

# Price inflation and wage growth in egypt



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## **ABSTRACT**

This paper is going to use granger causality test to test causality between price inflation and wage growth in Egypt. To measure the inflation we use two indicators which are the consumer price index (CPI) and the wholesale price index (WPI).

Wages are classified into public and private sectors wages, and in this study it's found that changes in public sector wage are independent from changes in price, but that in case that wages in this sector are not determined by market force.

Price inflation is caused by growth in private sector wages, but wage growth is a function of lagged changes in prices instead of expected inflation rates.

Inflation can be caused by many other factors than wages, danger of declining standards of living is managed by the delay in the response to inflation and pulling more and more people to poverty, although a great and a very important role in adjusting wages to current inflation can be played by collective bargaining and strengthening trade unions.

A law that carefully adopts and regulates the practices of collective bargaining and organizes a legal framework that guarantees workers' rights is essential, in addition to imposing a minimum wage to ensure a minimum living standard for the workers and will help workers to be efficient in work.

## **INTRODUCTION**

Economic literature identified many factors that are effective to price changes, these factors includes

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1- rising labor cost

2- changes in import prices in an open economy

3- changes in exchange rate

4- supply shocks

5- excess demand generated by fiscal and monetary policies

This research will focus on # 1 which is the labor cost , trying to identify if wage inflation is a cause or a effect of price inflation

Theories that support that wage inflation leads to price inflation consider wages as a cost factor , whose growth will cause price inflation , otherwise , alternative theories suggest that inflatin results from aggregate demand , which apply pressure on prices to rise them .

On ome hand , employers demand more labor to increase the increase in demand for products , which increase the scale pressure on wages . in the other hand , the increase in prices will decrease real wages , forcing workers to demand higher wages in the future and this view supports that price inflation cause wage inflation .

The whole purpose is to indentify causality effect and measure the wage growth as an indicator of short run price changes in us , Ireland

## 2. Inflation theories

### 2. 1. The Cost-Push Inflation Theory

Cost push inflation happens when the cost of production inputs is high so it decreases in aggregate supply in the economy , so because the goods produced is decreases (supply weakens) and demand for these goods remains consistent , the prices of finished goods increase and that's how the inflation occurs .

it is believed that if wage costs increases faster than productivity , the price might increase as the firm increases wage costs in the form of higher product prices , therefore changes in productivity and wages will be the indicator of future inflation .

in the meantime , there are boundaries to this cost-push inflation theory . to determine the prices , there are many factors used , the most important one is the wages , since they affect firms marginal costs . however sometimes higher wages may not cause inflation . if monetary policy tries to stabilize inflation , the effect of high wages is apparently eased . and also if the negotiations over wages between the workers and the firms in different sectors of the economy are not synchronized , different sectors are also effected by the relative prices of products . this relative price tend to reduced the effect on inflation . even if the wages negotiations were synchronized , different labor unions might have different powers of market . this might lead to higher wage increase later in the sectors with quite high market power , and as long as wages aren't perfectly linked , there will be a relative price effect “ Jonson and Palmqvist 2004 “, after that It will be more difficult to monitor the effect of wage inflation on price inflation , but this <https://assignbuster.com/price-inflation-and-wage-growth-in-egypt/>

effect will differ from one sector to another, leaving the final effect on prices unknown.

## **demand pull inflation**

occurs when price levels rise because of an imbalance in the aggregate supply and demand. When the aggregate demand in an economy strongly outweighs the aggregate supply, prices increase. Economists will often say that demand-pull inflation is a result of too many dollars chasing too few goods.

The theory of the inflation process is that it is caused by additional aggregate demand, this theory doesn't agree with the expansionary monetary policy increases aggregate demand to put pressure on the prices to increase, more labor are hired and attracted by the companies by offering higher wages, unless the elasticity in labor supply high so wages could rise.

Labor will negotiate for higher wages in the future cause the prices will increase, under such studies, there is an early indicator of inflation which is change in wages.

### **EMPIRICAL TESTS AND COUNTRY EXPERIENCE :**

Proves that at investigating the empirical link between price inflation and wage growth to recognize causality effects and find out the significance of wage growth to indicate changes of price in short run in Ireland, Switzerland and the UK, in this paper it will only be established on Ireland, most of those countries used the Granger-causality model that is based on

Expectations -augmented Phillips curve model of the inflation process , in accordance with this model , productivity -adjusted labor costs are marked up over by prices .

Mostly , empirical proofs showed that price inflation leads to wage growth where the influences of wage growth on price inflation is more than just a study

Empirical literature says that higher wage growth doesn't cause higher inflation . wage growth granger -causes inflation said the economic literature .

Switzerland :

IN Switzerland they constructed nominal hourly wages and unit labor cost , it was constructed from 1975 to 2005 to investigate the linkage between wage growth and CPI inflation to recognize causality effects and the consequence of wage growth as predictive indicator or short run price changes , proofs found that price inflation control wage growth where the control of wage growth on price inflation is more sensitive in the sample period .

Development of prices and wages in the Egyptian economy :

As measure by rate of change in CPI , inflation rates have considerably slowed down in the 1990's compared to the 1980's , when it achieved 20-24 % during late 1980's . and it looks like it started to accelerate again in the past 5 years , reaching to 17 % in 2004 , and more to 7% in last two years as shown in the table below . The step-up inflation happened because of the oil

subsidy cuts and their spread out effects on communications and transportation and so many other related things

Wages are the main source of income for most of the Egyptian households . wages are growing since 1990 at different rates in the public and private sectors in 2005 public sector average wage was one almost double the private sector average wage