisis.

> Policies required to contain rising inflation have an impact on households across the income scale, so it is essential to support wage workers and their families through the provision of adequate wages.

5.1. Macroeconomic policies

From the second quarter of 2022 onwards, central banks and monetary authorities across the globe have responded to the current inflation crisis by, in particular, raising interest rates to stop inflation from soaring further. On 15 June 2022, the US Federal Reserve raised its benchmark interest rates by 0.75 percentage points – the biggest hike since 1994 – as a first step towards gradually achieving a 2 per cent inflation rate by 2024. Similarly, in the second quarter of 2022, the European Central Bank (ECB) announced a gradual lifting of accommodative monetary policy. It subsequently raised interest rates by 0.25 percentage points in July 2022 and by a further 0.75 percentage points in September 2022 – the biggest rise ever. Like the Federal Reserve, the ECB also expects to achieve a 2 per cent inflation rate by 2024.

With interest rates going up, it is expected that the cost of financing will increase (as will the benefits of saving), that consumption and investment will drop, and that inflation will stop growing as the economy slows down. However, the tight monetary policy could lead to adverse outcomes for certain segments of the population and trigger a period of recession. Households, for example, may find it difficult to repay their debts, including their mortgages, the taking out of which entails the greatest investment risk for most households. The moves by the ECB during 2022 have already increased the cost of repaying an average mortgage in Spain by about €120 per month. This is likely to cause significant financial distress for low-income households in a country where the gross minimum wage is €1,167 per month. Higher interest rates increase the cost of both servicing mortgages and renting a house, which could delay the decision of young workers to become independent and start a family, further contributing to an ageing population. Moreover, those households that fell into debt during the

COVID-19 crisis so as to make ends meet now face the double burden of repaying their debts at higher interest rates, which will further drag down their standard of living. Although central banks are aware of these risks, the alternative scenario of continued price inflation is considered even more undesirable.

For business owners, higher interest rates increase the cost of financing their business, including the cost of investment. This may dampen the creation of wage employment in the private sector and contribute further to a slowdown in economic growth. Public employment creation can also suffer in periods of tight monetary policy. While high interest rates increase the attractiveness of public debt among investors because government bonds bring greater returns at a risk that is considered low, the interest payments on public debt faced by governments increase and this may ultimately divert resources away from public employment creation. For low- and middle-income countries, the current increase in interest rates in the United States, together with the ensuing appreciation of the US dollar, means that debt repayments have become more expensive, putting their economies in a weaker position at a time when their labour markets are still recovering from the effects of the pandemic (Estevaõ 2022).

One mechanism whereby tight monetary policy can stop inflation from rising further is the effect of such a policy on inflation expectations and therefore on moderating wage demands to avoid a wage–price spiral[2] (ECB 2022). This is because price expectations (or expectations of inflation in the future) are a key element in wage negotiations, including collective bargaining.[3] But is there a case for such a mechanism to play a role in reducing current inflation rates? Drawing on empirical evidence, this report has shown that nominal wages are not catching up with inflation and that the subdued wage growth, lagging behind productivity growth, that was already highlighted in the *Global Wage Report 2018/19* (ILO 2018) continues to characterize wage outcomes in many countries worldwide. There is in fact no evidence of a wage–price spiral either in high-income countries or in middle- and low-income ones, most of which are still at employment levels below those observed before the pandemic (IMF 2022d; Orchard 2022). It would seem, therefore, that much of the recent rise in inflation is the result of expansionary policies over the past few years combined with the recent increase in energy prices, bottlenecks in global supply chains caused by the COVID-19 crisis, and geopolitical conflicts, notably the war in Ukraine (ILO 2022c). It is also a moot point whether some large corporations may have taken advantage of the inflationary environment to raise their prices and profits (Zahn 2022). Wage workers, particularly those in the lower deciles of the wage distribution, are faced with higher and rising prices resulting from a battery of exogenous shocks which do not seem related to spiralling wages. In such circumstances, the bargaining process for future nominal wage adjustments should embrace a sufficiently large but prudent price expectation. This could contribute to safeguarding the standard of living of households – particularly low-income households – against unexpected future inflation hikes, while avoiding an undesirable wage-inflation spiral. Moreover, the report has shown that the gap between wage growth and labour productivity growth is widening further: in fact, the gap in 2022 is at its widest since the beginning of the twenty-first century. This means that there is room for average real wages to increase, not just to catch up with inflation but also to become aligned with productivity growth.

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2 The Phillips curve posits a negative relationship between unemployment and wage growth, whereby lower unemployment leads to higher wage and price inflation.

3 The expectation of a 2 per cent inflation rate in 2024 should certainly affect the adjustments behind collective pay agreements currently negotiated for the next two years. However, not too long ago, central banks together with the IMF had called for wages to increase since these were far too low to drive up inflation to the 2 per cent target (Vieira 2016).

5.2. The need to strengthen labour market institutions and wage policies

The report has demonstrated how inflation rates are also eroding the purchasing power of minimum wages. Given that 327 million wage earners before the pandemic, or 19 per cent of all wage employees worldwide, earned at or below the applicable hourly minimum wage (ILO 2020a), an adequate adjustment of minimum wages would in itself help significantly to improve the living standards of low-income households in the current cost-of-living crisis. The importance of minimum wages as a tool for reducing working poverty is highlighted by the fact that 90 per cent of ILO Member States have minimum wage systems in place. Minimum wages can protect low-paid workers against hefty losses of purchasing power at times of high inflation. However, for this mechanism to be effective, it is necessary that minimum wages be adjusted regularly to take into account the needs of workers and their families, along with economic factors. This adjustment process should be undertaken with the full participation of the social partners, in line with the Minimum Wage Fixing Convention, 1970 (No. 131). An adjustment of minimum wages would make a positive contribution to mitigating the current cost-of-living crisis while helping to sustain aggregate demand at a time when the global economy is slowing down as a result of various concurrent crises (ILO 2016). It is worth emphasizing that minimum wages also played a positive role during the COVID-19 crisis by serving as a benchmark in temporary wage subsidy schemes (ILO 2020b).

Strong social dialogue, including collective bargaining, can be instrumental in achieving adequate wage adjustments during a crisis. The prerequisite for this is adequate representation of employers' and workers' voices. However, several studies have pointed to the gradual decline in union power, accompanied by the rising power of large companies, as an important factor behind the slow real wage growth over the past three decades. Social dialogue, both bipartite and tripartite, played a critical role in the immediate response to the COVID-19 crisis in many countries and sectors, particularly when it came to designing and implementing national recovery plans. Considerable efforts were undertaken to strengthen the capacity of public institutions and employers' and workers' organizations to participate in such dialogue and arrive at common positions in tackling the challenges brought by the crisis (ILO 2021c). Unfortunately, according to a recent report by the Organisation for Economic Co-operation and Development (OECD), union membership among OECD countries has declined from about 33 per cent in 1975 to 16 per cent in 2018, while the share of workers covered by a collective bargaining agreement shrank from 46 per cent in 1985 to 32 per cent in 2017 (OECD 2019). In the United States, for example, the share of workers covered by collective agreements fell from 27 per cent in 1979 to just 11.6 per cent in 2019 (Hirsch and Macpherson, n.d.).

Collective bargaining and social dialogue can benefit from the use of sound empirical evidence to inform bipartite or tripartite negotiations. This report has highlighted the importance of using relevant data to examine how the COVID-19 crisis impacted on the labour market outcomes of wage employees. In particular, Chapter 4 sought to disentangle the effects of employment

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composition on wage outcomes, leading to a more accurate understanding of how the crisis affected employees across the wage distribution. It thus emerged that wage employment losses among women were greater than those among men, that low-wage earners lost more employment than higher-wage earners, and that wage earners in informal employment were more adversely impacted than those in formal employment. From a policymaking point of view, robust and detailed empirical evidence is required to guide the social partners and labour market institutions. During the pandemic, national statistical offices made great efforts to maintain the regular collection of survey data, but in several countries the coverage of data up to the end of 2021 (and sometimes into the first half of 2022) was not comparable to that of previous years. This was noticeable not least in wage statistics (see Appendix I, in particular the sections on the processing of data). Therefore, one relevant recommendation for policymakers is to enhance the capacity of national statistical offices – mostly, though not exclusively, in low- and middle-income countries – to collect labour market information, even during a crisis.

As pointed out in Chapter 3, consumer price inflation generally impacts most adversely on low-income households, which spend a larger share of their income on price-inelastic goods, particularly food, housing and transport. In some countries, the higher cost of living faced by low-income households is already taken into account when adjusting the minimum wage. For example, in Brazil the National Consumer Price Index (INPC), rather than the general price index, is used to adjust the minimum wage.[4] The INPC is computed over a consumption bundle of households earning between one and eight minimum wages, whereas the general price index uses a consumption bundle of households earning up to 40 minimum wages, which therefore covers almost all wage earners except for those in the top deciles. The INPC puts a greater weight on goods consumed among poorer households, and since 2011 it has been the index used to adjust the national minimum wage together with the variation in the previous year's GDP. Another example of a differentiated index is the US Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W), which is slightly above the Consumer Price Index for All Urban Consumers (CPI-U) since the former effectively considers low- and middle-income workers. In the United States, the CPI-W is used exclusively to adjust social security and federal retirement benefits, and not the earnings of wage employees (not even those on the minimum wage). Both countries (Brazil and the United States) provide examples of action that could help to adjust the nominal wages of low-income households so that – especially at times of high and rising inflation – real wages are aligned with spending patterns at the low end of the income distribution.

The creation of decent formal wage employment is a prerequisite for a more equitable distribution of wages and income, and is a key contributor to equitable and sustainable wage growth.

It should be added that the creation of decent formal wage employment is a prerequisite for a more equitable distribution of wages and income, and is a key contributor to equitable and sustainable wage growth. By the end of 2021, employment in high-income countries had recovered to the levels observed before the pandemic (sometimes even exceeding these), with some of these countries experiencing a surge in job vacancies (particularly in low- and semi-skilled occupations) while the number of jobseekers remained stable (ILO 2022a). In low- and middle-income economies, employment has not yet recovered to pre-pandemic levels, while informal employment seems to be on the rise – a scarring effect that may last far beyond the aftermath of the COVID-19 crisis. The Transition from the Informal to the Formal Economy Recommendation, 2015 (No. 204), provides guidelines that can help low- and middle-income countries to mitigate such effects.

4 INPC stands for *Índice Nacional de Preços ao Consumidor*. There is a third basket of goods and services calculated by the Brazilian Institute of Geography and Statistics known as the Necessary Minimum Wage basket. This basket has proved to be unaffordable at the prevailing minimum wage, but it helps policymakers to understand the effective inflation experienced by households earning one minimum wage, a rate that has been historically higher than that implied by the INPC (Lemos 2004).

5.3. Policies to support households, particularly the most vulnerable, during high inflation

Policies to ease the impact of the cost-of-living crisis on households range from measures targeting specific groups, such as means-tested vouchers provided to low-income households to enable them to buy essential goods, to more general interventions aimed at reducing the cost of living for all households, such as the (often temporary) reduction of indirect taxation on goods and services. For example, many governments, particularly among countries in the eurozone, are providing low-income households with energy vouchers to help them cope with the current energy crisis. In September 2022, the German government announced a €200 billion package to mitigate the impact of soaring energy prices on companies and households; the measure includes a brake on gas prices and a cut in sales tax for fuel. Likewise, in the same month the French Ministry of Finance announced a €45 billion package to shield households and businesses from energy price shocks. Also in France, households with an annual income below €10,800 have since 2018 been eligible for energy vouchers ranging from €48 to €277 per month.

Some countries (or blocs of countries) have introduced taxes, temporary or permanent, on oil and gas companies, large corporates or wealthier households, to help pay for measures during times of crisis. For example, in September 2022 the EU proposed a windfall tax on fossil fuel producers to offset the effects of the energy crisis. At the same time, Spain announced a battery of measures (some temporary, some permanent) aimed at increasing the Government's revenue to help cope with the current crisis while avoiding hurting vulnerable households. These measures included a (temporary) tax of 1.7 per cent on the patrimony of large fortunes (that is, households with €3 million or more in wealth), an increase in the tax paid by the top income bracket of up to 2 percentage points, a temporary tax applied to both large energy companies and the banking sector and, at the same time, a reduction in income tax among low-income households along with a reduction in tax payments among small enterprises and own-account workers. In the United Kingdom a levy of 25 per cent was imposed in May 2022 on the profits of major oil and gas companies operating on its territory, a levy that is expected to raise more than £28 billion in the next few years. In October 2021 the OECD agreed to introduce a landmark reform to the international tax system, which will ensure that multinational enterprises (MNEs) will be subject to a minimum 15 per cent tax rate from 2023. The agreement covers 136 countries and jurisdictions representing more than 90 per cent of global GDP and, if applied, could reallocate more than US$125 billion of profits from around 100 of the world's largest and most profitable MNEs to countries worldwide (OECD 2021). Measures such as these could help governments raise the resources needed to weather the current crises. Assuming that energy producers do not pass their higher costs on to consumers, such policies could significantly mitigate the cost-of-living crisis for low-income households without negatively impacting on inflation or prices.

> Cuts to VAT can mitigate the burden of inflation among low-income households while further helping to reduce inflation.

Cuts to value added tax (VAT) can mitigate the burden of inflation among low-income households while further helping to reduce inflation. In Germany, for example, VAT was reduced for six months, from 1 July to 31 December 2020, as part of the COVID-19 stimulus package to foster aggregate demand. In addition to considerably lowering the cost of basic goods and services (for example, the earlier VAT rate of 7 per cent on food was reduced to 5 per cent), it is estimated that the policy boosted German GDP by 0.3 per cent (Funke and Terasa 2022). As the current cost-of-living crisis begins to threaten the economic survival of households, several countries are cutting VAT rates on energy. For example, Spain has reduced VAT on electricity from 21 per cent to 5 per cent as of June 2022, while VAT on gas in Germany has been reduced from 19 per cent to 7 per cent as of August 2022. The benefits of reducing VAT on essential goods and services are twofold. As highlighted in Chapter 4, these are the goods that take the largest share of income among low-income households, which means that cutting their cost can help the latter to weather the crisis. At the same time, the reduction of VAT contributes to lowering the general price level, which is also the objective of tight monetary policy.

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5.4. Tackling the gender pay gap

The *Global Wage Report 2018/19*, which drew on data from 2014–16, estimated the global gender pay gap at around 20 per cent (ILO 2018). On the basis of a smaller sample of countries, the current edition suggests that gender pay gaps have changed little in recent years, despite the efforts by several countries across all regions of the world to reduce pay discrimination and achieve equal pay for work of equal value. This reflects the complexity of tackling pay gaps between women and men.

Significantly more needs to be done to further reduce gender pay inequalities in the world of work. This includes addressing the part of the gender pay gap that can be explained in terms of the labour market attributes of women, that is, by improving the educational situation of women and striving for a more equitable distribution of women and men across occupations and industries. It also includes addressing other factors underlying the gender pay gap – notably by reducing the motherhood pay gap, increasing pay in undervalued and highly feminized sectors and industries, and implementing legal frameworks and policies to increase pay transparency at the enterprise level with a view to eliminating pay discrimination. The Equal Pay International Coalition, a joint initiative launched by the ILO, UN-Women and the OECD in September 2017, has managed to reach out to governments, the social partners and a considerable number of enterprises in the private sector as part of its mission to achieve equal pay for work of equal value.[5] This and similar initiatives enable countries across the world to learn from successful examples of how to measure and monitor pay gaps at the national level, to familiarize themselves with the tools that some major economies are applying, and to understand which are most effective in reducing pay discrimination between women and men.

In addressing gender inequalities in the world of work, it is important to take into account one possible consequence of the COVID-19 crisis, namely a wider gender gap in employment, particularly in low- and middle-income countries (ILO 2022a). When women leave the labour market, they are less likely than men to return; moreover, women are less likely than men to find a job (ILO 2017a). The widening of employment gaps between women and men can also weaken the bargaining power of women in the labour market, especially in low- and middle-income countries, where they tend to dominate in low-paid jobs. This would undoubtedly contribute to maintaining or even increasing the gender pay gap between women and men, which could become one of the long-lasting effects of the COVID-19 crisis.

5 See https://www.equalpayinternationalcoalition.org/.

5.5. The role of multilateralism

Although prices were already on the rise before the outbreak of war in Ukraine, it is unquestionable that the conflict has contributed to increasing inflation rates, particularly among countries that depend heavily on the supply of oil and gas from the Russian Federation. A prolongation of the war could thwart expected productivity outcomes and drag large economies, especially those of the eurozone, into a recession. In such circumstances, despite the need to channel public spending into support measures for low-income households, it is also important to consider public investment in the promotion of energy sources that are a viable alternative to carbon-based fuels. This could in itself be a way of increasing wage employment in new sectors, but more importantly, it would help to increase global stability by cutting dependence on geopolitically sensitive energy sources and facilitate a just transition to a resource-efficient economy.

Although the recent health crisis and the war in Ukraine seem to be the key drivers of uncertainty at present, the fact is that over the past two decades the world has arguably been drifting in a direction that endangers the prospect of achieving prosperity and peace for all, as called for by the United Nations 2030 Agenda for Sustainable Development. The 17 Sustainable Development Goals pursue a world without extreme poverty and with equal opportunities for everyone to realize their potential. Global funding and mobilization of resources are key to achieving these goals, and although the international community has so far provided considerable support, more needs to be done.

The negative effects of climate change; increasing inequalities; the poverty, discrimination, violence and exclusion endured by millions of people, including the discrimination that women and girls continue to suffer in many parts of the world; the lack of vaccines and access to adequate sanitation and essential healthcare for all; and the growing digital divide between poor and wealthier countries – all these factors may contribute to economic, social and political conflicts that threaten the very existence of humankind.

Accordingly, in 2021, the United Nations Secretary-General presented an agenda of key proposed actions grouped under 12 commitments, which together seek to reaffirm global solidarity as a way of overcoming crises. *Our Common Agenda*, as the document is entitled, includes the strengthening of decent work as one of these key actions (UN 2021). The creation of decent wage employment, along with policies to ensure adequate wages, which are relevant to several of the Sustainable Development Goals, can make a vital contribution to the pursuit of social justice.