Why do people dislike inflation? Wage erosion and conflict

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Quick overview

- Survey eliciting the (individual) effort required for maintaining purchasing power
  - Keeping real wages constant through an inflationary episode requires bargaining, which is costly
    - Nice way of measuring bargaining costs in a survey setting.
  - Workers expect that employer's nominal wage offers vary little with hypothetical inflation rates.

- Model of the distribution of bargaining effort over time.
  - In the absence of bargaining wage growth only partly incorporates inflation (and no productivity growth).
  - As effort is costly, there is an inaction zone: workers prefer to let real wages fall over a range of wages between the actual and the desired one.
  - Real wage growth can be decomposed into three components: real wage erosion , a "forward looking" wage growth due to bargaining and a "backward looking" wage growth.

Quick overview

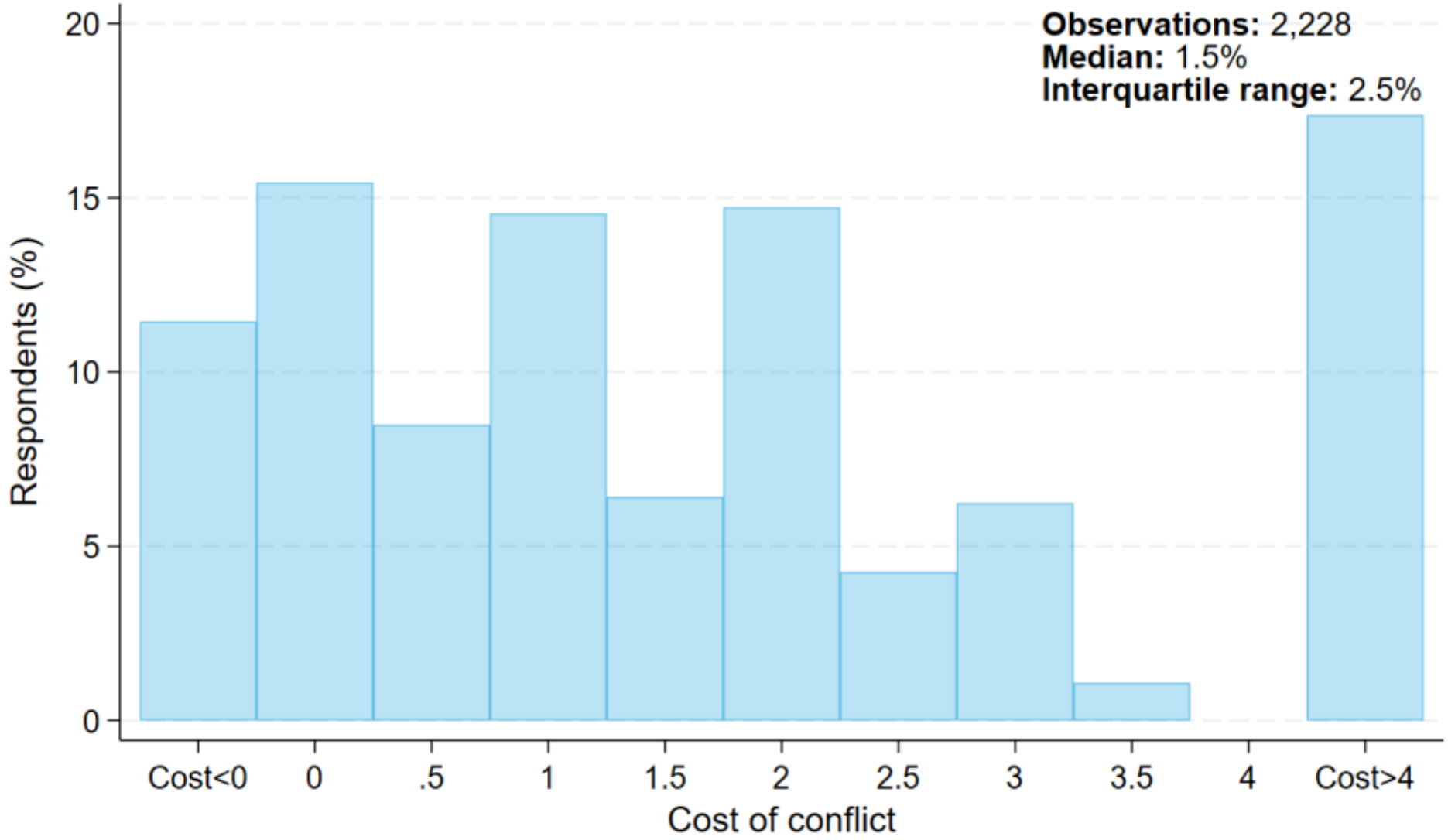
- Workers only bargain if it is worth the pain (i.e. the deviation between actual and “target” wages is large enough)
  - Bargaining-induced wage increases are approximately equal to the cost of bargaining
  - Overall wage growth understates welfare, as a costly effort is needed to preserve bargaining power.

- Welfare costs are substantial, nice correspondence between survey and the data

Comment number 1: Heterogeneity in workers

- The empirical model shows a **large dispersion in costs of bargaining**
  - Measured as the wage growth offered by the employer that the worker would acccept

- A few possibilities:
  - Inflation hurts most **people at the bottom of the income distribution** –their share of price-volatile consumption is just larger.
    - Non-homotheticities
  - **Financial literacy**: do all of us understand inflation?
    - ES: In the rise of the inflationary episode, one third of the population 18-79 did not answer correctly to whether a 1% increase in inflation causes a loss in purchasing power
  - The **costs of bargaining** vary among workers (mobility and monopsony, more on this below).



Note: this figure illustrates the distribution of the cost of conflict (c^{conflict}), which is defined as the difference between the wage growth participants would receive if they take actions to increase their pay (w^{action}) and their indifference wage ($\tilde{w}^{\text{default}}$), which is defined as the minimum wage growth participants would be willing to accept if offered by their employers. The data is limited to respondents who bargain first and then accept the offer. We also include respondents who always and never take actions to achieve a higher pay with a c^{conflict} of less than zero and more than 4, respectively. Summary statistics are presented inside the figure.

Comment number 1: Heterogeneity among workers (ii)

- The model perhaps may nicely rationalize the dispersion in costs as a function of the distance between the “desired” and the actual wage.

- However, ample evidence on differences across workers in exposure to inflation, financial literacy or bargaining costs.

- Can the survey evidence be used to split workers along income, schooling, gender and see what the model can teach us about the distribution of bargaining costs?
  - Alternatively, if workers do not understand inflation, the set of inactive may be larger.

Comment number 2: What role for firms?

- Action-induced real wages evolve according to a term depending on productivity growth and shocks

where the action-induced (real) wage is given by

$$\log w^*_{i,t} = \log w^*_{i,t-1} + g_z + z_{i,t}, \tag{3}$$

and $z_{i,t}$ captures the idiosyncratic productivity shock and g_z captures trend productivity growth

- Firms aware of bargaining costs could exploit **wage setting power**
  - Already departing from wages equal to marginal productivity, it would be helpful to spell a wage setting model.
  - Would the relevant dynamics of "action-induced wage growth" be related to productivity OR to perceived outside opportunities?

Comment number 3: The link between wages and inflation?

- In canonical models wage growth leads to inflation.
  - Arguably, labor costs have a negative drift in this model (at most they can keep up with productivity)
  - Which brings to the previous point: what role for firms in Price setting behavior?
- Widespread inactivity regions may prevent inflation, possibly mitigating costs.

Miscellaneous

- Current episode: the elasticity of wage separations to the wage is becoming larger in the US (Autor, Dube, 2024)
  - Are the costs of bargaining becoming less important? Some geographical partition in the survey could be used to test for this?

- In several European countries we have decided to avoid individual bargaining costs to and delegate the task to unions (Belgium, full Cost of Living Agreements).
  - Is there some interesting industry/union vs non-unión variation to be exploited?

CONCLUSION

- Great study

- THANKS!!!