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Inflation, wages and equality: cross-disciplinary conversations

Paul Edwards, Charles Baden-Fuller, Christopher Pissarides, Jill Rubery, Colin Crouch and Peter Taylor-Gooby

Abstract
Rising inflation and a wave of strikes during 2022 have aroused echoes of the 1970s. In this article, experts from the fields of economics, sociology and social policy consider what has changed, what remains the same, and what the lessons might be – with a notable degree of agreement. Raising wages, particularly for the lower-paid groups in the public sector, is likely to reduce poverty and has a very low risk of generating further price inflation. Giving in on pay will be costly, and may have to be funded by taxes in the short term. In the longer run the only way out of our difficulties will be more effective growth generated through improved productivity.

Keywords
Inflation, wages, poverty, trade unions, strikes, productivity.

Note on the authors
See end of article.

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Introduction

Paul Edwards and Charles Baden-Fuller

Rising inflation and a wave of strikes during 2022 have aroused echoes of the 1970s. The image of the 'winter of discontent' of 1979 (a usage tracked down by the industrial relations scholar William (Lord) McCarthy to an inspired sub-editor on the *Sun*) continues to have resonance. We brought together four experts, all Fellows of the British Academy, from the fields of economics, sociology and social policy, to consider what has changed, what remains the same, and what the lessons might be. Their brief was to engage in a conversation through short and non-technical presentations. Revised versions are presented in this article. In keeping with the idea of a conversation, academic referencing is kept to a minimum. Given the rapid pace at which events are moving, it should also be stressed that the contributions were finalised in January 2023.

In the UK, our current (unanticipated) bout of inflation, defined as a general rise in prices as opposed to a change in the price of a particular commodity, has been and continues to be a social burden, and the recent inflation has been particularly difficult for the poor – as their costs of living have risen faster than the average and their incomes have (in general) been rising more slowly. And it is widely agreed that exogenous shocks (such as the Ukraine war) have been an important driver of rising prices. Other Western countries face similar challenges, but the UK has a particular set of circumstances that heighten the effects; these include historical liberal monetary policy, a weak exchange rate (important since global energy prices are set in US dollars), generous Covid-19 support, and notoriously low productivity.

Unsurprisingly, workers have demanded significant wage rises in an attempt to maintain real wages and an acceptable standard of living. Most significant strikes during 2022 were in the public sector, as in the NHS and education, or public services such as the railways and the Post Office. The ability of public sector workers to strike is bolstered by their relatively high level of union membership: around 50 per cent of employees, compared to 13 per cent in the private sector. But discontent goes wider, as illustrated by disputes at companies including Amazon. The government has been reluctant to make pay settlements that match these inflationary pressures; more significantly they have been much less generous in their offers than their private sector equivalents.

The rhetoric for those wanting more pay, particularly those at the lowest levels of income employed in the public and related sectors, is that they can no longer afford to live and keep their families together (with dignity and safety) without higher wages (and benefits). The rhetoric defending low pay offers has been that higher wage rises (and correspondingly union activism) is both 'unaffordable' to the institutions and 'inappropriate' to the national situation because it is the cause of (some further) inflation.

The conversation produced a notable degree of agreement. Raising wages, particularly for the lower-paid groups in the public sector, is likely to reduce poverty and has a very low risk of generating further price inflation. Giving in on pay will be costly, and may have to be funded by taxes in the short term. In the longer run the only way out of our difficulties will be more effective growth generated through improved productivity.

Chris Pissarides, giving the macro-economic view, is clear that economists are concerned about issues of inequality when they consider their policy measures.

- Although the UK economy did well from the early 1990s until 2008, since the financial crisis it has struggled to maintain its growth on account of low productivity.

- The 2020-2021 loosening of monetary policy coupled with substantial fiscal stimulus was intended to protect the UK population, especially the less well off, from potentially terrible economic consequences of the Covid-19 pandemic, but coming out of that period of support has not been easy – because of the debt burden and underlying monetary situation. Yet, he argues, this situation was not necessarily inflationary, had appropriate fiscal and monetary measures been taken. However, the Ukrainian war intervened, and a new challenge emerged – steeply rising prices of oil and gas.
- In the current situation, he argues, wage rises, particularly those in the public sector need not be inflationary. Whether the government should pay more to a particular group is indeed a complex question that will influence the level of debt and taxation.

Jill Rubery, drawing on heterodox economics and political economy, asks what is different between today and the 1970s, an era of continuous high inflation. In both cases, labour and trade unions have been receiving blame for inflationary pressures. This, she argues is unfair and incorrect.

- It is more accurate to say that 'inflation causes trade unions to act' to protect their real wages than that 'unions cause inflation' in contexts of externally driven price rises.
- In the 1970s, governments used incomes policies to bring down expectations of inflation and reduce wage cost push inflation. This approach underestimated the role of claims to re-establish customary standards of living following externally-driven cost increases due for example to the 1970s oil price rise.
- Incomes policies in the 1970s were implemented much more strongly in the public than the private sector leading to major strikes and the situation today is similar. Public sector pay has not kept pace with inflation since the financial crisis and is falling further behind under the current inflation wave.
- Today, in the first part of the 21st century, there is little reason to suppose that pay awards will be inflationary, and once again, it seems that avoiding paying public sector workers properly is likely to have serious long-term adverse consequences.

Colin Crouch looks at the social processes of pay bargaining and places the UK in comparative perspective.

- In comparison to capitalists, workers have been disproportionately hit by the recent oil and gas price increases. Just as in the 1970s, they have reacted to being asked to bear the brunt of these extra burdens, and demanded more wages and better contracts to lessen their pain. In the 1970s, it was unions who did most of the bargaining; today it is the hidden hand of market forces that has pressured companies to pay up, with only the government-run institutions holding out. Brexit has also affected the labour market because of labour shortages.
- There is a collective action problem for unions: they have an interest in keeping down inflation because it reduces everyone's real wages, but moderating one's own pay demands will work only if pay and inflation in general are controlled. In the 1970s, various 'social contract' efforts attempted unsuccessfully to address this problem. These are now absent, but European evidence indicates that co-ordinated bargaining can still be effective.

Peter Taylor-Gooby, giving a social policy perspective, drills down into the important details of what is happening to wages and wealth, particularly those at the bottom end of the scale during these inflationary times, and how we should see this in historical context.

- During the first half of the last century, poverty declined significantly in the UK. Although the date of the start of a shift towards more inequality cannot be agreed, in the last 20 years inequality has become more pronounced to make the situation in the UK among the worst in Europe.
- Income inequality is pronounced amongst women, who typically earn less than men and are particularly prominent in low-paid jobs, including those in public sector low paid jobs. So, the current inflationary challenge hits them hardest. Pensioners are also hard hit, but current policy protects them better than those of working age.
- Policy more carefully targeted in improving the low-paid, low-wealth group is needed, but even more important is the need to address the underlying causes of the problem.

We conclude that there is a broad consensus among the different disciplines that the challenge of inflation is indeed linked to both wages and inequality, because inflation influences the real wages of workers and disproportionately affects those with lowest incomes (and wealth). And we also broadly agree that the causal relationship is mainly one way – that is, inflation causes inequality, and wage rises, especially in the public sector, have little direct effect on future inflation. The challenges of managing inflation in the context of weak productivity growth are massive. As Colin Crouch asks: 'to what extent can public services employees be made to accept declining living standards while vacancies exist in flourishing parts of the private sector; and to what extent can governments preside over public services of declining quality?'

Post-pandemic inflation and inequality

Christopher Pissarides

In the decade and a half before the financial crisis of 2008, the United Kingdom, along with the rest of the industrialised world, experienced a period of macroeconomic stability with economic growth. Labour productivity grew steadily, unemployment was low, and the granting of independence to the Bank of England in 1997 helped it maintain monetary stability with low inflation. The growth in trade and the emergence of new digital technologies promised a long period of low-inflation prosperity. This was the period of the 'Great Moderation'.

But then the financial crisis came, the construction and housing sectors virtually collapsed, and several banks were threatened with bankruptcy. The newly elected government of 2010, faced with increasing debt levels and with a looming sovereign debt crisis in Europe, embarked on a 'debt reduction' policy, which necessitated cuts in public spending, including public investment. Despite this policy, debt levels continued increasing, from 42 per cent of GDP in the year before the crisis to 85 per cent just before the Covid-19 crisis, and productivity growth stalled. Because of this, and the Covid lockdowns, output per worker dropped below its 2010 level, and unlike its main competitors, Britain is still struggling to recover national output to pre-Covid levels.

It is not surprising that the main problem faced by government during this period became the 'productivity puzzle'. It was thought to be a puzzle why Britain, a country with a good business environment and a good record during the Great Moderation, would fail to recover its productivity growth, especially in view of the new technologies that were entering production elsewhere. But looking deeper into the causes, and with the caveat that such complex phenomena cannot have a simple explanation, it seems that Britain's malaise is due to the lack of technologically advanced

investments. A combination of insufficient public investment and ageing infrastructure, combined with the uncertainties brought by Brexit, Covid-19, and the frequent change of government policies – and personnel – removed the incentives necessary to invest in new technology and compete successfully in international markets.

Without productivity growth there cannot be sustainable wage rises; and this may not be too bad if living standards are maintained. But, new technologies, to the extent that they were applied, Covid-19, and especially inflation, conspired to reduce the living standards of workers on low incomes. Almost all new technologies are based on digital equipment, and so complementary to more highly skilled workers. In the Covid-19 lockdowns, jobs that could be done remotely, again mainly the ones that use digital technologies, carried on almost without disruption. But jobs that required personal contact, such as the ones in the hospitality sector, retail or in care, were badly hit. Hospitality, retail, and personal care have a bigger concentration of low-income workers than other jobs, leading to an increase in inequality at a time when the average level of incomes was falling.

During the Covid-19 lockdowns, government tried to avoid massive redundancies by introducing the furlough scheme, which supported workers to remain in their jobs but not work. It paid to employers 60-80 per cent of their wages. It cost 70 billion pounds to support 11.7 million jobs, and it benefited 21 per cent of employers, about 1.3 million. Per job the furlough scheme cost about 6,000 pounds, spread over 18 months.

Normally, at the end of the lockdowns, government would be aiming to repay the borrowing used to finance the furlough scheme, possibly funded by a national insurance surtax on employers. In these circumstances the scheme would be neutral on aggregate and over the long term. The government would have acted as a lender to employers, collecting its 'loans' later through taxation; the uncertainties of Covid-19 would not have allowed a private banking system to perform this role, so government policy would have been welfare-enhancing.

But as the lockdowns were ending and the global economy was returning to something resembling normal, the war in Ukraine broke out, raising energy and food prices. These products are proportionally a bigger fraction of the consumption bundle of low-income households. Low-income households, who suffered reductions in their living standards before the pandemic through the increase in inequality, were hit by another cost-of-living shock.

The high inflation that followed the Covid-19 spending and the energy crisis associated with the Ukraine war is not easy to deal with. On the one hand monetary policy had to be tightened to reduce the money supply in circulation, and on the other hand some fiscal policy was needed to support low-income families faced with large reductions in their living standards. But even if fiscal policy was tightened to support the anti-inflation stand of monetary policy, as recommended by the International Monetary Fund (IMF), the fact that the rise in energy (and food) prices was a relative price adjustment meant that inflation would not have fallen quickly. Energy and food prices added to inflation, because energy and agricultural products are raw materials to just about every product and every household in the country.

A rise in the general index of prices is not fought with tighter monetary policy if it is caused by a rise in the relative prices of key products. The rise in relative prices necessitated a fall in living standards, because we all had to pay more for our food and energy consumption. The danger from this kind of relative price adjustment is that wages might rise after collective bargaining to offset the impact of inflation, and if this rise is accommodated by monetary policy, it can lead to more inflation. It then creates a wage-price spiral which would be much more difficult to control.

Does this risk mean that we should do nothing about the rise in the cost of living? Not necessarily, but the decision of what to do is a political one and not just an economic one. Doing nothing except for fighting inflation essentially amounts to a policy that favours higher-income families, which are not as exposed to the prices of food and energy as low-income families. Supporting households and SMEs (small and medium-sized enterprises) with one-off transfers is a better way of supporting low incomes, and in this respect, a targeted policy would be better than one with general coverage – the policy actually pursued in Britain and most other European countries.

History has shown that in the labour market the private sector has been able to negotiate reasonably good wage adjustments, but not sufficient to offset entirely the negative impact of inflation on living standards. Such a below-inflation adjustment avoids the build-up of inflationary expectations and shares the burden of the relative price rises, but on balance it is likely that it will not be enough to compensate low-income families for the higher costs that they are facing. But the government's response to public sector workers, to keep their wage adjustments below the private sector adjustments, exacerbates inequalities. The public sector workers affected are mainly low-income workers, working in the health and education sectors. Their products, which are government-funded services to the community, are not traded at a price that needs to cover costs, so any wage rises would not feed on to prices and lead to a wage-price spiral. The only impact wage rises in these sectors would have would be on either taxation or government debt, which are not inflationary.

Looking at the bigger picture of who bears the burden of the rise in the cost of living, the worst affected appear to be low-income public sector workers. Low-income private sector workers are doing better, but not much better. Inequalities will likely be exacerbated by this policy. In view of the heavy burdens borne by the same low-income public sector workers during the pandemic, this seems to be particularly harsh.

Do trade unions cause inflation or does inflation cause trade unions?

Jill Rubery

The current wave of strikes and pressure for wage settlements to be close to the rate of inflation has led to many comparisons being made to the 1970s and the so-called 'winter of discontent'. Just as happened in the 1970s, the focus, at least from the government, is on stopping trade unions causing inflation through their wage demands. Yet in both periods it is externally-driven cost pressures – through taxes, a declining pound, and rapidly escalating energy costs – that triggered resistance by trade unions as they seek to defend and restore their customary living standards. Far from trade unions causing inflation, it may be inflation that is causing trade unions.[1] Before this post-Covid shock, inflation had been at a low level for a long time, and trade unions were coming to be regarded as an historical irrelevance. The current wave of strikes may indicate that that might be too hasty a conclusion.

It is in fact much easier today to make the case that inflation is driving industrial action rather than vice versa: the limited coverage of collective bargaining, the erosion of real wages since the

[1] This inversion of the assumed direction of causation was coined by the Cambridge economist Frank Wilkinson and many of the ideas in this piece reflect his contribution to the understanding of inflation and wage bargaining – see tribute article (Rubery *et al.* 2022).

financial crisis, the worldwide hike in energy prices and the falling pound all point to an inflation process that is primarily externally driven. The key question that is different today is whether the decline in collective organisation over recent decades has permanently reduced the capacity of the working classes to resist erosion of living standards. This is the outcome that the government is banking on. However, it may have misjudged the mood, particularly of the still-unionised public sector workforce. Many of the striking workers have at least three key grievances: the impact of the extended austerity measures introduced from 2010 on their living standards; the empty implied promises by the nationwide clap for frontline workers in the pandemic; and the excessive workloads caused both by the pandemic and by labour shortages in the post-pandemic period.

A key issue in the 1970s was the use of policies to try to control what was characterised as trade union-fuelled cost-push inflation (Hunter 1975; Tarling & Wilkinson 1977). The premise behind these income policies was that it was vital to bring down trade union expectations of what wage increases other groups would succeed in negotiating so that wasteful wage-price spirals could be avoided. This view reflected the belief of economists, including Keynes, that as wages were bargained over in money terms, workers were more concerned about not falling behind other groups than about maintaining living standards, as they had little direct control over prices. Others have challenged this view, and argued instead that workers' resistance is indeed sparked by difficulties in maintaining their customary standard of living. This resistance is reinforced by the range of pressures that convert an upturn in consumption standards into a socially-embedded norm as to what constitutes an acceptable living standard. This pressure stems from desires not to feel excluded from observable rises in living standards and changes in consumption patterns, an approach that underpins the use of relative not absolute poverty to determine who is missing out.[2] These apparently higher consumption standards are in any case difficult to reverse. Many of the old products and services that people used to purchase may have disappeared along with opportunities, for example, to use domestic labour to substitute for wage goods.[3] Declines in demand for basic materials – for example dressmaking material – may reduce supply channels and raise prices – and the manufacture of goods may no longer allow for do-it-yourself repairs. Moreover, without access to technology-enabled products and services, the costs of living may be fact be higher – as evidenced by prepaid meters for energy for those who are not able to pay through bank direct debits. This ratcheting up of the customary standard of living through a joint process of changing social expectations, and changing availability and prices of alternative goods and domestic labour, can be argued to have sustained the expansion of capitalism and its intrusion into many areas of activity previously outside the capitalist sphere. At the same time it is through historically-determined norms of acceptable consumption standards that workers have also been able to capture some share of the surplus, and thereby to some extent confound predictions of Marxist economists that there would be an inevitable immiseration of the working classes (Wilkinson 2012) .

The focus instead in the 1970s on wage-price spirals that were fuelled by concerns over which group is faring better in the wage bargaining round downplayed the real distributional conflicts, and led to misguided attempts through incomes policies to try to control inflation. One particularly

[2] This approach to understanding consumption was developed by Duesenberry in 1949 (see Mason 2000) but was marginalised by economists as too sociological, despite even Adam Smith referring to custom as determining life necessities. However, the notion of relative income has been widely used in understanding poverty (Townsend 1979).

[3] These changes in household consumption patterns as women entered the labour force in response to labour demand have been argued to contribute to the increasingly permanent commitment of women to labour market participation (see Humphries & Rubery 1984).

badly designed income policy guaranteed that wages would rise automatically by 40p for every inflation point above a threshold of 7 per cent, as the politicians were so convinced that this would reassure unions and thereby bring down wage claims such that the guarantee would never be triggered. In practice this was introduced just as the oil price shock hit and the 40 pence increase was triggered 11 times.

Another problem with the incomes policies was that the government lacked mechanisms to enforce incomes policies in the private sector, so that in practice it was mainly public sector workers' pay that was subject to constraint, just as happened with the wage freezes in public sector pay after the 2010 financial crisis. The erosion of real wages in the public sector occurred over multiple years and, when governments of different persuasions finally realised they needed a reset to their public sector pay structures, the consequent high catch-up settlements did spark further wage bargaining rounds, as private sector workers sought to emulate the apparently generous public sector settlements.

Despite the many problems in controlling inflation in the 1970s and the willingness to blame trade unions, there was no real interest in reforming wage setting to provide a more co-ordinated response to inflation, as applied in various Nordic countries. This co-ordination of settlements still prevails in Norway, for example, where the private sector wage award is then mirrored to a large extent in the public sector, thereby preventing the emergence of major gaps. Likewise, in the current period the government appears to be hoping that these distributional issues will just disappear, and there is no discussion of reform of current wage setting arrangements.

What are the parallels with the 1970s for today's conflicts over real living standards?

First of all, many of the key pressures in both time periods have been externally driven but exacerbated by internal problems. The worldwide energy price rise and a declining pound will necessarily result in a decline in GDP and real income on average. Interest rates had to rise after the autumn 2022 financial crisis to stem further falls in the pound, but the continued increases are being driven by a central bank view that inflation is demand-led rather than an external cost-push pressure.

A key issue is how the decline in real GDP is distributed. Exposure to particularly high price rises in key areas, such as energy and food, for lower-income groups who spend more on these commodities, is intensifying the squeeze on the vulnerable who are not well placed to absorb these pressures. A lot depends on what happens to minimum wages and to Universal Credit, which together provide key support for low-income working households. A major difference from the 1970s is that benefit levels have in fact been 'cut to the bone', so that there is no fat on which claimants can draw to survive such a hike in prices of essential goods. The need to raise benefits in line with inflation is a consequence in fact of the government's policies of keeping benefits at below acceptable living standards, and consistently refusing to raise them in line with rising living standards and productivity growth. If benefits do not rise with earnings in the good years, then they must maintain their low real value in the bad years.

A further parallel from the 1970s is the fiscal drag effect on the tax that people are paying on their declining real earnings, which may further fuel unrest over wages. The 2022 early autumn debate on tax cuts was bizarre as it focused only on tax rates not tax thresholds, yet as the Institute for Fiscal Studies (IFS 2022a) has shown, the freezing of tax thresholds has involved a major increase in tax on a given level of real income. This was recognised to be one of the 'mistakes' of the 1970s, which was remedied by the so-called Rooker-Wise amendment that required personal

tax thresholds to be increased by the rate of inflation unless there is a vote not to do so. This problem was overshadowed in the autumn by the announced cuts to rates of tax, though the IFS has produced a comprehensive and shocking analysis of this tax by stealth. The 2010-15 coalition government made a lot of fuss about taking many low-paid workers out of tax altogether by raising thresholds, but the reversal of this policy of high tax thresholds has received rather limited scrutiny.

The pressure on living standards is thus spread widely, but particularly affects both those reliant on benefits due to their very low level, and those who have faced long-term erosion of real earnings due to the austerity measures imposed after the financial crisis. Gradual erosion may be tolerated in a context of weak trade union organisation. But this means that households have tended to turn to other methods to get by, such as by adding hours of labour, particularly by women. However, the more dramatic erosion threatening living standards in the current crisis appears to be galvanising at least unionised groups into action, including those where taking action raises moral dilemmas such as nurses and ambulance drivers. It is too early to say if the current industrial unrest will extend to non-unionised groups, although this is not implausible given evidence of some successful resistance by gig workers in the UK. This spread of discontent may be in part contained by the fact that private sector pay setting is proving more responsive than the public sector. Companies, driven in part by labour shortages, are raising pay at higher rates than in the public sector, and many – for example supermarkets – have announced more than one wage increase.[4] In contrast many of the public sector proposed pay increases for 2022/23 were based on conditions before the hike in energy levels even occurred. The current government is using the 1970s winter of discontent as an argument for not seeking a negotiated solution, but both then and now many of the problems can be considered to lie with ill-judged policies of successive governments.

Further reading. On trade unions, real wages and inflation, see works by Frank Wilkinson summarised in Rubery *et al.* (2022). On incomes policies and winter of discontent, see: Hunter (1975); Tarling & Wilkinson (1977). On customary standard of living and concept of relative poverty, see: Mason (2000); Townsend (1979); Wilkinson (2012); Humphries & Rubery (1984). And on taxation and personal allowances, see: IFS (2022a).

Then and now: the politics of inflation in the 1970s and now

Colin Crouch

The inflation crises of both the 1970s and the present period originated exogenously; in fact, both started with major increases in the price of oil that were triggered by overseas wars. In the 1970s the initiating spark was a reduction in the supply of oil by Arab oil producers in retaliation for Western support for Israel in the latest Arab-Israeli war. Today it is Russia's response to Western support for Ukraine in its war with that country.

A rise in the price of one commodity does not in itself constitute inflation; if it simply results in reduced demand for that commodity, there is no transfer across to the general price level. Inflation is defined as a rise in the general level of prices. Two factors might lead a rise in the price of one

[4] One cause of cost-push inflation, however, is reduced time periods between pay settlements (Tarling & Wilkinson 1977), and one consequence of the lack of collective bargaining in the private sector in the UK is the absence of properly co-ordinated pay setting that could act to moderate inflation.

or a few commodities to generate inflation. The first occurs if a commodity is of major importance to the production of other goods. The second occurs if the rise in prices leads to successful demands for increases in wages, that in turn feed into price rises for other goods. In both cases the price rise in the initial commodity seeps into the prices of a wide range of goods and services.

Oil, and other forms of energy that will be affected by increases in the price of oil, are major examples of commodities meeting the first criterion. Very few economic activities can be carried out without energy, in both their production and transport. The effects will not be equal: a bakery uses far more energy per unit of output than an insurance office; but both will feel some effect. In both the 1970s and now, increases in the price of oil have therefore led to increases in the general price level – in other words, inflation.

Once this happens, people will try to protect their living standards by seeking increases in their incomes to compensate them for the rise in prices they are experiencing. If enough of them are successful in doing this, they provoke a further increase in prices – or, in the case of public service workers, in levels of taxation needed to finance their pay increases. In this way inflation can become a self-reinforcing spiral. The vigour of the spiral will depend on the extent to which pay demands are successful, and on whether firms and public service departments can absorb wage rises through efficiency gains and (in the former case) reductions in profits.[5]

Workers seeking to protect themselves from inflation appear in this scenario as helpless victims of the spiral. If many of them successfully secure pay rises, they help generate more inflation, which then hurts them during the next twist of the spiral. If they fail to secure a rise, they are hit by the current spiral and then by the next one that their more successful peers have helped to create. For any one group of workers it is irrational to respond to this predicament by exercising restraint, as their restraint will have too small an effect on prices overall to make a difference, while they will lose out by not seeking to protect themselves.

The only way in which they can avoid this is if trade unions representing workers across a large proportion of the economy agree to co-ordinate their actions. Their joint actions will have a large discernible effect on the general price level. This gives them a strong incentive not to seek pay increases that will lead only to more inflation.

Inflation politics in the 1970s

These processes were very much in evidence in the 1970s. Some countries possessed co-ordinating mechanisms of this kind among both unions and employers' organisations: the Nordic countries, Germany, Austria, to some extent the Netherlands and Switzerland. These countries had significantly better records of suppressing inflation after the initial outbreak than those with highly decentralised wage bargaining or divisions among rival groups of unions: Belgium, France, Italy, the United Kingdom, the United States.[6] In all these latter cases, governments tried to encourage forms of co-ordination in imitation of the better performing countries. In the UK this took the form of the so-called 'Social Contract', a semi-formal agreement between union leaders and government. The former would restrain wage claims in exchange for some favourable social policies. There was some temporary success, though even that had to be reinforced by some statutory powers restricting wage rises, but while there was action and good will at central levels, organisational structures to

[5] Flemming (1976) proves an excellent, accessible account of the inflationary spiral from the perspective of the 1970s.
[6] Crouch (1985) provides a contemporary summary of these different experiences.

support cordination were lacking, and the experiments collapsed.

From at least 1945 onwards, most governments in the democratic world had more or less agreed that they would sustain demand in order to keep unemployment at low levels. One means available to bring an end to an inflationary spiral is to stop this full-employment guarantee. If governments failed to print more money to accommodate the inflation, demand would be reduced across the economy, leading to increased joblessness. Workers would then lose their ability to demand pay increases. This is what happened in those countries such as the UK, unable to co-ordinate wage bargaining. Unemployment rose sharply and the inflation spiral came to an end.

The politics of inflation today

This is not the place to evaluate the overall consequences of these actions in the late 1970s and early 1980s. Our task is to examine possible similarities between that period and the present.

The first point to note is that unions have become weaker almost everywhere, and their memberships and strength are more concentrated in public services.[7] The sharp decline in employment in two of unions' main strongholds – manufacturing and mining – has both produced membership decline and left public services as the main unionised sectors. This changes the dynamic of wage bargaining. Today wages pressure is more the result of market forces rather than union action in the private sector. Public services pay is not determined by the state of demand and profit levels as in traded sectors of the economy, but by government policy on taxation levels. Government can combat inflation by suppressing pay in these services. This is what has been happening in the UK during the recent bout of inflation. Pay has been rising in the private sector, mainly in response to labour shortages. These shortages have been caused, partly by the loss of immigrant workers following the country's leaving the European Union, and partly by many persons who left the workforce during the Covid-19 pandemic deciding not to come back to work. There are the same shortages in public services, but government can decide to ride out the unpopularity produced by inadequate public services in order to limit inflation by suppressing public services pay.

In this context strikes are far more likely to occur in public services than in the rest of the economy. Their dynamic is quite different from those in the private sector, where the issue is whether employers can risk losing customers and profits longer than workers can withstand loss of wages. In public services (including privatised ones where government still holds the purse strings by deciding how much it will increase contractors' payments to meet wage claims) workers still face the same economic hardship, but for government there is a blame game between themselves and unions: who will the public blame for the disruption to services? These services are already under stress following a decade of austerity in the wake of the 2008 financial crisis, followed by the disruption of the Covid crisis. Government might be able to have the public blame unions for strikes, but not for the wider issues of inadequate services.

These sector differences also exist, though in different form, in those Western European countries still retaining some elements of co-ordinated bargaining. Unions representing workers in internationally traded sectors (mainly but not solely manufacturing) are careful not to make wage settlements that will make their export industries uncompetitive; and unions in the non-traded sectors (public services plus many private services and some local manufacturing) accept that their wage claims must fit in behind this level. Stability is not always maintained; there is currently

[7] See Sano & Williamson (2008).

conflict among many airline employees, whose sector suffered heavily during the pandemic. But overall it seems to hold. In the UK there is absolutely no policy on either side to try to construct co-ordination.

The politics of inflation today are very different from that in the 1970s. Then the principal conflict was whether co-ordinated collective bargaining could contain the inflationary spiral, or whether unemployment would be allowed to rise to squeeze out wages pressure. Today both union power and government's capacity to act are focused more sharply on public services. To what extent can public services employees be made to accept declining living standards while vacancies exist in flourishing parts of the private sector? And to what extent can governments preside over public services of declining quality?

Inflation, inequality and poverty

Peter Taylor-Gooby

The sections above by Chris Pissarides, Jill Rubery and Colin Crouch explain that inflation in the UK is largely driven by exogenous price rises in energy and fuel, exacerbated by the decline in value of the pound, which in turn has been accelerated by Brexit. The price rises have been addressed by interest rate rises, attempts to contain pressures for wage increases matching inflation, and limited policies to address the impact of energy price rises on households.

The policy of seeking to persuade workers in the private sector to accept real wage cuts as incomes fail to keep pace with rising prices has been unsuccessful, but demands for wage increases across most of the public sector have been kept to low levels. The outcome is the current wave of strikes affecting the NHS, railways, buses, postal workers, Border Force staff and other areas.

The link between inflation and public sector unrest must be seen in the context of the longer-term trend to a decline in the labour share of productivity increases (evident since the 1970s and particularly marked in the UK), rising poverty and inequality (again marked in the UK), government policies since 2010 to impose a substantial fall in public sector wages, and cuts in the welfare state that reduce the benefits that help support bottom-end wages. Other trends such as the real-terms increase in housing costs have also borne heavily on the low-paid. Population ageing has contributed to growing pressure on social care and the NHS.

There is some evidence of a shift in public opinion against the trend to inequality, and of concern about the growth in poverty and the damage to welfare state service that austerity policies have produced. In the context of broader developments, the public sector response to further cuts in living standards is not surprising.

Government policies have led to increases in debt from 42 per cent of GDP in 2007 to 85 per cent by 2019. Debt then rose sharply in response to the wage support 'furlough' scheme and a programme of ill-regulated loans and payments to business during the Covid-19 crisis, so that debt now stands at 102 per cent of GDP (October 2022; ONS 2022a). Options for government to manage the situation are explored at the end of this section.

Decline in the labour share of productivity

The share of increases in GDP that went to the labour force remained roughly constant at about two-thirds or slightly less in developed countries for the century up to 1990s. It then fell to the

mid-50s in percentage terms (Oberfield & Grossman 2022). The chief factors in this appear to be greater use of technology, the outsourcing of labour from developed to undeveloped countries, and the weakening of the bargaining power of labour (Guschanski & Onaran 2022). The impact of the decline in trade union influence has been particularly marked in the UK. These trends set the context for increasing inequality.

Rising poverty and inequality

Income and wealth inequality is greater in the UK than in most other advanced countries (HoC 2021). Poverty rates are also higher.

The IFS Deaton Review shows that inequality in the UK fell during the early post-war period, plateaued in the 1960s, and then rose sharply in the 1980s, to plateau again. Incomes at the 90th percentile, previously three times those at the 10th percentile, are now four times – relatively a third larger. However, the incomes of the smaller minority of super-rich have moved rapidly upwards. The top percentile, which received 4 per cent of all incomes, now receives more than 8 per cent, a doubling of their relative share (Joyce & Xu 2019). The review also shows that, while poverty among pensioners fell, poverty among working-age families and children has increased rapidly during the 1980s and early 1990s, fell slightly in the early 2000s, and rose sharply since 2010, so that about a third of UK children now live in poverty.

The picture in relation to wealth is even more striking. Inequality in wealth holdings fell between 1900 and 1985, then plateaued, and is now rising. The top 10 per cent of wealth-holders own about half of all wealth, and the top 1 per cent about one tenth. The effect of greater inequality is exacerbated by the fact that total wealth has expanded rapidly since the mid-1980s from about a third to more than 80 per cent of GDP. This increase has been fuelled by a property boom, rapid growth in the value of stocks and shares, and laxer taxation of wealth. The result of the wealth boom is massive wealth inequality, privileging the rich (Resolution Foundation, 2022).

Public sector wages

The public sector accounts for about 5.9 million workers, a fifth of the total labour force, the majority of them women. While overall wages have remained roughly constant in recent years, as the extra value of productivity has risen to counteract the declining wage share discussed earlier and inflation has whittled away cash increases, the gap between private and public sector wages has grown, particularly since 2010 (ONS 2022b). Government policies of a 2010-2012 public sector pay freeze, followed by a pay cap of 1 per cent and then 2 per cent annually, and pressure on review bodies to follow government inflation and austerity targets have resulted in a 4.2 per cent overall decline in public sector wages, taking inflation into account, since 2009. Cuts have been particularly sharp for nurses and other health sector workers, social workers and education sector workers. They have hit women disproportionately. The real wage cuts contribute to the present unrest.

Welfare state and benefit cuts

Numbers on Universal Credit, the main mean-tested benefit for working-age people on the poverty line, rose from about 2 million to about 5.7 million during the Covid-19 pandemic, and have not

fallen subsequently. About half of claimers are in paid work (a little under one in ten of all workers) and use the benefit to top up wages which fall below poverty levels.

Those over pension age on low pensions (about 9 per cent of the 12.3 million pensioners in the UK) receive means-tested pension credit, paid up to more than twice the level of the working-age benefit.

Pension credit has been increased at a rate slightly higher than inflation since 2010, while Universal Credit has fallen in real terms, particularly since 2015 (ONS 2022c). The result is that the benefit has fallen from about 14 to about 12 per cent of the value of median wages for a single worker. In addition, something like a third of all those on benefits do not actually receive the headline rate of benefit due to caps for large benefits, children above two in the family, and rent above 30 per cent of the average for a local authority area, and also to delays in claiming, repayment of debt up to 10 per cent of benefit (typically incurred through payments to survive while waiting for benefit, or for energy bills or council tax payments), or sanctions for errors or overclaiming. Benefit uprating is implemented some six months in arrears, leading to further poverty for claimants.

Minimum wage rates rose between 2001 and 2010, taking inflation into account, then fell in 2015, but have since recovered and risen by about 4 per cent since 2016 (HoC 2022). The government price cap scheme for household energy bills reduces the impact of price rises, but bills have nearly doubled on average for most households in 2022, and are likely to increase by a further fifth in 2023. The effect of caps is weaker for those on prepayment meters. There is no corresponding policy to manage food price increases, which are the second most rapidly rising area contributing to current very high inflation rates.

These policies impose severe cuts in the living standards of the poor, who were already suffering from a decade of austerity. Most low-paid workers, benefit claimers and pensioners, especially low-income pensioners, are women, so the impact of real benefit cuts is gendered. In addition, the poor pay more. Those on low incomes are more likely to purchase energy through prepayment meters, and tend to spend a higher proportion of their income on food. Food prices at the bottom end have increased much faster than overall inflation. One illustration is that the cost of the food parcel provided by one local food bank rose by over 20 per cent in the period in which ONS measures of inflation rose by 11.7 per cent (CFB 2022). The numbers of impoverished people coming to food banks have roughly doubled since the beginning of the Covid-19 pandemic, and an increasing proportion are in low-waged employment rather than on benefits (Trussell Trust 2022).

The government policies and price rises that cut living standards even further for those at the bottom contribute to poverty and inequality, and further exacerbate the pressures for pay increases in line with inflation on the part of the lowest-paid workers.

What can be done?

The problems of inequality and poverty and of industrial unrest resulting from inflation rates that outstrip wage increases, especially in the public sector, are due to specific policies that are set in the context of long-run factors outside the control of government. The high level of public debt resulting from tax reductions in the context of austerity since 2010, and from Covid-19 spending, in a context where the emergency budget of the previous government leadership has undermined confidence in UK economic management, limits the freedom of action of the current government. It will not be possible to make progress in managing poverty and inequality without taking action to address the long-run issues. This must include measures to improve productivity (targeted

investment, training, labour force management) and trade with the EU, and to reduce wealth and income inequalities. Such policies would confront the interests of powerful groups, and would require vigorous and determined action over the course of several parliaments to achieve.

In the more immediate term, a number of issues could be addressed. Measures to tackle inequality could increase tax revenue and enable the government to tackle poverty.

In relation to inequality:

- Initial moves might include taxation of the 300,000 residents with non-domiciliary status who do not contribute to the UK exchequer. This would raise about £3.2 billion, and would remove the incentive for non-domiciled residents to invest outside the UK, since their income from investments abroad is UK tax-exempt (Advani *et al.*, 2022).
- Closing loopholes such as entrepreneur's relief which allows very rich people to pay 10 per cent rather than 40 per cent tax on income taken as capital gains. This applied to 9,000 individuals in 2021 and accounted for about £11.5 billion of tax foregone.
- Further measures could include addressing the loopholes in the taxation of inheritance, and reforming local taxation to make it more progressive.

In practice it is unlikely that measures to address these issues would raise the sums currently lost, since further loopholes would be discovered and exploited, but it is likely that the tax take could be substantially improved to enable immediate measures to address poverty to be implemented. Universal Credit and related benefits currently cost some £76 billion (OBR 2022):

- The policies in relation to capping benefits, sanctions, delays, and debt recovery that reduce the benefits actually received could be removed at a cost estimated at between £2 and £3 billion.
- In addition, benefit rates could be increased. Real increases would be expensive and take time to implement, but the £20 a claimant cut in October 2021 when the pandemic was officially at an end could be restored at a cost of a little over £5 billion.

None of this would be easy to accomplish, but the alternative appears to be further industrial unrest that is driven by inequality and, in the UK, is currently exacerbated by exceptionally high inflation. This will take place in a context of continuing unsatisfactory productivity and even greater wealth and income inequality. Government has cut tax and increased government debt during the last decade. Without modest tax increases for those most able to pay it is impossible to make progress.

Further reading. For an up-to-date review of inequality and its causes in the UK, see IFS (2023); and for a wider view, see Piketty (2022); and JRF (2022).

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Note on the authors

Paul Edwards is Emeritus Professor of Employment Relations, Birmingham Business School, University of Birmingham. He is a Fellow of the British Academy, and has served as the chair of the Academy's Social Science Group.

Charles Baden-Fuller is Centenary Professor of Strategy at Bayes Business School, City, University of London and Senior Fellow at the Wharton School. He is a Fellow of the British Academy and of the Strategic Management Society.

Sir Christopher (Chris) Pissarides is a Cypriot economist and a Fellow of the British Academy. He is the Regius Professor of Economics at the London School of Economics (LSE), and Professor of European Studies at the University of Cyprus. His research focuses on topics of macroeconomics, notably labour, economic growth, and economic policy. In 2010, he was awarded the Nobel Prize in Economics, jointly with Peter A. Diamond and Dale Mortensen, for their analysis of markets with theory of search frictions.

Jill Rubery is a Professor of Comparative Employment Systems at Alliance Manchester Business School at the University of Manchester. Her research focuses on comparative analyses of employment systems with a specialisation in gender and labour market structure. She was elected a Fellow of the British Academy in 2006.

Colin Crouch is sociologist and political scientist. He is professor emeritus of Warwick University Business School and an external scientific member of the Max Planck Institute for the Study of Societies, Cologne, and a Fellow of the British Academy. His works on the crises of the 1970s include *Class Conflict and the Industrial Relations Crisis* (1977); edited, with Alessandro Pizzorno, *The Resurgence of Class Conflict in Western Europe*, two volumes (1978); *The Politics of Industrial Relations* (1979 and 1982); *Trade Unions: the Logic of Collective Action* (1982); and *Industrial Relations and European State Traditions* (1993).

Professor Peter Taylor-Gooby is Professor of Social Policy at the University of Kent, and a Fellow of the British Academy. He is a Founding Academician at the Academy of Social Sciences and, previously, a Fellow of the Royal Society of Arts and President of the British Association for the Advancement of Science, Sociology and Social Policy Section.

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