Inflated prices and inflated opinions

Rising inflation has been a big issue for workers this year. **Trenton Elsley** looks at reactions to these increases and considers their validity in relation to low earners' needs. He also gives some useful tips to wage bargainers regarding inflation demands.

Inflation has certainly become a talking point, or rather several talking points. This is because inflation is a very real issue with immediate consequences and it is a fairly complex issue that is not easily reduced to a single digit or even double-digits.

Many of us are concerned that rising prices are putting pressure on our ability to match what we need with the income we have. Some are concerned that inflation is overstated. Others are concerned that those who say that inflation is overstated are interested only in manipulating markets in their favour. Some are concerned that the Reserve Bank raises interest rates in response to rising inflation, regardless of the source and structure of inflation. Some are concerned that wage increases for workers should protect their real incomes. Others are concerned that higher wage increases for workers will fuel inflation further. Still others are concerned that fixating on inflation compromises a working class agenda.

Let us briefly consider each of these concerns.

IS INFLATION OVERSTATED?

Many are concerned that rising prices are putting a great deal of pressure on our existing expenditure.

South Africans share the experience with other parts of the world of a significant rise in the price of goods and services, not luxury items but items like food, transport, property, interest rates and electricity. Many households cannot move away from inflation heavy items in their monthly expenditure, food being the most obvious example.

When you consider the low levels of savings in South Africa and the disturbingly high household debt as a proportion of household income, it becomes clear just how vulnerable many are to rises in prices. Low income households will sink further into poverty and they will be joined by households with incomes that previously were close to meeting household expenditure, but which can now no longer balance needs with income.

Some are concerned that inflation is overstated. I am referring to the recent attention seeking behaviour of Investec Asset Managers.

Like any 'good' accusation their argument has a thread of truth in it. Investec exposed an open secret. The results of the 2005 Income and Expenditure Survey have already been published and so they influence the reweighting of items which make up the basket of goods used to measure inflation. Investec argued that Statistics South Africa was taking too long to reweight items and that inflation was exaggerated based on the available information. Their argument follows that the Reserve Bank is therefore reacting to a higher rate of increase in inflation than it should be. Therefore it is raising interest rates when it shouldn't be.

If the reweighting of the Consumer Price Index (CPI) bears any resemblance to the findings of the 2005/2006 Income and Expenditure Survey, then inflation is likely to slow. The reason is that two of the main changes are a lesser weighing for food and transport items and these same items are currently two of the leading drivers of inflation.

This might also fuel allegations that government is massaging inflation to its own ends. When you consider that there are major changes in methodology between the 2000 and 2005/2006 Income and Expenditure Surveys, Statistics SA needs to carefully consider how it reweights key items. Investec's assertion that inflation is overstated is only true with the current situation. If food and transport prices lower then the picture changes.

Others who believe that inflation

Low income earners experience worse price rises because inflation is driven by higher food and transport costs

is overstated are interested only in manipulating markets in their favour. Allegations that Investec purposefully released its statement to shore up bond prices just when it went long on bonds are only speculative. Basing a financial position on the potential effect of the statement would be irresponsible. Investec only made certain facts public and as much as we might dislike such manipulative behaviour the real concern is how easily financial markets are manipulated.

RESERVE BANK RIGIDITY

Others contend that the Reserve Bank raises interest rates in response to rising inflation, regardless of the source and structure of inflation. The South African Reserve Bank practices strict or fully fledged inflation targeting monetary policy and has committed itself to holding inflation between 3% and 6%. The tool they use to influence inflation is the raising or lowering of interest rates.

Fully fledged inflation targeting creates the impression that the Reserve Bank is serious, very serious about combating inflation and that it will use a defined set of policy instruments, interest rate manipulation, to achieve its goal. This makes inflation predictable as a counter to uncertainty. To a large extent, inflation-targeting monetary policy is a self-fulfilling prophecy. Inflation targeting is partly about attempts to manage inflation through the manipulation of interest rates and partly about talking inflation down.

It is fair to say that the Reserve Bank has been spectacularly successful in bringing predictability to monetary policy in South Africa. What speculation remains is not about if the Reserve Bank will raise interest rates in the face of rising inflation, but rather by how much it will raise interest rates. This continues despite growing calls from mainstream commentators for a more nuanced approach.

The Reserve Bank's approach to inflation is so rigid that it openly admits that it is committed to managing inflation above all other macro-economic variables. In a remarkably frank assessment of monetary policy the chief economist of the Reserve Bank says, "If the Bank is of the opinion that the attainment of the inflation target can only be achieved at costs too high to the economy, it is still obliged to attain the inflation target."

The Bank's rigidity on inflation is structured into the formulation of its policy. To illustrate the point, consider a 'crime targeting' policy adopted by national government. Any deviation from such a policy would by definition suggest that government was not serious about crime. The very formulation of a policy such as 'inflation targeting' closes down a discussion on what constitutes a policy which targets inflation. It sets itself up as the only approach and makes policy change exceedingly difficult.

PROTECTING REAL INCOMES

Some are concerned that wage increases for workers should protect their real incomes. And they should be. At the very least, inflation benchmarking can be used as a tool for formulating a bottom-line wage demand or a demand which seeks to protect real incomes from falling. But most unions are not getting it right and wage increases tend to trail inflation rates, especially in times of rising inflation.

We need to move away from the current scenario whereby employers come to the table with a below inflation proposal, which gives them room to move to somewhere close to or just above inflation. In principle, a mutually accepted measure of inflation should be a benchmark of where wage bargaining starts.

No trade union can be expected to accept a sub-inflation increase which is a decrease in the real value of wages without very good reasons. Bargaining should in principle begin at a level that is benchmarked against a mutually accepted inflation index and proceed from there. Unions should consider introducing such an agreement in principle into negotiations. It could constitute a demand in itself, which is then put into practice in subsequent years.

There is a tension between negotiations which are forward looking and inflation statistics which are retrospective or backward looking. An average increase in pay for low wage or minimum wage jobs in 2007 of 7.8% compares favourably with average CPIX of 6.5% in the same year. Unfortunately we should be comparing the 2007 settlement level to CPIX data that is released in 2008. CPIX for July 2008 tracks the change in prices between July 2007 and July 2008. This is closer to the period of the 2007 wage increase. By this measure workers who saw a 7.8% in July 2007 will have seen their real incomes decline by a little over 5% over the course of the 12 months to July 2008 (see graph).

Many people do not realise that inflation figures are an average and neglect that Statistics SA actually calculates inflation for five different expenditure groups. It is also true that average inflation is far more representative of the high expenditure groups than it is of lower expenditure groups.

The current structure of inflation means that in recent years low income earners have experienced a rate of inflation that is significantly higher than the average CPI or CPIX. This is because inflation is driven by rising food and transport costs, which make up a greater share of workers' expenditure than for higher income households. Negotiators should consider using the different indicators (shown in the table above) where possible.

Some believe that higher wage increases fuel inflation further. This line of argument relies on the idea that anything that pushes up prices pushes up inflation. The argument also tends to be put forward in isolation, ignoring all other inflation push factors, thereby suggesting that workers, through their trade unions, are responsible for inflation.

This argument is in fact not an argument and looks a lot more like an ideological assertion that a the working class should absorb inflation, while others have the right to simply pass inflation on.

COMPROMISING THE WORKING CLASS

Still others are concerned that fixating on inflation compromises a working-class agenda. I support this idea if inflation benchmarking is the only pillar of a collective bargaining strategy. It would however be contradictory to suggest that inflation is not an important benchmark in wage negotiations. The inflation rate simply determines the effect on real wages of any wage increase.

Unions should be familiar enough with inflation to make use of it for members. But trade unions should also be developing alternative approaches to wage bargaining that allow for a share in the wealth that is produced, which goes beyond the cost of living.

There are a number of questions to ask when pursuing such an agenda. Are unions using bargaining models which link remuneration to value added and to the profit margins of the enterprise in question? What shapes are these models taking? Is there any productivity bargaining taking place in South Africa? What are the advantages and dangers of existing models to workers' interests?

The challenge is for unions to open up spaces and share experiences on these issues. Unions need to unlock the political will to break new ground in bargaining strategies which will take their members beyond cost of living increases.

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Stats SA calculates inflation for 5 expenditure groups

		Annualised CPIX July 2008	Monthly expenditure range	Expenditure group index minus average CPIX
Expenditure Groups	Very Low	15.3	0 to R948	2.3
	Low	15	R949 to R1,684	2
	Middle	14.2	R1,685 to R3,004	1.2
	High	13.4	R3,005 to R7,539	0.4
	Very High	12.7	R7,540 plus	-0.3
	Average CPIX	13	-	-