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SPECIAL STUDY No. 4

Incomes Policies

Some Foreign Experiences and Their Relevance for Canada

by

David C. Smith

prepared for the

Economic Council of Canada

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October, 1966

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Foreword

The recurrent difficulties that modern industrial nations face in attaining price stability, consistently and simultaneously with other economic goals, have led in recent years to a widespread interest in the possible use of "incomes policy" to supplement the existing tools of economic policy. In Canada there has been a great deal of discussion in this area, particularly during the past year; the experience of other countries has captured the attention of many government, business and labour leaders. Clearly, the debate would be encouraged by and would benefit from a wider public understanding of the issues involved.

Only recently has a body of economic analysis begun to emerge in this field. Until now, there has been no comprehensive study which examined the many issues surrounding the use of incomes policy in a manner directly relevant to Canada's constitutional position and special economic circumstances.

In 1965 the government requested the Economic Council of Canada to undertake a broad examination into prices, costs, incomes and productivity, and their relationship to sustained economic growth. As one part of this general inquiry, the Council was asked "to review the policies and experiences of other countries in this field and their relevance for Canada".

The Council requested David C. Smith, Professor of Economics, Queen's University, to make the detailed examination necessary to assist the Council in reporting on this particular aspect of the government reference. Professor Smith's study is based in part on discussions with authorities on the subject in management, labour, government and universities abroad. This comprehensive survey has been of substantial assistance to the Council in formulating the views and recommendations contained in its *Third Annual Review*. Although this special background paper by Professor Smith is being published under the auspices of the Council, the views and conclusions in it remain his own.

John J. Deutsch
Chairman
Economic Council of Canada

ACKNOWLEDGEMENTS

This study was greatly assisted by many people in labour, management and governmental organizations and in the universities of a number of countries. It is easy to acknowledge specifically in the following the contributions from published material but not those from personal discussions in the countries. The latter have nevertheless been of particular importance for this study.

The author also wishes to express his appreciation to the Economic Council of Canada for the support of an independent study of the topic.

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Chapter 1

Introduction

The continual search for better national economic policies is influenced by the types of policies in other countries. As a result, the changing fashions in economic policies in the past have frequently had an international rather than a purely national character. Some have brought economic benefits; others clearly have not. Some have soon been discarded, while others have become, usually in modified form, a more permanent feature of a country's policies. Foreign experience has thus been an important, at times a useful, at times a dangerous, source of influence on the development of national economic policies.

A good example of the significance and difficulties of determining the relevance for Canada of foreign economic policies is the current interest in incomes policy. A number of western countries have been experimenting recently with a type of economic policy most frequently referred to as incomes policy, national wage-price policy, or wage-price guideposts. In public discussions, it has not always been clear what a country has to do to be classified as having an incomes policy, but there is little doubt that Canada and some other western countries have been hesitant to venture into this form of policy in relatively normal peacetime conditions. Yet, the force of foreign examples and fears of stronger inflationary pressures in the future than were experienced during the first half of the 1960's have stirred a greater interest in this type of anti-inflation policy in Canada, particularly during the past year.

Publicity about foreign efforts has been especially unsettling for the Canadian position of indifference to this form of policy. In view of the United States' wage-price guideposts, the recent British efforts with incomes policy and the discussions and applications of incomes policies in other countries, should not Canada be attempting to seize some of the advantages which other countries apparently have felt can be gained from this form of policy? Reports of the Organisation for Economic Co-operation and Development which have supported incomes policies for all member countries, including Canada, and which have pointed to Canada as being one of the few exceptions in the recent wave of interest in this type of policy, have added to the importance of this question.

If it is felt in a country that a superior form of economic policy, such as incomes policy, has been developed abroad, pressures mount for a revision in the conduct of the country's policies. These pressures, not entirely unlike those which exist in private markets for goods and services, are important for transmitting more broadly the benefits of improved techniques, but they can also be easily misdirected in the area of national economic policies because of the difficulties of discovering and making known the welfare gains or losses from new types of policies. The alleged superiority of a particular form of economic policy abroad may be based on misinterpretations of its nature and actual advantages in other countries, or on mistaken notions about its relevance for an environment in which the economic and noneconomic goals, institutions, resources, and state of economic conditions are quite different.

This study explores the question of what Canada can learn from recent foreign experience with incomes policy, but a few points of caution are in order at the outset:

First, *incomes policy* is a highly abstract term that may be used to represent a wide range of possible policy approaches. If there is scepticism about trying in Canada anything similar to the forms of incomes policy currently practised abroad, this does not exclude the possibility of other approaches which some might not call incomes policy but which others might find it convenient to do so. The trouble with abstract terms such as *incomes policy* and *economic planning* is the public confusion that often arises from the varying usage of them.

Second, there will obviously be a great diversity of views in every country about the usefulness of particular types of policies, and incomes policies are in an unsettled state in all the countries reviewed here. In examining foreign experiences the intention is not to evaluate the wisdom of the policies pursued but to try to extract, from the developments up to now, general points that are relevant for others.

Third, since noneconomic as well as economic factors, distinctive features of economic institutions, and Canadian constitutional issues will all influence the desirability of any kind of economic policy, there are many factors outside the main focus of this study that will be important in judging the value of some form of incomes policy in Canada. The views expressed in this study are, of course, not necessarily those of the Economic Council of Canada.

Thus the purpose of this study is to examine the arguments that have been advanced on both sides of the case for an incomes policy, to indicate some of the various forms and effects this type of policy has had abroad, and to suggest a few implications of foreign experiences for current Canadian discussions of incomes policy.

MEANING OF INCOMES POLICY

The first problem is to decide on the meaning of incomes policy. The initial general impression is one of considerable confusion over the content of the term. The variety of other titles – national wage policy, national wage-price policy, wage-price guideposts, guiding lights for wage and non-wage incomes – attests to this.

Obviously, governments have long been concerned about the appropriate development of incomes and prices. They have frequently in the past exhorted labour and management to exercise restraint on pay claims and prices, and have often attempted through moral suasion and legislation to improve collective bargaining arrangements. Labour and management organizations generally have some views about the appropriate course of wages, profits and prices and attempt to gain support for them both through private policies and through influencing government decisions. Everyone is concerned about means of avoiding waves of disruptive strikes over pay claims. Governments have many specific policies to affect incomes and prices in particular sectors, have intervened frequently in labour disputes, and have had to develop some form of wage policy for their own employees. Are all these things incomes policy? If incomes policy is defined simply as a policy concerned with the development of incomes and prices, then the term would include most government economic policies, such as monetary and fiscal policies, commercial policy, exchange rate policy, and combines policy. As others have remarked, some may at times use the term only to describe something that governments have been doing for a long time, a problem of terminology like the case of Molière's character who discovered to his surprise that he had been speaking prose all his life.

A more specific meaning of incomes policy has, however, gained wide currency and will be used in this study. In a report, the Organisation for Economic Co-operation and Development defined it in the following way:[1]

> What is meant by an incomes policy . . . is that the authorities should have a view about the kind of evolution of incomes which is consistent with their economic objectives, and in particular with price stability; that they should seek to promote public agreement on the principles which should guide the growth of incomes; and that they should try to induce people voluntarily to follow this guidance.

[1] Organisation for Economic Co-operation and Development, *Policies for Price Stability* (Paris, 1962), p. 23.

In current discussions abroad there appears to be substantial agreement that there are three components to an incomes policy:

First, it must involve the working out of general targets for the whole economy of the appropriate development of the major forms of incomes and of prices. Most frequently, this has taken the form of targets for compensation to employees, which is the largest component of income, and for prices, since other incomes depend on the relation between prices and compensation to employees.

Second, to make these over-all targets meaningful for individual decisions, a finer breakdown of them into guides for wage and price decisions is necessary. Should the principles that guide compensation to employees in various sectors be expressed in terms of the national targets, or are there principles that should permit differentiation in the development of incomes by sectors? If the target is general price stability for the economy, what are the principles that should guide particular prices, and might it be desirable to add separate guides for some components of nonwage incomes?

Third, there must be some devices that can be expected to induce people to follow these guides and thus behave differently than they would in the absence of incomes policy. Emphasis has been placed on the use of moral suasion rather than direct controls, but some forms of persuasion are stronger than others. In countries that have attempted an incomes policy for any length of time it has been clear that various types of sanctions have had to be developed for the policy to have much effect. They may include, for example, public exposure and condemnation of wage and price decisions inconsistent with the guides, prior notification and deferment of wage and price decisions, strong government pressures through purchasing and stockpile policies, selective tariff or export subsidy changes, and selective use of anti-restrictive-practices policy. A number of measures may thus be employed besides statutory powers to limit wage and price changes.

While this definition narrows considerably the discussion of incomes policy there are many who argue for an even stricter definition. For example, it is sometimes suggested that there can be an incomes policy only if there is a comprehensive, rigorous form of national economic planning. Under the definition used in this study the United Kingdom and the United States could be said to have had an incomes policy at times in the post-war period. However, some disagree with this position, holding that the only western country that has practised an incomes policy for a significant period of time in the post-war years has been the Netherlands. A study of British incomes policy, published at the beginning of 1966, concluded that "despite all the declarations, speeches, resolutions, reports and machinery, the truth is that Britain has no incomes policy".[1] It is suggested here, however, that the definition does provide a useful screening of the minimum components of an incomes policy, although the form and sources of interest in it can still vary greatly.

SOURCES OF INTEREST

Interest in incomes policy has been stimulated principally by the desire to reduce the rate of general price increase at high employment levels. Clearly, in this context, incomes policy cannot be studied in isolation from other economic policies. The seriousness of the apparent conflicts among the objectives of price stability, a satisfactory balance-of-payments position, and full employment will depend on the mix of other economic policies. It is usually agreed that very rapid price increases or high unemployment rates are best tackled by more appropriate monetary and fiscal policies. Incomes policy is suggested as a supplement to reduce the pressure on wages and prices when neither large excess nor deficient demand conditions are being experienced. Attention to incomes policy has been particularly strong in most countries when, at rates of unemployment that are generally regarded as about right, undesirably large price increases, particularly in relation to the balance-of-payments position, are encountered, and there is a reluctance to use general deflationary policies or more direct measures to improve the balance of payments.

Conceptually, then, several questions can be identified as being important for an over-all assessment of the usefulness of incomes policy. How serious are the conflicts between price stability and low unemployment rates, given a proper management of general aggregative economic policies, and what is the relative importance of price stability and unemployment in public preferences? If there is a strong commitment to a low unemployment rate but price increases are being experienced that are opposed, for example, because of balance-of-payments difficulties, is incomes policy an efficient instrument for solving the problem without offsetting costs to other objectives, such as growth or freedom in collective bargaining? Might there be other more efficient instruments, such as more flexible exchange rate systems or measures to improve the flexibility and adaptability of the economy? Or is the search for ways to avoid a conflict between price stability and low unemployment rates dangerously diverting attention from the hard choices that have to be made in national economic policies?

Other sources of interest in incomes policy have not been insignificant and should be mentioned because they have played some role in the countries reviewed in this study.

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[1] John Corina, *The Development of Incomes Policy* (London: Institute of Personnel Management, 1966), p. 54.

First, incomes policy has sometimes been viewed as a vehicle for improving the growth of productivity in an economy. In many countries there has been a serious and growing concern about the rigidities in economic adjustment processes in both labour and product markets. Lack of adaptability to economic processes impairs the rate of economic growth, raises the rate of price increases for given unemployment rates, and makes a country more vulnerable to balance-of-payments difficulties. The question is not whether these rigidities are unimportant but whether incomes policy does anything to reduce them. Generally, the answer is vague, but some suggest that the process of working out guides for incomes will induce management and labour to co-operate on matters that will improve productivity. This argument has been particularly noticeable in the United Kingdom. Others suggest that such co-operation can have the reverse effect and introduce new rigidities.

Concern over these rigidities need not lead to support of incomes policy, but rather to other approaches such as competition policy, labour market policy and commercial policy. Sweden, for example, has paid a great deal of attention to the improvement of the adaptability of the economy in order to facilitate growth, but there has been no official incomes policy and clearly little interest in incomes policy as a device for improving productivity.

Second, interest in incomes policy has at times been stimulated by questions about the appropriate long-run distribution of income. Usually this interest has focused on questions about the primary distribution of income as determined by the wage and nonwage income structure but, recently, in the case of France, for example, it has also included discussions of the redistribution of primary income through such means as government taxes and transfer payments. To some, this source of interest is unfortunate for it diverts attention from the issues of incomes policy as a stabilization instrument and plunges the debate into the treacherous area of a good distribution of income, a debate which has historically always generated more heat than light. With some justification others point out that if incomes policy means the setting of guides for the development of various forms of income, the question of its effects on income distribution cannot be escaped anyway.

Thus incomes policy does involve important distribution issues and needs to be integrated with the wide range of social and economic policies that affect the longer-run distribution of income. But, as defined in this study, incomes policy is not a necessary step for tackling the many problems of income distribution which all countries are currently facing and which many types of government policies affect. There are highly important questions about the need for a more specific and better-integrated set of policies to deal with problems of poverty, of incomes in the agricultural sector, of the redistribution of income by age, employment status, region of the country, family conditions, and so forth, but they are not ones on which this study focuses.

Third, it is sometimes alleged that there are noneconomic arguments for incomes policy. The process of working out appropriate guides for incomes, it is argued, may be important for inducing co-operation between management and labour and thereby reducing social conflict and increasing the political stability of the system. It may, on the other hand, be argued that this process can have the opposite results. Incomes policy may also be suggested as a useful device for a government to reduce its exposure to criticism and to gain support for other policies. Thus, more specific economic responsibilities have been assigned to governments in post-war years for maintaining low unemployment rates, high growth rates, balance-of-payments equilibrium and price stability. By suggesting guides for incomes and seeking labour and management co-operation in adhering to them, a government may be able to indicate a larger area of private responsibility for the economic welfare of the nation, and protect itself against as large a loss in popularity if the economy diverges from the professed economic goals. Incomes policy may also have some direct political appeal by conveying to the public the government's concern about inflation even if the policy has no effect.

OUTLINE OF THE STUDY

Clearly one of the problems in discussions of incomes policy is that the phrase has an elusive quality like that of economic planning. Given the above definition, it is important, however, to sort out the principal questions likely to influence one's position on incomes policy. In the next chapter questions about the general case for incomes policy are discussed. How do various views about the causes of inflation have a bearing? Has the recent emphasis on directly influencing nonwage incomes or prices as well as wages, compared with the almost exclusive emphasis on wages in the earlier post-war years, reflected a change in economic reasoning or a strategy argument to gain the support of labour? What are the variables influencing wages and prices that incomes policy is expected to affect? Are there important noneconomic arguments that fall more in the realm of political than economic theory?

The third chapter will examine some of the questions about the form in which incomes policy might be implemented. What kinds of aggregate targets for incomes have been suggested and why may there be difficulties in establishing them? How might guides for specific wage and price decisions be worked out, and is there sufficient knowledge of the functioning of an economic system to be sure that they will not do more harm than good? What kinds of devices may be tried for gaining adherence to the guides, and how important is the structure of institutions, such as the degree of centralization of labour market organizations, in developing them?

The rest of the study examines how the questions raised about incomes policy have, in fact, been approached in a few foreign countries. Even the most cursory survey of foreign interest in incomes policy indicates that there has been much more talk than action about this type of policy. The Netherlands is the only country which over much of the post-war period followed a strict form of incomes policy. A number of countries have begun, however, some modest experimentation with this type of policy, particularly since the beginning of the 1960's; other western countries remain clearly sceptical.

In this study the countries were selected both because of their range of approaches and their particular interest to Canada: the United States where wage-price guideposts have been used since 1962 and where important claims have been made for their effectiveness; the United Kingdom where the persistent efforts to develop an incomes policy have run into many difficulties in the past but where stronger measures have been introduced this year to try to make it more effective; the Netherlands where incomes policy was of considerable importance over most of the post-war period but where more serious problems in its implementation were encountered in recent years; Sweden where there is, contrary to popular interpretations abroad, no official incomes policy and where there has been so far little support for one, although there is a highly interesting private wage policy developed through the centralized labour market institutions; France where incomes policy is being discussed to a considerable extent in terms of medium-term economic planning and of the appropriate longer-run distribution of income, and where a few steps towards incomes policy have recently been taken.

Aspects of each country's experience that may help to throw some light on the issues raised in this and the next two chapters will be examined, but it is not the intention to make either an extensive study of foreign experience with incomes policy or an intensive study of any one country's experience. The aim is to stimulate discussion about some important questions in the area of incomes policy.

Chapter 2

The General Case for an Incomes Policy

The idea of an incomes or national wage-price policy to help contain inflation is not new, interest in a centralized system of criteria, administered by the government, to govern wage and price movements has a long history, although the sources of interest, the form and the names for it have varied. Historically, attempts to remedy bouts of inflation in various countries have often been in the form of direct curbs on money incomes and prices, especially when there have been severe economic dislocations, such as in wartime, or when it has been generally popular to blame the causes of inflation on basic weaknesses in economic markets that permit profiteering by a few powerful economic groups in the society. But it has also proved to be extraordinarily difficult to maintain for long a central direction of prices and incomes in a free society.

THE RECURRENT INTEREST IN INCOMES POLICY

In its modern from interest in incomes policy arose out of the debates in western countries at the end of World War II about the best means of preventing a return to the high unemployment rates of the 1930's. Many economists in the 1940's argued that success in achieving full employment in the post-war world could mean a more rapid rate of increase of prices. Thus, in his influential work on full employment policy, Beveridge stated:[1]

> . . . there is no inherent mechanism in our present system, which can with certainty prevent competitive sectional bargaining for wages from setting up a vicious spiral of rising prices under full employment.

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[1] William H. Beveridge, *Full Employment in a Free Society* (London: George Allen & Unwin Ltd., 1944), p. 199.

Many others warned of this danger, including Keynes:[1]

> Some people argue that a capitalist country is doomed to failure [in preserving stability of internal prices] because it will be found impossible in conditions of full employment to prevent a progressive increase of wages. According to this view, severe slumps and recurrent periods of unemployment have been hitherto the only effective means of holding efficiency wages [wages per unit of output] within a reasonably stable range. Whether this is so remains to be seen. The more conscious we are of this problem, the likelier shall we be to surmount it.

This concern about the inflationary consequences of full employment heightened interest in new policy measures that might moderate the conflict between full employment and price stability. A national wage policy was widely discussed as one possible device, and it is of interest that attention at this time was focused more on the problem of containing wage increases than of containing increases in nonwage incomes or of direct measures to restrain prices. This emphasis on wages was related to a number of factors: the growth of labour unions in the inter-war period had led to fears about the consequences of greater concentrations of power in labour market institutions; there was the evidence of the mid-thirties that, despite high unemployment, surprisingly large wage increases still occurred; economists in examining problems of full employment and price stability were greatly influenced by the economic theory of J.M. Keynes, in which money wages were not treated as flexible in response to changing economic conditions.

For a number of years after the end of World War II, economists debated the pros and cons of a national wage policy.[2] The problem of moving from a concern about the conflict between price stability and full employment to specific remedies for it proved extremely difficult to resolve. It appears that the negative side of the debate about the merits of a national wage

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[1] John Maynard Keynes, "The Objective of International Price Stability", *Economic Journal*, LIII (June-September, 1943), p. 187. Quoted in H. M. Douty, "Some Problems of Wage Policy", *U.S. Monthly Labor Review*, LXXXV (July, 1962), p. 734.

[2] Among the many important writings on the topic at this time are: H. W. Singer, "Wage Policy in Full Employment", *Economic Journal*, LVII (December, 1947), pp. 438-55; Melvin W. Reder, "The Theoretical Problems of a National Wage-Price Policy", *Canadian Journal of Economics and Political Science*, XIV (February, 1948), pp. 46-61; "Symposium: Wage Policy", *Review of Economic Statistics*, XXIX (August, 1947), pp. 137-60 (articles by S. E. Harris, S. H. Slichter, J. T. Dunlop); B. H. Higgins, "The Optimum Wage Rate", *Review of Economic Statistics*, XXXI (May, 1949), pp. 130-9; Ralph Turvey (ed.), *Wages Policy Under Full Employment*, (London: Wm. Hodge & Co. Ltd., 1952).

policy carried, and interest in further discussion of the topic in professional economic journals declined.

Since the end of the 1950's there has been a renewed interest in the topic in a number of western countries. The persistence of general price increases, difficulties in solving balance-of-payments problems, and a stronger conviction that cost factors have played a significant role in price increases have all been important factors. A study by a group of economic experts for the Organisation for European Economic Co-operation, *The Problem of Rising Prices*, which stressed the role of cost factors in causing inflation and which recommended national wage policies, appears to have had a large influence since its publication in 1961.[1] In general, however, a greater interest in incomes policy in recent years seems to have arisen more from the frustrations that governments have experienced in trying to meet an ambitious set of economic objectives – in keeping economies at full employment levels while maintaining reasonable price stability and a satisfactory balance-of-payments position – than from significant new theoretical insights in support of incomes policy.

POST-WAR PROBLEMS OF CONTAINING INFLATION

In western countries reviewed in this study, inflation has been moderate but persistent during the post-war period, even since the special pressures from post-war reconstruction and the Korean war were removed. However, there has been no evidence to support the fear that toleration of moderate inflation is bad because moderate inflation inevitably leads to runaway inflation.

In Tables 2-1, 2-2 and 2-3, annual percent changes in three major price series – the consumer price index, the wholesale price index, and the implicit price index for Gross National Product – are given for selected western countries for 1950-65. It is evident that the Canadian performance on prices, in relation to the other countries, has been quite good, and that general price increases in North America have been relatively small from the end of the 1950's to the mid-1960's. Of interest, but not surprising, is that incomes policy alone has clearly not been the panacea for inflation. In the Netherlands where a strict form of incomes policy existed over most of the post-war period, general price increases over the past 15 years have been higher than in some other countries, including Canada and the United States, although this of course is not a sufficient test for its effects.

[1] William Fellner *et al.*, *The Problem of Rising Prices* (Paris: Organisation for European Economic Co-operation, 1961).

TABLE 2–1

Annual Per Cent Changes of Consumer Price Index
Selected Countries 1950-65

Year	Canada	United States	United Kingdom	Netherlands	Sweden	France	Germany (F.R.)
Average Annual Rate of Increase 1950-55	2.50	2.17	5.50	3.79	5.66	5.43	1.93
	(Annual per cent increase from preceding year)						
1956	1.5	1.5	4.9	1.1	3.6	1.9	2.5
1957	3.1	3.5	3.8	6.7	4.6	2.7	2.0
1958	2.6	2.7	3.0	2.1	5.5	15.1	2.2
1959	1.1	0.8	0.5	1.0	0.0	6.2	0.9
1960	1.2	1.5	1.0	2.0	4.2	3.6	1.4
1961	0.9	1.1	3.4	1.0	3.0	3.3	2.3
1962	1.2	1.1	4.3	2.0	3.9	4.8	3.0
1963	1.8	1.3	2.0	3.9	2.8	4.8	2.9
1964	1.8	1.4	3.3	5.6	3.6	3.4	2.4
1965	2.5	1.6	4.8	5.3	5.3	2.5	3.4
Average Annual Rate of Increase 1955-65	1.77	1.64	3.09	3.06	3.63	4.79	2.31

Source: OECD, *General Statistics* and *Main Economic Indicators*.

TABLE 2–2

Annual Per Cent Changes of Wholesale Price Index
Selected Countries 1950-65

Year	Canada	United States	United Kingdom	Netherlands	Sweden	France	Germany (F.R.)
Average Annual Rate of Increase 1950-55......	0.68	1.43	3.82	3.21	5.72	4.68	3.42
	(Annual per cent increase from preceding year)						
1956...........	3.1	2.9	4.6	0.0	4.4	3.7	0.5
1957...........	2.7	3.6	3.8	2.0	3.2	4.8	1.8
1958...........	0.2	2.3	1.2	-1.0	1.0	6.6	0.1
1959...........	1.4	-0.2	0.7	0.0	0.0	6.8	-1.0
1960...........	0.2	0.8	1.5	0.0	2.0	3.7	1.7
1961...........	1.0	0.0	2.7	0.0	3.0	3.0	2.3
1962...........	1.8	0.3	1.3	1.0	2.9	1.1	2.2
1963...........	2.1	-0.3	0.7	2.0	2.8	3.0	1.1
1964...........	0.9	0.4	2.7	5.8	3.7	2.4	0.8
1965...........	1.8	1.8	3.8	2.8	2.7	0.5	2.4
Average Annual Rate of Increase 1955-65......	1.52	1.15	2.28	1.24	2.60	3.54	1.21

Source: See Table 2–1.

TABLE 2–3

Annual Per Cent Changes of Implicit Price Index for GNP Selected Countries 1950-63

Year	Canada	United States	United Kingdom[a]	Netherlands	Sweden	France	Germany (F.R.)
Average Annual Rate of Increase 1950-55......	3.67	2.53	5.01	3.94	6.19	6.34	3.47
	(Annual per cent increase from preceding year)						
1956...........	3.9	3.4	6.2	3.3	4.8	5.0	3.3
1957...........	3.1	3.7	4.0	5.4	3.7	6.0	3.2
1958...........	1.8	2.5	4.5	2.0	3.5	12.4	3.1
1959...........	2.6	1.7	1.5	2.0	1.0	6.0	1.0
1960...........	1.5	1.6	1.5	2.0	4.0	2.8	3.0
1961...........	0.7	1.3	3.2	1.9	2.9	3.7	3.8
1962...........	1.5	1.0	3.5	3.8	5.6	4.4	4.6
1963...........	1.8	1.4	1.8	4.5	3.5	5.1	2.7
Average Annual Rate of Increase 1955-63......	2.09	2.07	3.28	3.11	3.59	5.64	2.97

[a] Annual per cent changes of implicit price index for Gross Domestic Product from 1956.
Source: See Table 2–1.

The rate of general price increases has been one important economic indicator that has been combined with others in judging the success of government economic policies. An important feature of post-war economic policy discussions has been the development of more specific quantitative economic goals against which to judge the actual performance of the economy. There has been both a large increase in available data on unemployment, prices, and growth that permit a constant testing of the direction of the economy in relation to the recent past and in relation to other countries, and, also a more specific assignment of economic responsibilities to governments to ensure a satisfactory national performance in terms of these indicators. The economic goals have not emerged, however, as fixed, objective aims to which governments have rigidly committed themselves, and they have been strongly influenced both by the recent experience of the country and also by the recent experiences of other countries. Unemployment rates in some West European countries, for example, have been well below what was thought to be either possible or desirable at the end of World War II, but, given this experience in a country with low rates and the experience of other countries with low rates too, the scope for governments to allow rises in the unemployment rate in any one country is more limited. Thus the pressures from public comparisons tend to fix more specific limits to the variation in the main economic indicators that are commonly regarded, for reasons that are not always too clear, as important for economic welfare.

Most western governments have repeatedly professed a desire for greater price stability than has actually occurred but none has been prepared to take the courses of action that would bring price stability. This objective has not in practice been easy to achieve for a variety of reasons:

–Attempts to curb price increases have usually, at least in the short run, conflicted with other objectives. Deflationary policies generally have some unfavourable effects on the unemployment rate. Direct controls impinge on freedom of choice, as well as suppressing only for a while the manifestations not the causes, of inflation. Periodic short-run deflationary policies, often referred to as "stop-go" policies, have been opposed on the grounds that they are unsettling to growth processes.

–Price stability is a difficult objective for one country to tackle alone, particularly if the country is highly dependent on international trade. The rate of increase of prices in an open economy will depend heavily on price movements in countries with which it trades, especially if the exchange rate is kept relatively fixed. Clearly, in the case of the Canadian economy, for example, the rate of increase of prices in other countries, especially that of the United States, has a major impact on Canadian price increases.[1]

[1] See, G. L. Reuber, R. G. Bodkin, E. P. Bond and T. R. Robinson, *Empirical Study of Wage-Price-Employment Interrelationships in Canada* (Economic Council of Canada: forthcoming).

TABLE 2–4

Unemployment Rates as Published, 1951-65 and after Adjustment to U.S. Definitions, 1959-65

Per Cent

Year	Canada	United States	United Kingdom	Nether-lands	Sweden	France	Germany (F.R.)	Canada	United States	United Kingdom	Sweden	France	Germany (F.R.)
	As Published							Adjusted to U.S. Definitions					
1951.....	2.4	3.3	1.2	2.3	1.8		9.0						
1952.....	2.9	3.1	1.7	3.5	2.3		8.4						
1953.....	3.0	2.9	1.7	2.8	2.8		7.5						
1954.....	4.6	5.6	1.4	1.9	2.6		7.0						
1955.....	4.4	4.4	1.1	1.3	2.5		5.1						
1956.....	3.4	4.2	1.2	0.9	1.7		4.0						
1957.....	4.6	4.3	1.5	1.2	1.9		3.4						
1958.....	7.0	6.8	2.0	2.3	2.5		3.5						
1959.....	6.0	5.5	2.2	1.8	2.0	1.3	2.4	6.0	5.5	3.1	n.a.	2.8	1.6
1960.....	7.0	5.6	1.6	1.2	1.4	1.3	1.2	7.0	5.6	2.4	n.a.	2.6	0.7
1961.....	7.1	6.7	1.5	0.9	1.2	1.1	0.8	7.1	6.7	2.3	1.5	2.3	0.4
1962.....	5.9	5.6	2.0	0.8	1.3	1.2	0.7	5.9	5.6	2.9	1.5	2.5	0.4
1963.....	5.5	5.7	2.4	0.9	1.4	1.3	0.8	5.5	5.7	3.4	1.7	2.8	0.5
1964(1)...	4.7	5.2	1.8	0.8	1.1	1.1	0.7	4.7	5.2	2.4	1.6	2.3	0.4
1965(1)...	3.9	4.6	1.5	0.9	1.1	1.3	0.6	3.9	4.6	2.2	1.2	2.8	0.4

(1) Preliminary.

Source: As published figures from International Labour Office, *Yearbook of Labour Statistics*, various issues. Adjusted figures, and as published figures for France, from Arthur F. Neef, "International Unemployment Rates, 1960-64", *Monthly Labour Review*, March 1965, p. 258 and Arthur M. Ross, "Guideline Policy – Where We Are and How We Got There", in *Guidelines, Informal Controls, and the Market Place*, eds. George P. Shultz and Robert Z. Aliber (Chicago: University of Chicago Press, 1966), p. 131.

–The meaning of price stability has not been too well defined. There is no single, perfect measure of the degree of price stability in a country. The coverage and biases in the construction of indexes create problems. Usually the over-all movements in the major indexes, including the consumer, wholesale, and implicit price indexes, need to be examined, Even then, if the source of concern about price stability is the balance-of-payments situation, more specific indexes for the prices of internationally traded goods will be important to examine, since experience has shown that these do not always move closely with the other major price indexes. Further, it is clear that a fixed absolute level of general prices would not be a desirable objective. Not only will a continual movement of relative prices be an essential mechanism for allocating resources but also some movement of the general level of prices will be important for adaptation to changing internal and external economic conditions. While interest in the topic has waned, there were important debates not so long ago about whether or not there was some appropriate trend rate of decrease of general prices.

–Since price stability must be viewed in the context of a number of economic objectives which may conflict, the emphasis placed on it in public preferences, particularly in relation to a low unemployment rate, becomes important. In most western countries a low unemployment rate has been a particularly important objective over the post-war period, and the general impression is that this objective has been given greater weight in many of the West European countries than in North America.[1] (An attempt has been made to convert the widely differing measures of national unemployment rates to a common measure and these are given for selected countries in Table 2-4.) Memories of the grave hardships suffered during the high unemployment of the 1930's have been an important factor in this post-war emphasis on low unemployment rates, and these may fade as a new generation assumes leadership roles. But earlier fears of the serious consequences from moderate rates of inflation, such as western countries have experienced in the post-war period, have also decreased. There has been no obvious evidence that moderate rates of price increase have been injurious to growth. Moderate rates of inflation have not automatically turned into runaway inflations. The general price increases have not caused large shifts in the distribution of incomes, such as from wages to profits, and government welfare measures have helped, in part at least, to compensate losers from inflation. But these points do not mean that concern about the dangers of inflation has disappeared. Depreciation in the value

[1] For example, after allowing for differences in official measurements of unemployment, R. A. Gordon concluded: "European countries set their full employment goal at a lower unemployment rate than does the United States, and they have in recent years been more successful in achieving the goal." R. A. Gordon, "Full Employment as a Policy Goal", in Arthur M. Ross (ed.), *Employment Policy and Labor Market* (Berkeley: University of California Press, 1965), p. 42.

of money imposes costs on holding money. Varying rates of price increases are unsettling and costly to financial planning. Disruptive balance-of-payments difficulties may be encountered. An ingrained fear of inflation remains an important source of pressure on the formation of public policies.

The search for improved policies to deal with inflation thus remains important, and in recent discussions the search has followed a number of routes. One is to accept the present evidence of conflicts among economic objectives and to provide better information about them in order to aid in the difficult policy choices that have to be made. Considerable attention has been paid to estimating from the past both the apparent conflicts between price stability and other objectives, such as low unemployment, and also the relative costs to society of a slightly lower or higher performance on these objectives.[1] Second, closer study of the mix of aggregative policies may reveal that there is room for reducing the conflicts that appear to have existed in the past between, for example, price stability and full employment. There are various ways through which monetary and fiscal policies may affect the rate of price increases, and not all will have the same effect on the relation between the unemployment rate and the rate of increase of prices. Third, improvements in economic adjustment mechanisms may not only modify the rate of price increases associated with given unemployment and growth rates, but also make the economy less susceptible to balance-of-payments difficulties at given rates of increase of prices. Improved commercial, competition and labour market policies would be included in this approach. Fourth, some form of incomes policy to attempt to affect directly the movement of earnings and prices may be proposed.

Interest in this fourth route – incomes policy – will be influenced by the degree of public pressure to try to achieve a more ambitious set of economic policy objectives than seems to be currently possible with existing economic policies. The development of more specific quantitative policy objectives in the post-war period has increased the importance of a wider range and more skilful use of economic policy instruments. But, also there have often been important constraints on the use of economic policy instruments which may cause difficulties by increasing the number of objectives relative to the means for achieving them. For example, in western countries particular concern about moderating the rate of price increases has emerged when balance-of-payments difficulties have been encountered. The real adjustments that are required may be hampered by constraints on monetary and fiscal policy, arising from public pressures for a low unemployment rate, public myths about the appropriate budget balance or level of interest rates, and an unwillingness to let an exchange rate adjustment

[1] An important study in this vein is G. L. Reuber, "The Objectives of Monetary Policy", Working paper prepared for the Canadian Royal Commission on Banking and Finance (Ottawa: mimeo., December, 1962).

help, due to a belief in the virtues of an unchanged rate. Under such conditions there is an increased interest in searching for new devices. Various new ones may be suggested, but it has been under these kinds of conditions that much of the interest in incomes policy has been generated.

The suggestion that incomes policy can moderate the rate of price increases without offsetting costs to other objectives, and can thus make possible a more ambitious set of economic objectives, has an obvious appeal. But is it true? To explore this question it is necessary first to consider some of the differences in views about the way inflationary processes work.

SOME RELEVANT ISSUES ABOUT THE CAUSES OF INFLATION

The case for incomes policy rests in part on the importance of income and price decisions as an independent source of inflation. This is not the place to attempt a detailed review of the vast amount of theoretical and statistical literature on the causes of inflation,[1] but a brief discussion of some of the issues relevant for incomes policy cannot be avoided.

(a) The Role of Monetary Demand Conditions

"Things are usually not what they seem to be" has long been a theme of theoretical investigations into the way economic processes influence the general level of prices. Although individual wage and price decisions may appear to bear little relation to general economic conditions, economists have long pointed to the complex system of market forces that determines the general pattern of relative wage and price movements, and which makes the general level of wages and prices depend on monetary demand conditions in the economy.

The general price level will depend on the flow of money payments in relation to the flow of goods and services, and thus if the flow of money payments is rising relatively more rapidly, increases in the general price level will occur. Since it is true by definition that money payments will be split up in various forms of money incomes, it follows that if the flow of money incomes is rising more rapidly than the flow of goods and services, prices will be rising. While both these statements are true they tell us nothing about the causes of general price increases. Is the cause of inflation that monetary demand is rising more rapidly than output, and that

[1] Among the important reviews of this literature are: Martin Bronfenbrenner and F. D. Holzman, "Survey of Inflation Theory", *American Economic Review*, LIII (September, 1963), pp. 593-661; Fritz Machlup, "Another View of Cost-Push and Demand-Pull Inflation", *Review of Economics and Statistics*, XLII (May, 1960), pp. 125-39; E. V. Morgan, "Is Inflation Inevitable?" *Economic Journal*, LXXVI (March, 1966), pp. 1-15; R. J. Ball, *Inflation and the Theory of Money* (Chicago: Aldine Publishing Co., 1964).

the various forms of money income and prices adjust upwards in response to this? Or is it that money incomes and prices are, for some reason, pushed up too fast and that the necessary monetary demand conditions to maintain this are induced? Clearly the answer cannot be determined by looking at individual wage and price decisions. The standard justification for an individual price increase is that costs have gone up. This explanation can be completely correct in an individual case, since a price rise may be due to a rise in costs of materials, higher wages, or a higher cost of capital. But such observations tell us nothing about the causes of the cost increases, or whether the individual increases are part of a general upward movement in prices or part of the adjustment of relative prices that continuously plays a role in re-allocating economic resources.

The answer must be sought in a more general study of economic relationships. The predominant theme of economic analysis of inflation has been that monetary demand conditions are the key source of inflationary pressures and that money incomes and prices adjust to variations in monetary demand conditions. Those who place primary emphasis on this source of inflation argue that a pushing-up of wages or prices from the supply side may have some short-run effects on inflation and may also have adverse effects on the best allocation of economic resources, but the scope for an independent push from the supply side is severely limited. If in one sector, wages or prices are pushed up through the exercise of market power, the quantity of labour services and output in that sector will not rise as much, but the resources released from that sector will depress the rate of increase of wages or prices in other sectors, that is, relative wages or prices will tend to adjust to absorb the released resources. If, for some reason, the over-all level of wages is pushed up beyond that justified by monetary demand conditions and there is no induced expansion of monetary demand, there will be an increase in unemployment which will in turn check the pressures for a further push from the side of wages. Many economists have agreed, however, that under such conditions, wages may not adjust very quickly to absorb the unemployed resources and that quite long periods of general unemployment could result. But a steady push from the wage side would not lead to a cumulative price rise, because if monetary demand conditions are not expanding, there would be a growing rate of unemployed resources that would curb the wage demands.

Among those who stress the paramount importance of monetary demand conditions in causing inflation, there have been some important differences about the reasons for a more rapid rise in monetary demand than in output. Some economists stress more the crucial role of the money supply.[1] If there

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[1] See, for example, Milton Friedman, ***Inflation: Causes and Consequences***, (Bombay: Asia Publishing House, 1963).

is a more rapid rate of increase of the money supply and the effect of this on total monetary demand is not offset by an increased desire to hold money balances, a higher rate of price increases will result. There is little doubt that no sustained major inflation can occur without an accompanying rise in the money supply, but other economists have attached less importance to the closeness of the link, at least in the short run, between the money supply and prices and have focused more on the relationship between planned money expenditures and given money incomes. If households, businesses, governments, and foreign buyers plan to spend in excess of the current output of goods and services in the economy, general increases in prices can be expected. If expenditure plans are cut back through, for example, a tighter fiscal policy, inflation will be reduced. These differences in view of the closeness of the relationship between changes in the money supply and changes in the general level of prices are not unimportant, but in both cases there is a common emphasis on the primary importance of monetary demand conditions in causing inflation.

The policy implication from this general line of approach is that better control of monetary demand conditions is the main route for better anti-inflation policy. It does not follow, however, that an open economy with a fixed foreign exchange rate will be free to follow much of an independent course on the rate of price increases relative to that of its close trading partners. A reduction in the rate of increase of prices relative to those abroad may progressively increase the country's foreign exchange reserves and lead to pressures for a continual upward revaluation of the exchange rate or to an induced faster expansion of domestic monetary demand conditions and prices. Conversely, a rise in the rate of increase of prices may reduce over time the country's foreign exchange reserves and lead to pressures for a continual devaluation of the exchange rate or to an induced slower expansion of monetary demand conditions and prices. Some variation in the rate of price increases among countries on fixed exchange rates occurs, but the degree of independence for anti-inflation policy is limited, particularly for a highly open economy like the Canadian with its close economic links to the United States.

(b) The Independent Role of Cost Factors

Control of monetary demand conditions can halt any major inflation, but this point is consistent with the view that the actual mechanism by which inflation, particularly mild inflation, is generated may depend on cost factors. Assuming that there is an independent upward push on wages and prices, some general increase in prices will occur but, if there is no accompanying expansion of monetary demand, the price increases will produce a growing unemployment of resources which will in turn ultimately restrain a continued upward push on wages and prices. While there is thus a built-in check to longer-run inflation from the cost side, this may provide little solace to a policy-maker wrestling with the problem of containing inflation in the short run without a rise in the unemployment rate. In addition, if there is some mechanism by which an induced expansion of monetary demand conditions takes place, the inflationary process can continue to occur.[1]

It is important at this point to consider some of the determinants of government decision-making, an area that has long received inadequate attention in the explanation of economic processes. General monetary demand conditions are strongly influenced by government policies. In the pursuit of national economic objectives, the government may respond to pressures from the supply side by increasing aggregate demand in order to prevent the emergence of higher unemployment, and so accommodate a rising level of prices. In other words, the strength of the government's commitment in the short run to a fixed low unemployment rate is an important factor in the scope for a significant push on wages and prices. J.R. Hicks has pointed to this route for the expansion of monetary demand conditions as being of greater importance than in earlier years.[2]

> So long as wages were being determined within a *given* monetary frame-work, there was some sense in saying that there was an "equilibrium wage", a wage that was in line with the monetary conditions that were laid down from outside. But the world we now live in is one in which the monetary system has become relatively elastic, so that it can accommodate itself to changes in wages, rather than the other way about. Instead of actual wages having to adjust themselves to an equilibrium level, monetary policy adjusts the equilibrium level of money wages so as to make it conform to the actual level. It is hardly an exaggeration to say that instead of being on a Gold Standard, we are on a Labour Standard.

In practice, governments, particularly in North America, have not been as rigidly committed to a fixed low unemployment rate as this line of reasoning might suggest. Table 2-4 showed that annual average unemployment rates in Canada have fluctuated between 2.4 and 7.1 per cent in the past 15 years and in the United States they have been between 2.9 and 6.7 per

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[1] An important article on the way a continual inflation may be generated from the cost side is Abba P. Lerner, "Inflationary Depression and the Regulation of Administered Prices", *The Relationship of Prices to Economic Stability and Growth*, Compendium of Papers Submitted by Panelists before the Joint Economic Committee, 85th Congress of the United States, (Washington: U.S. Government Printing Office, 1958), pp. 257-68.

[2] J. R. Hicks, "Economic Foundations of Wage Policy", *Economic Journal*, LXV (September, 1955), p. 391.

cent. The range for European countries in the Table has been much narrower but not insignificant. On the other hand, this evidence does not mean that the money supply and general monetary demand conditions have been left as independent, and as something to which the economic system is expected to adjust. Rather, they have been determined to a considerable extent by the balancing of economic objectives in government economic policies.

Cost inflation models can be constructed, but difficult questions persist about how they can explain the varying rates of inflation and about why wage and price decisions are taken that are inconsistent with market conditions. What determines whether these decisions give rise to a 3 per cent, 4 per cent, or any other rate of increase of prices? Above some point, price increases in an industry, including one in which there is little competition, will no longer be profitable. Why would we therefore expect a push from the price side to continue?

To many economists, difficulties in finding answers to these questions indicate the limited importance of many of the popular arguments about cost inflation, but there may be at least some partial answers that are not insignificant. For example, the routes through which a government reacts to a push on wages and prices from the supply side are usually much more devious than a simple defence of a low national unemployment rate. Through subsidies, tariffs, tax changes and so forth, governments have important effects on demand and employment conditions in individual sectors of the economy. Traditional economic analysis has tended to assume that the painful correctives in market adjustment mechanisms will be allowed to work, but, for social and political reasons, governments frequently step in to prevent these adjustments from occurring. Thus, the adverse consequences on the unemployment of resources from a push on wages and prices in a particular sector above what is justified by market conditions can be prevented by a variety of government initiatives to restore the quantity of output demanded in the sector.[1] Thus, leaders of labour organizations may find it advantageous to press harder for higher wages than would normally be in the interests of the workers in that sector because the laying-off of workers from wages being too high may be offset by public action to ensure jobs for workers in the sector. Businesses may find it easier to give in to larger wage demands and raise prices if it is expected that government policy will support output and employment in the sector. The cumulative effect of this action in various sectors will tend to be a higher rate of increase of prices.

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[1] In economic terms government protection of employment of labour and capital by sector means wage and price decisions will be influenced not only by the shape of given demand curves but also by the right-ward shift of demand curves induced by moving up the given demand curves.

Thus while governments have placed particular emphasis on maintaining low unemployment rates and on easing the impact on particular groups of economic adjustment processes, these highly important objectives may nevertheless pose more difficult issues for anti-inflation and growth policies. They can strengthen the forces that are usually included under cost inflation analysis and they may make the necessary resource re-allocations associated with growth more difficult. Clearly, much will depend on whether the types of government measures to ease the impact of economic adjustment mechanisms facilitate, at the same time, the movement of resources, or whether they simply shore up inefficiencies.

Also, a particular difficulty in translating economic analysis of the causes of inflation to policy prescriptions is that much of economic analysis in the past has focused on the final outcome of the working of economic adjustment processes in the long run, whereas policy is greatly influenced by short-run considerations. Less attention was paid, until recently, to the determinants of the rate and timing of wage and price changes which will, in fact, be extremely important for economic policy.

The timing and pace of price movements will be sensitive to a wide range of factors that are largely overlooked in analysis that focuses on long-run equilibrium positions – factors such as conventions about major wage negotiations, strategies about the best timing of both wage and price adjustments, changing expectations, the bargaining strength of organizations to press quickly for income adjustments in disequilibrium situations, and union rivalries for wage increases.

Much recent discussion of short-run inflation has proceeded in terms of a distinction between demand-pull and cost-push factors,[1] but both conceptually and statistically, the distinction has been hard to maintain. While economic adjustment mechanisms assumed in traditional economic analysis of inflation work slowly and imperfectly, the timing of wage and price decisions will be greatly influenced by short-run strategies. Thus, a price or wage increase in a major industry that may appear to be totally unjustified on the basis of current market conditions may be simply part of a gradual adjustment to past changes in demand and cost conditions. On the other hand, the increase may be an exploitation of a new protected position for the industry that has increased its market power or the result

[1] There are theories which combine both sets of factors. A particularly influential one in the United States, advanced in its most complete form by C. L. Schultze, is referred to as a "demand-shift" explanation. Essentially, it suggests that prices are levered upwards as a result of prices rising in those sectors towards which demand is shifting and of prices not falling in the contracting sectors. See C. L. Schultze, "Recent Inflation in the United States," Study Paper No. 1, U.S. Congress, Joint Economic Committee, *Study of Employment, Growth, and Price Levels* (Washington: U.S. Government Printing Office, 1959).

of a serious error in forecasting. The term *administered prices* is often used to imply that since there is considerable discretion as to the timing and size of price changes in many industries, a large part of inflation can be explained by administered pricing. But it is doubtful whether this phrase has promoted much understanding of the complex factors affecting pricing decisions. As M.A. Adelman has pointed out:[1] "'Administered prices' is a catchy phrase which promises everything, explains nothing, and thereby gets in the way of our learning something".

The importance of expectations in influencing wage and price decisions, in the short run, also makes it very difficult to draw a sharp distinction between demand-pull and cost-push factors. These expectations may not adjust too quickly or smoothly to shorter-run changes in actual economic conditions. Government efforts to lower the rate of increase of prices by curtailing the expansion of demand, may be partly frustrated by the absence of a quick response in the movement of wages and prices. This may indicate something about the strength of market power in economic markets, but it may also reflect the role of expectations about future demand, price and wage conditions.

Despite these difficulties of classifying the causes of inflation, there is the important policy question of the responsiveness of the rate of wage and price increases to aggregate policies that influence general monetary demand conditions. Given the determinants of wages and prices in the short run, is there a systematic relationship between aggregate demand conditions and the rate of change of wages and prices, or are the latter largely independent of demand conditions?

This question has stimulated a large amount of empirical research in many western countries in recent years. It has followed on the pioneering work of A.W. Phillips who found a close statistical relationship between the rate of change of money wages and the unemployment rate for a long period of British economic history.[2] Since the unemployment rate is frequently taken as a proxy for the state of aggregate demand conditions, a relationship between demand conditions and the rate of change of prices could be derived by adding a relationship between the rate of change of money wages

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[1] M. A. Adelman, "A Commentary on 'Administered Prices'", in *Administered Prices: A Compendium on Public Policy.* Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, United States Senate, (Washington: U.S. Government Printing Office, 1963). This compendium provides an excellent discussion of the question of administered prices.

[2] A. W. Phillips, "The Relation Between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1862-1957", *Economica*, XXV (November, 1958), pp. 283-99.

and the rate of change of prices. "Phillips Curves" or "trade-off" curves have since been estimated for many other countries, including Canada.[1]

This research has had important implications for anti-inflation policy. First, it has tended to confirm the paramount importance of general aggregative monetary and fiscal policies for controlling inflation, since the studies have pointed to a fairly stable systematic relationship between general monetary demand conditions and the rate of increase of prices. Second, by indicating that, in the past, higher rates of price increases have been associated with lower rates of unemployment, and lower rates of price increases have been associated with higher rates of unemployment, the research has been interpreted as highlighting the difficult policy choices that have to be made in anti-inflation policy. If slowing the expansion of monetary demand to curb the rate of increase of wages and prices will be partly at the expense of a slightly higher unemployment rate, there are the difficult policy questions about the appropriate combination of price-stability and full-employment objectives. The research also leads to the interesting question of whether there are new policy devices for reducing the apparent conflicts between a low unemployment rate and stable prices. It is in this context that arguments for incomes policy as well as other types of policies are often advanced, but before examining the arguments, it is important to note a few difficulties in the way of rigid interpretations for policy purposes of recent research on "trade-off curves".

First, the emphasis on a relationship between aggregate demand conditions and the rate of increase of wages and prices is, of course, consistent with many other variables having an important role. Most studies have recognized a number of them. For an open economy, the rate of increase of foreign prices will be important.[2] Wage negotiations are affected by movements in the consumer price index and by the bargaining strength of unions, which is in turn influenced by economic conditions.[3] Other factors, determining the speed of economic adjustment processes, require further research. Charts 1-A to 1-E show the unemployment rate and the rate of increase of earnings and the consumer price index for five countries since 1953. For these countries, it is clear that the three series have shown broadly similar patterns of movement over time, but there are also very

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[1] See, for example, S. F. Kaliski, "The Relation Between Unemployment and the Rate of Change of Money Wages in Canada", *International Economic Review*, V (January, 1964), pp. 1-33; G. L. Reuber, "The Objectives of Monetary Policy, 1949-61, Empirical 'Trade-Offs' and the Reaction Function of Authorities", *Journal of Political Economy*, LXXII (April, 1964), pp. 109-32; G. L. Reuber, R. G. Bodkin, E. P. Bond and T. R. Robinson, *op. cit.*

[2] Reuber, Bodkin, Bond and Robinson, *op. cit.*

[3] Richard G. Lipsey, *An Introduction to Positive Economics*, (London: Weidenfeld & Nicholson, 1963), pp. 431-41.

important differences that easily destroy any conclusion based on the view that there is always a close association in their movements. Other variables have clearly played some role also.

Second, since the relationships estimated in statistical studies have been based on the past when economic fluctuations occurred, there is a danger in drawing policy implications for the future that abstract from the existence of economic fluctuations. There can be a difference between what one would expect to be the rate of increase of prices, if the economy remained at a 3 per cent unemployment rate, than what could be obtained from estimates based on past experience when fluctuations occurred.

Third, serious difficulties exist for drawing implications from international comparisons of the relationships, not only because of measurement problems, but also because the unemployment rate as a proxy for demand conditions is not the same among countries. It may also not be too satisfactory as a proxy within a country over time.

Fourth, the integration of this approach with general economic theory is still incomplete and the various routes through which monetary demand conditions change may affect the relationship between the rate of increase of prices and the unemployment rate.

INCOMES POLICY AS AN ANTI-INFLATION POLICY DEVICE

The analysis of inflation is far from being in a settled state, but there is little doubt that the main defence against inflation must be a control of general monetary demand conditions. Yet, anti-inflation policy is constrained by a number of factors other than the ability to control these conditions. Foreign price increases and the balance-of-payments situation will be important. The policy may conflict with the full employment objective. Economic adjustment mechanisms do not work so smoothly or quickly that difficult policy choices between lower rates of price increase and higher employment levels can be avoided.

There is thus much interest in the possibilities for lowering the rate of price increases at high employment levels, and the economic case for incomes policy contributing in some marginal way to affecting this relationship needs to be viewed in this context. It is also important to recognize that there are many alternative routes to affecting this relationship. Some are in the direction of creating conditions in which competitive forces in economic markets have a wider scope, and may take the form of changes in commercial and combines policies. Others are aimed at providing positive assistance to economic adjustment processes, such as recent attempts in a number of countries to develop improved labour market policies. Generally, all measures that aim at reducing rigidities and improving the efficiency with which the economic system works could be regarded as relevant for this problem.

CHART I-A

RELATIONSHIP BETWEEN UNEMPLOYMENT RATE AND PER CENT CHANGE IN HOURLY EARNINGS AND CONSUMER PRICE INDEX, SELECTED COUNTRIES, 1953-65

TO SHOW THE RELATIONSHIP BETWEEN THE SERIES MORE CLEARLY, THE SCALE FOR THE UNEMPLOYMENT RATE HAS BEEN INVERTED

CANADA

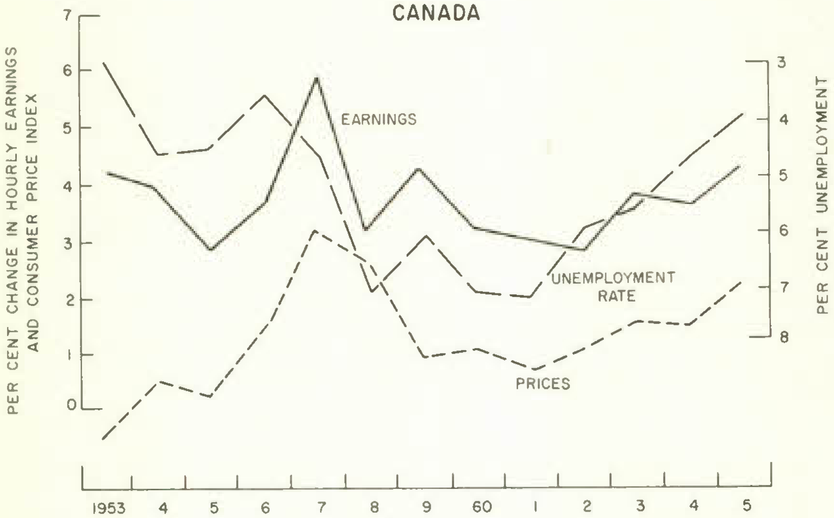


CHART I-B

UNITED STATES

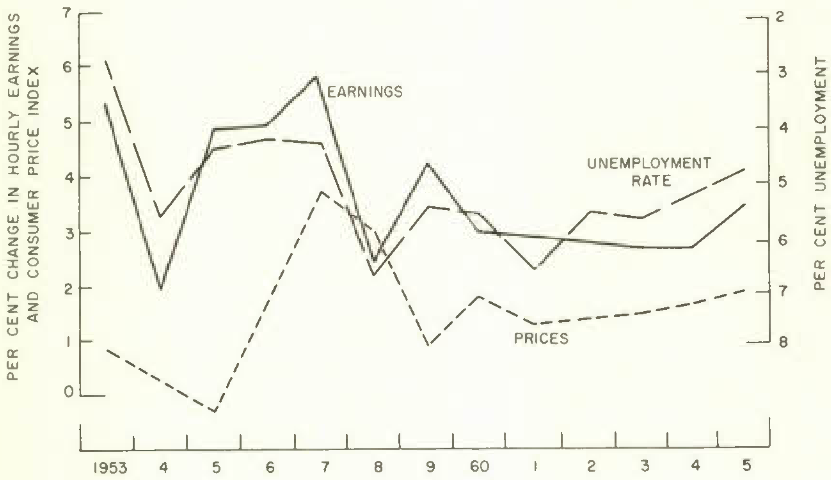


CHART I-C

UNITED KINGDOM

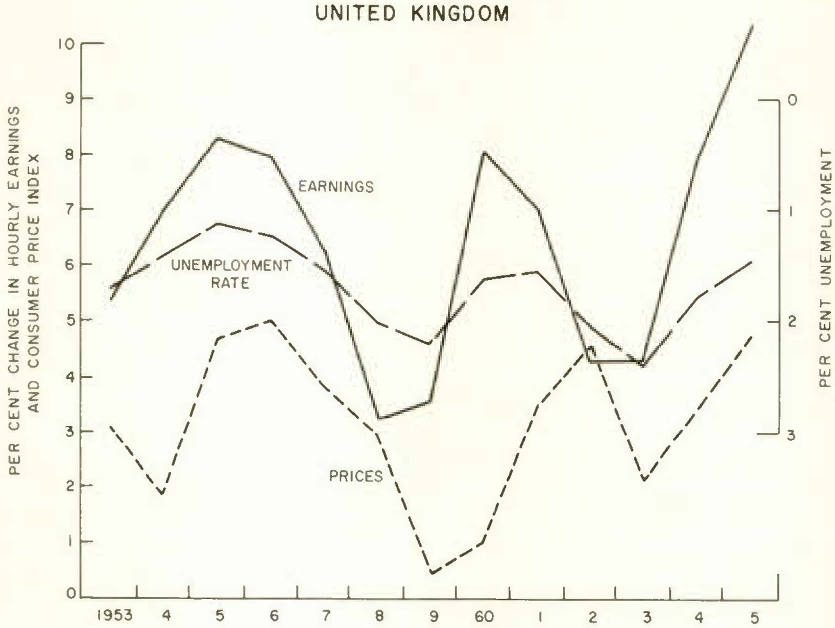


CHART I-D

NETHERLANDS

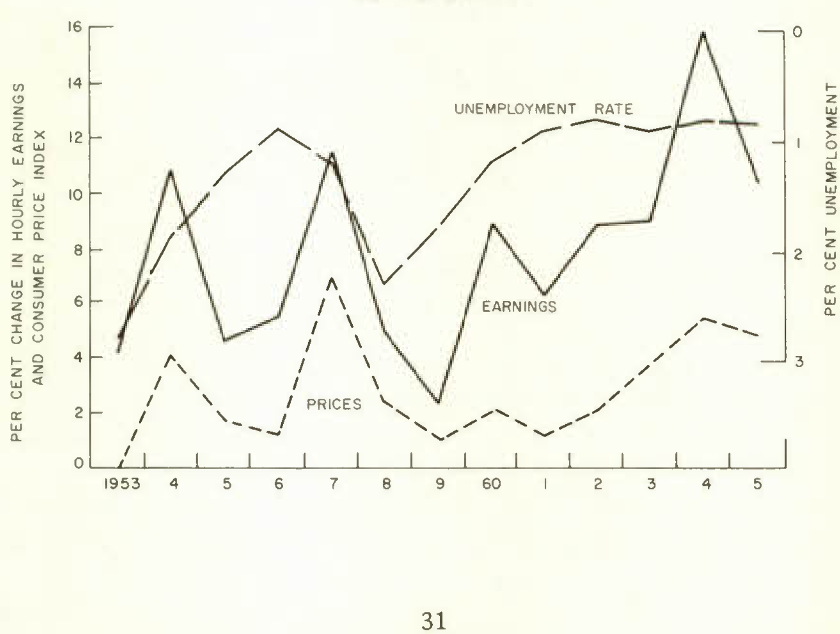
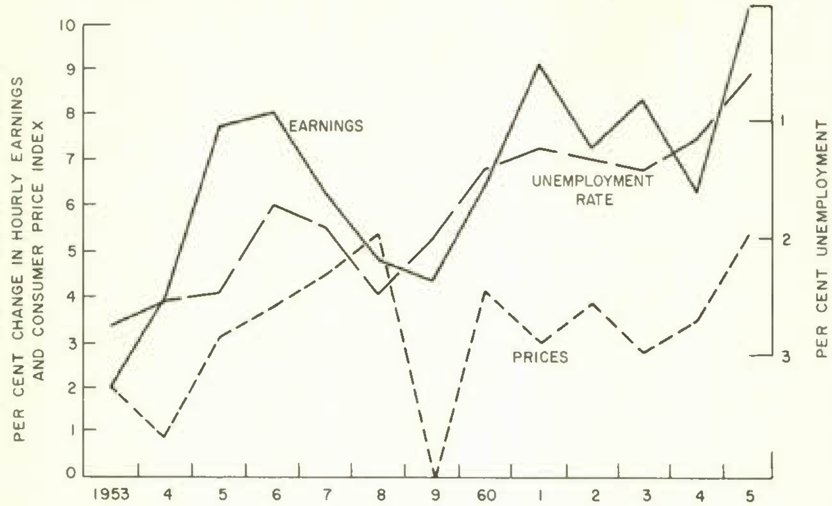


CHART I-E

SWEDEN



(a) How Might It Have an Effect?

The focus of this study is, thus, on only one possible route, the one which is most frequently labeled incomes policy. But how is incomes policy to work? What is it in the determinants of wage and price decisions that incomes policy is expected to affect and will it do so without offsetting costs to other economic and noneconomic goals? Most of the discussion of incomes policy has tended to focus more on the importance of doing something than on the way it is to be done. But a number of suggestions about the possible ways in which incomes policy could have an effect will be noted here, and these, along with the problems of working out the machinery for implementing an incomes policy, discussed in the next chapter, will be examined later in the light of the experience of a number of countries.

It is clearly possible to suppress an inflation through controls. But the difficulties of maintaining controls without a rising number of evasions, the serious problems of administering them without doing serious damage to resource allocation, and the infringement on freedom of choice in economic markets have meant there has been little interest among most western countries in elaborate systems of wage and price controls unless the country was experiencing wartime or severe economic crisis conditions.

Support for incomes policy has been based on the view that it can affect wage and price decisions through persuasion rather than through direct wage and price controls. The borderline between persuasion and direction is not always very clear, but several ways, through which incomes policy might have an effect without an elaborate system of controls, have been suggested.

First, incomes policy may help to alter expectations. Wage and price decisions are influenced by what people think will be the changes in other wages and prices. General expectations about the future rate of increase of prices may become higher than the government feels is desirable. If incomes policy can bring about a smoother and quicker adjustment of expectations when restrictive monetary and fiscal policies are implemented, unemployment of economic resources will not be as large. The problem may prove in practice to be a recurrent one rather than a once-and-for-all one. Evidence of a waste of resources in the short run may lead to strong pressures on the government to revert quickly to more expansionary policies which will in turn justify previous expectations. But, due, for example, to balance-of-payments difficulties, the government may soon bring in again more restrictive policies, and a pattern of "stop-go" policies can thus emerge. These abortive attempts to curb price increases can weaken the country's growth performance.

If incomes policy does have these effects on expectations, it will be useful in supporting changes in general policies. In this case, however, the use of targets and criteria for wage and price decisions is merely to emphasize the change of direction in government policy and strong declarations of intent by the government, followed by action which showed it was not bluffing, would be sufficient. Incomes policy would thus not have the role many of its supporters have suggested for it, and there would not be a need for an elaborate machinery to implement it. The opportunities for incomes policy to have an effect in this manner are likely to be quite limited and confined mainly to the short run. If the forecasts of the government are not too accurate or the government does not back up its announcements with appropriate supporting policies, confidence in the relevance of the guides of incomes policy will quickly break down.

Second, closely related to this idea of influencing general expectations, is the argument that much of the upward pressure on wages comes from a jockeying by unions to gain a better relative position in the wages structure for their members, and from the belief that it is necessary to bargain hard for wage increases to prevent profits from rising relative to wages. As a result of this struggle over relative incomes, both money wages and prices rise faster than they would otherwise and there is little effect on real wages. An incomes policy, it is argued, may reduce these sources of pressure on the wage side by convincing unions that the guides for relative wages will provide a fair wage structure and that the policy will cover profit movements as well as wage movements. Other people feel these points represent largely wishful thinking and have little chance of success on a voluntary basis, especially in the environment of aggressive economic opportunism that is characteristic of North American economic markets. If, in implementing the policy, it is not possible to contain some groups within the guides, an increased restlessness with the operation of the policy is likely to undermine it. In commenting recently on the difficulties of implementing British incomes policy on a voluntary basis and in arguing in support of the use of stronger sanctions, *The Economist* stated:[1]

> The essence of [the recent British] . . . kind of incomes policy is that people should voluntarily restrain themselves from asking for more than the country can afford. But nobody is going to restrain himself voluntarily unless the next man does the same. If restraint is to be voluntary it must appear to be fair. It would be hard indeed to persuade even the best-intentioned trade union leader that a system of limitation on pay rises is really fair when it allows whacking pay rises for -- as a start -- judges, doctors, civil servants, MPs and ministers of the Crown. This is not to say that all trade union leaders are well-intentioned. But this primary impression of unfairness makes it impossible for even the best-intentioned ones to win their argument with their critics within the unions.

Third, recent discussions of incomes policy have emphasized the existence of a few key wage and price decisions in the economy that are subject to considerable discretion as to the timing and size, and which public opinion can influence. Thus, R.M. Solow has argued:[2]

> In our imperfect world, there are important areas where market power is sufficiently concentrated that price and wage decisions are made with a significant amount of discretion. When times are reasonably good, that discretion may be exercised in ways that contribute to premature inflation. (Institutions with market power may actually succeed in exploiting the rest of the economy temporarily or permanently, or they may see their decisions cancelled out almost immediately by induced increases in other prices and wages.) People and institutions with market power may, in our culture, be fairly sensitive to public opinion. To the extent that they are, an educated and mobilized public opinion may exert some restraining pressure to forestall or limit premature inflation.

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[1] "Incomes Policy Now", *The Economist*, (June 18, 1966), p.1283.

[2] Robert M. Solow, "The Case Against the Case Against the Guideposts", in *Guidelines, Informal Controls, and the Market Place*, eds. George P. Shultz and Robert Z. Aliber (Chicago: University of Chicago Press, 1966), p. 44.

An important supplementary argument is that there are important institutional links which establish a fairly close relation between wage and price decisions in a few key sectors and pressures for wage and price movements elsewhere in the economy. The importance of this argument is that many of the problems of a comprehensive policy would be reduced. By focusing on a few key sectors, the administrators of an incomes policy could exert an influence on wages and prices throughout the economy. Many doubts have been raised about the significance of this point, however, and it will be important to examine it more closely in later chapters.

Fourth, it may be argued that incomes policy will have some effect by exposing more clearly the impact of the vast array of special government policies on wages and prices, thus encouraging a more systematic review and better use of these policies. Through such measures as subsidies, tariffs, tax relief, and special expenditure programmes, governments attempt to help particular sectors of the economy, but the encouragement these policies give to higher wages and prices in these sectors is often not publicly recognized. It may be argued that by reviewing the operation of incomes policy, the government will be in a better position to improve the economic basis of these other policies. On the other hand, critics of incomes policy may suggest that if the guides of incomes policy do not make much economic sense, it is not clear that much improvement will, in fact, be achieved through this route – that it should not require the mechanism of an incomes policy to supply a better economic basis for other government policies.

Other, stronger theoretical arguments than the ones mentioned here may emerge, especially with greater knowledge of the determinants of group responses. But incomes policy has not received a great deal of serious economic analysis so far, which is indicative to some of its shaky foundations and to others only of present weaknesses in the understanding of economic processes.

(b) Does It Ever Have an Effect?

It would be very simple to dismiss the whole topic of incomes policy as complete fantasy if it were clear that every attempt to implement an incomes policy had met with complete failure to influence the course of wages and prices. It might still retain some interest as a political device but it would be of little interest for economic policy.

It is clear, however, that there will always be some form of sanctions that can make incomes policy have an effect, as wartime wage and price controls have demonstrated. And there is little doubt that controls on money incomes in the Netherlands over the post-war period have had an important effect at times. Nevertheless recent interest in incomes policy has been based on the belief that only mild forms of persuasion techniques will be sufficient for it to have some effect. Is this true? There have been some failures. But have there also been some successes?

For a number of reasons, it is difficult to answer this question in quantitative terms.

Since incomes policy can take a variety of forms and can be implemented with different degrees of strictness, there is the problem of quantitative measure for incomes policy itself. For example, it will be pointed out later that while there has been a sustained effort to develop incomes policy in the United Kingdom since 1961, the nature of the policy has varied greatly within the period.

Also, to test for the effect of incomes policy it is necessary to estimate as accurately as possible what would have happened in the absence of the policy. An economic model that appears to provide an adequate explanation of past economic experience with earnings and price movements can be used to see whether the introduction of incomes policy makes a difference, but the results, of course, will depend on the confidence one has in the particular model used.

Finally, what are the criteria for measuring the success of an incomes policy? If the objective is to reduce the conflict between price stability and high employment, then the test is to see whether incomes policy had some independent effect on the rate of increase of prices. But there is also the time period to consider. If some success was achieved for a brief period, but if there was then a reaction which led to an above-average rate of increase of prices for a time, is this evidence that the policy worked? Clearly the answer depends on the objectives of the policy. If the policy had been conceived as one to add only short-run flexibility in influencing prices, the answer would be yes. But if the objective had been to have a longer-term impact on the rate of increase of prices, it would be no.

The success of the policy will also have to be judged in terms of its effect on other economic and noneconomic objectives. Even if it did pass the test of having some independent effect on prices, it might be judged a failure on other grounds, such as those of impairing economic growth processes, of diverting public support from other important types of economic policies, or, especially if control devices were used, of interfering with freedom of choice in economic markets. The hesitancy of most western countries in introducing more forceful measures to implement an incomes policy stems from the fear that the costs in terms of other objectives are too high.

The most comprehensive statistical tests of the effects of incomes policies in moderating the rate of increase of wages and prices in various countries are contained in a companion study by G.L. Reuber *et al.*[1] Their evidence is consistent with the view that incomes policies have had at times a restraining influence on the rate of increase of wage rates in the United States, the United Kingdom and France, but that the policies have not had an impact on the rate of price increases except for the indirect effect through wages. In a paper presented to the Canadian Political Science Association meetings this year Professor F. Brechling produced statistical evidence that wages and prices have risen relatively more slowly since the introduction of the wage-price guideposts in the United States, but he indicates other plausible explanations for this. For the United Kingdom he also finds a slower rate of increase of weekly wages in three short-term periods when incomes policies were in effect. But there is clearly scope for further study on how compensation to employees behaved relative to weekly wages in countries such as the United Kingdom where the differences can be great; how long-run the effects were, since they may have shown up principally in the timing of increases; and on the routes through which the policies worked (as will be shown later, much of the recent emphasis in incomes policies has been on affecting price decisions directly).

While incomes policies of the more moderate form cannot therefore be summarily dismissed on the grounds that they have never had an effect, it is necessary to probe more deeply into their broader consequences in the following chapters on the experiences of a number of countries. Are there other factors which may have played a role and were the effects wiped out when the incomes policies broke down? In countries such as the United Kingdom where the aim has been to affect earnings and where there is an important difference between the movement of earnings and wages, has it been more difficult to affect the rate of increase of earnings? What other economic and noneconomic costs have been encountered in trying to moderate the rate of increase of prices through an incomes policy?

THE ROLE OF NONECONOMIC FACTORS

Regardless of the position one takes on the economic case for an incomes policy, political and social factors can be expected to play large roles in whether a country adopts an incomes policy and on the form it will take.

Influences on government decision-making processes will be important. We noted earlier in this chapter that in most countries in the post-war period there have been pressures for higher and more specific standards of performance on the economic objectives of a country. As a result, too much may be expected of governments, and especially in difficult economic

[1] *Op. cit.*

situations they will be attracted by devices that hold the promise of reducing governmental responsibility for the economic welfare of the country. Incomes policy may be attractive because of its emphasis on greater private responsibility for moderating the rate of increase of wages and prices.

A search for devices such as incomes policy is likely to be particularly urgent when the economic situation involves serious short-run conflicts among economic objectives. If the economy is moving to lower unemployment rates, but prices begin to rise more rapidly, or serious balance-of-payments difficulties are encountered, various remedies such as deflationary policies, exchange rate adjustments, or trade controls will be unpopular to some extent. A means of reducing the government's loss of popularity and a useful strategy for ultimately taking the more fundamental, but more unpopular, courses of action, may be first to suggest more private responsibility for the economic situation.

Incomes policy also has the advantage of appearing to the public as a direct attack on inflation. Aggregative policies, such as monetary and fiscal policies, work more indirectly through market mechanisms; the economic benefits that can be expected from proper management of them have generally been difficult to explain to the public. Economic arguments about the appropriate management of monetary and fiscal policies have often not had the support from governments which economists had hoped for because the arguments have not had the direct political appeal of more direct types of policies. To a public uneasy about inflation incomes policy has the attraction that it appears to commit the government more strongly to the restraint of inflation. Such a policy makes it seem the government is doing something about it. In addition, to a public suspicious of its exploitation at the hands of powerful economic groups, some direct pleasure may accrue from censure and sanctions against large businesses and unions that violate the guides of an incomes policy. As Edelman and Fleming argue in a study of the politics of wage-price decisions, incomes policy is frequently a political symbol that tends to yield some returns to a government because the people feel reassured about this evidence of the government's concern about inflation.[1]

There are also serious political risks to incomes policy. If the general guides for wages and prices are violated, repeated government intervention to attempt to gain adherence to them can adversely affect the government's popularity. On the other hand, allowing the guides to be violated continually can be politically embarrassing. Given some limitation on the number of unpopular steps it feels it can take in the short run, a government trying to implement an incomes policy may be diverted from other measures of more

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[1] Murray Edelman and R.W. Fleming, *The Politics of Wage-Price Decisions* (Urbana: University of Illinois Press, 1965).

basic importance to the economy. The implementation of criteria for wages and prices can involve a government more deeply in bitter disputes about appropriate wage and profit rates than it wishes to be involved. The stricter the form of incomes policy the greater the political risks, as the use of strong sanctions to implement it may bring strong public criticism about interference with individual freedom of choice in economic markets. The hesitancy of western countries to venture far in the direction of control devices for implementing an incomes policy, except when it is felt crisis conditions make them unavoidable, reflects the general fear of the damage they will cause to other objectives of the society.

Incomes policy may also be viewed, however, as having some social advantages in so far as it moderates aggressive competition over materialistic gains and promotes greater harmony among labour groups and between labour and management. To many, there is something very attractive about at least trying to work out a system where individual earnings will move according to some objective criteria, and thus in trying to reduce the struggle over appropriate relative income positions. But the issues are immense. While economists have been busy on the criteria for incomes that would make economic sense, it is clear that social and political factors are involved.[1] In the countries examined in later chapters it will be important to note the role of these factors which seem to have played a bigger part in interest in incomes policy in some West European countries than in North America, particularly in earlier post-war years. It will also be important to recognize that the alleged social advantages may turn out to be illusory. In transferring the development and implementation of criteria for incomes and prices from impersonal market mechanisms to incomes-policy administrators, social tensions over appropriate relative income positions may be increased.

MAJOR POINTS IN THE CASE FOR AN INCOMES POLICY

Some general issues relevant for the case for an incomes policy have been raised in this chapter. A number of points were stressed as of particular significance:

(1) Although incomes policy is frequently heralded as a new policy device, it has had, under various forms and titles, a long history of public discussion and experimentation in most countries.

(2) The degree of conflict which a country appears to experience in its economic objectives will stimulate interest in new policies, including incomes policy. The apparent degree of conflict between, for example, a low unemployment rate and a satisfactory balance-of-payments position will not be the same within a country over time or among countries

[1] See Andrew Shonfield, *Modern Capitalism, The Changing Balance of Public and Private Power* (London: Oxford University Press, 1965) pp. 217-20.

at any one time, and it may also be reduced by a more appropriate combination of existing policy instruments. Considerable variation in the intensity with which various countries search for something like an incomes policy is not unexpected.

(3) The role of monetary demand conditions and, in countries such as Canada, the great influence of foreign prices severely limits the contribution that an incomes policy can be expected to make to price stability. One can suggest a number of factors which have played some role in inflation and over which it is hoped incomes policy will have some effect, but these factors, which have been viewed as of some importance in mild inflationary movements, are unlikely to be of much significance for major inflations. Thus many supporters of incomes policy suggest fairly modest aims for it. It is sometimes argued that if the problems of developing an appropriate machinery for incomes policy can be worked out, it might be possible to keep the unemployment rate about one half to one percentage point lower for a given rate of increase of prices.

(4) Much of economic analysis stresses the advantages of not interfering with longer-run economic adjustment processes. Not surprisingly, policy is greatly influenced by short-run considerations and by important social aims, including support of those hurt by economic processes. The problem of marrying necessary short-run expedients and social policies with the promotion of longer-run economic adjustments raises many issues that are beyond the scope of this study. The question of whether incomes policy contributes to or aggravates attempts to find solutions to this problem involves consideration of many noneconomic factors.

(5) It is not correct to dismiss incomes policy simply on the grounds that it will never have an effect in moderating the rate of increase of wages and prices. Clearly it can have, and the effectiveness of incomes policy will be influenced by such factors as the strength of the sanctions that are introduced with it and the length of time over which its effect is measured. In countries that have tried some form of incomes policy in the post-war period there have been some notable failures, but there is also evidence that in some cases it may have had at least a mild effect, particularly on the timing rather than the longer-run rate of wage and price increases. Yet, an assessment of its net benefit requires in addition consideration of any costs in terms of other economic and noneconomic objectives.

It is in the next chapter, where the machinery for an incomes policy is discussed, that many of the most difficult issues in the case for an incomes policy are raised.

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Chapter 3

Problems of Devising an Incomes Policy

Support for incomes policy depends not only on views about the way inflationary processes work, but also on the possibilities of devising methods of implementing the policy successfully without serious costs in terms of other economic and noneconomic goals. The form which incomes policy can take varies greatly and will be moulded by particular features of a country. But all countries will face some problems in common. Incomes policy must involve (a) some means of working out appropriate, general targets for prices and major forms of income, (b) derivation from these targets of specific criteria or guides for individual decisions about earnings and prices, and (c) devices which will affect individual decisions in the direction of the guides. Some general problems in developing machinery for these components of incomes policy will be discussed in this Chapter.

GENERAL TARGETS FOR INCOMES AND PRICES

The initial step is to work out the appropriate general targets for prices and incomes. Since price stability is not in itself a well-defined, independent, policy objective, the first problem is to derive a satisfactory target for it. As discussed in the last Chapter, most countries seem to have abandoned an interest in having trend productivity increases reflected in a gradual, longer-term fall in prices. A rigid commitment to constancy of average prices, on the other hand, would pose serious statistical and economic problems. As was also noted, there is no single price index that is generally accepted as the best measure of price stability, and there is a not-unfounded suspicion that the most frequently used price indexes contain some upward bias. There is the problem of conflicts between stable prices and low unemployment rates discussed in the previous Chapter. Balance-of-payments adjustments may require some variation in the movement of general prices. Particularly for highly open economies, attempts to maintain constancy of average prices over time may be frustrated by positive rates of increase of foreign prices, unless a country is prepared to revalue its exchange rate periodically. In practice, then, the appropriate or desirable performance on prices will depend on a balancing of policy objectives and the state of economic conditions. The task for incomes policy is likely to be that of achieving somewhat greater price stability than seems to be currently possible with existing policies and economic conditions.

(a) The Use of Regular National Plans

The method of translating this general aim into specific targets for prices, wages, and nonwage incomes can vary. One broad approach is to have a regular national plan in which the targets are derived from a complex exercise involving detailed projections of the main components of economic activity, an evaluation of the problems these projections pose for attaining national economic objectives, and an appraisal of the extent to which other economic policies might alter the expected course of the economy.

Significant variations are clearly possible with this approach. A regular annual plan, as in the Netherlands, may be viewed as necessary in order to obtain relevant targets for current wage and price decisions, but it may also be supplemented by periodic longer-term plans to fit the targets into better perspective. Conversely, the emphasis may be on longer-term plans, such as five-year plans, and the targets for the five-year period may then be related to desirable targets for each of the five years. This latter approach is the one that France has been taking in recent incomes-policy discussions. In addition, there is clearly much variation possible in the degree of detail with which these plans are formulated.

An approach using regular national plans has advantages from the standpoint of making incomes policy effective. It permits targets to be closely relate to the state of the economy, and there is thus less chance that they will be viewed as irrelevant for current conditions. It permits quicker adjustment of the targets when special problems such as balance-of-payments difficulties threaten. The comprehensive approach of a plan may tend to make the targets more acceptable to labour and management because it will show more clearly the importance of the targets if such alternatives as higher unemployment are to be avoided.

The derivation of targets for incomes and prices from regular national plans also has a number of serious difficulties. It involves a greater commitment to national economic planning than many western countries have so far been willing to make. If annual national plans are used there is a heavy reliance on the accuracy of economic forecasting techniques which many feel are still too imperfect for this purpose. If targets change frequently there is the serious problem of obtaining acceptance each time from labour and management. Since the different major forms of income fluctuate relative to each other as economic conditions vary in the short run, tensions over the administration of incomes policy may rise. For example, it is well known that profits tend to fall relative to wages in a recession and rise in a boom. If the projections of the plan show a rise in profits relative to wages management is likely to argue that no greater restraint on prices and profits is necessary because this is merely a normal adjustment, whereas trade unions may argue that this is evidence of incomes policy placing a greater restraint on wages than on profits. Also, in many western countries wage contracts expire at various times of the year and have varying lengths, adding further complications for regularly adjusted targets.

(b) The Use of Productivity Trends

These difficulties have led to a different approach that has gained greater popularity in recent discussions of incomes policy. It begins with the assumption that approximate price stability is the desirable objective and proceeds to show by a bit of simple economic arithmetic the targets for major forms of income that would have to be achieved over the longer run to satisfy this assumption. Relatively fixed rather than regularly changing targets are worked out and they depend on the expected growth of productivity in the economy. This is the approach which, for example, has been stressed in the United States and the United Kingdom and which appears to have been favoured in recent OECD studies.[1]

The method can be understood more readily if we begin with some highly simplifying assumptions. Let us assume, merely as a starting point, that there is an economy in which only one product is produced and in which there is no foreign trade. The value of the total output of this product and the establishment of its price can be looked at in two ways. First, the value of the output will be the same as the total money payments for it. Second, since the total money payments will accrue as income to someone, the value of the output is also the same as the total of money incomes. The money incomes will be in various forms such as wages, salaries, gross profits, rent and interest. By definition, then, we will get the same answer for the price per unit of output whether we divide the total money payments for the product by the number of units of the product or whether we divide the total money incomes by the number of units of the product. It follows that if the price is not to rise over time, total money incomes cannot rise faster than the number of units of product. This conclusion may be expressed another way if we divide by the number of people or by the number of hours worked. Thus, average incomes per person or per hour cannot rise faster than average output per person or average output per hour, if prices are not to rise.

[1] See, for example, Organisation for Economic Co-operation and Development, *Policies for Price Stability* (Paris, 1962).

This point, which we have shown in a very simple example, has been taken as the basis for working out targets for incomes policy in actual situations. It is argued that for prices to remain approximately stable over time the trend rate of increase of money incomes per person or per hour must not exceed the trend rate of increase of productivity expressed in per-person or per-hour terms. This is a target for the rate of increase of total money incomes, but to translate it into targets for the major forms of incomes another step is necessary. Frequently, it is assumed that since the shares in total income of the major forms of income have not fluctuated greatly in the long run, approximately equal rates of growth for the broad categories of income would be appropriate to expect in the future. The targets for average compensation to employees and for average nonwage income would thus become the same as the trend rate of increase of average productivity.

Before examining how criteria for individual wage and price decisions might be related to these targets, it is important to consider some advantages and disadvantages to formulating aggregate targets for incomes this way.

The trend-of-national-productivity approach is simple, easily understood, and does not involve the difficulties associated with frequently changing targets. There is no need for regular national economic plans. It serves the important educational function of showing the significance of increases of productivity in determining what will happen to prices when money incomes rise, and of bringing out the point that both compensation to employees and nonwage incomes can rise at the same rate as productivity without price increases.

The latter point is apparently frequently misunderstood by the public.[1] An example may show the reasoning more clearly. If the expected trend rate of increase of productivity is 3 per cent, and if an approximately constant division of total income between wage income and nonwage income is held to be appropriate, then the targets for price stability will be rates of increase for both wage income and nonwage income of about 3 per cent. If initially wage income made up about two thirds of total income and nonwage about one third, these targets would mean that increases in income would also be distributed in the same proportion -- two thirds to wage income and one third to nonwage income. Setting the target for the increase in wages equal to the trend rate of increase of productivity does not mean therefore that labour will get the whole increase in income.

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[1] Robert M. Solow, "The Case Against the Case Against the Guideposts", in Shultz and Aliber, eds., *op. cit.*, pp. 44-5.

The problems of deriving these targets are in practice, however, more complicated than the above might suggest. A number of difficulties can be noted:

(1) With international trade the role of foreign prices must be considered. The value of the output will be distributed not only in the form of money incomes to people in the country but also as payment for imports of goods and services, including the services of foreign capital. The targets need not yield price stability in this case. If the rate of increase of money incomes is the same as the rate of increase of productivity but import prices are rising, there will be a tendency for costs of production and prices to rise. Thus, foreign prices will upset the simple arithmetic for price stability, and their significance will be greater the more open the economy. For an economy such as the Canadian where foreign prices are a major determinant of domestic prices, this will be very important, whereas it would be much less important for the U.S. economy. In addition, there are balance-of-payments adjustments to consider. Targets for a lower rate of price increase domestically than abroad would tend to produce over time balance-of-payments surpluses that will lead to pressures for a more rapid increase of prices domestically or periodic exchange rate revaluations. The point is that although a lower rate of increase of domestic prices than of foreign prices may at times be desirable, the targets for appropriate wage and price developments must depend heavily on the country's external position and cannot be derived solely from calculations of domestic productivity trends.

(2) The measurement of productivity is in practice a much more complex and controversial issue than would be implied by our simple example.[1] There is the problem of the output to be included in the measurement. Should it be net output, which would exclude depreciation or, gross output? Should it include both the government sector, including all military expenditures, and the agricultural sector? There are also the usual index-number problems of aggregating a diverse set of goods and services, the composition of which is changing as a result of new products and quality changes. Finally, there are the problems of what should be included in the denominator. Should it be man-hours or a broader measure of factor inputs? Should there be some weighting of man-hours to take account of the distribution of labour by quality, skills, and so forth? For example, productivity may remain constant in each sector of the economy but labour may shift from low-productivity to high-productivity sectors with the result that total productivity shows a rise. For wage policy, it is generally argued that an increase in productivity from this source should not justify increases in wage rates in the economy, since the shift in labour to better-paying occupations has already raised the

[1] For discussion of the main issues here for incomes policy, see Barbara R. Berman, "Public Information in the Operation of the Wage-Price Guideposts: The Productivity Statistics", *American Statistical Association, 1962 Proceedings of the Business and Economic Statistics Section*, pp. 58-60.

wage bill and further wage rate increases would mean a rise in unit labour costs in the economy.[1]

These issues in the measurement of productivity may not be regarded as of great practical importance for incomes policy. If the intention is to have only very rough global targets for incomes policy, the defects of the productivity series may not be viewed as too serious. But there may be times when the statistical problems of measuring national productivity become important. In 1966, revised figures for productivity were published in Canada and they showed important changes from earlier estimates. For example, the annual rate of increase of output per man-hour in manufacturing from 1949 to 1965 was revised upwards from 3.1 per cent to 3.9 per cent, and the revised series did not show the same slowing down in the rate of increase at the end of the 1950's that the earlier series did.

(3) Given an acceptable national productivity series, the measurement of a trend for the series may be done in various ways. Disputes may arise over which way is best. If it is based on past data, simple, easily understood methods, such as a five-year moving average, may be too influenced by short-run variation in the series and lead to frequent changes in the target. This problem, as we note in a later chapter, caused some controversy over the U.S. wage-price guideposts in 1966. More complex but better statistical methods for trend estimation may be viewed more suspiciously by the public, especially when current rates of productivity increase are in excess of the trend figure. It is possible, on the other hand, to base the productivity target on a medium-term or long-term forecast. In this case too, however, public acceptance of the competence of this projection will be important.

(4) Targets for wage and nonwage incomes based on trend estimates of productivity will not be very useful if the economy does not, in fact, follow fairly closely along this trend. For these targets to serve as a basis for working out criteria to guide specific wage, nonwage income, and price decisions it will be important that the rate of increase of money incomes is kept closely in line with the rate of increase of productivity. If monetary demand conditions cause the rate of increase of money incomes to diverge upwards from the productivity trend line, the targets will be viewed by various groups as an unfair and meaningless basis for devising criteria for individual wage and price decisions. Similarly, if monetary demand conditions are producing a rate of increase of money incomes below the trend of productivity, the targets may raise aspirations among various groups about what they should be getting, but the targets will not mean much for restraining inflation. Thus, the use of national productivity trends to devise tar-

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[1] H. A. Turner and H. Zoeteweij, *Prices, Wages and Incomes Policies in Industrialised Market Economies* (Geneva: International Labour Office, 1966), p. 116.

gets for incomes policy presupposes that the authorities are quite confident about keeping the economy on a stable path of expansion of monetary demand close to the path of productivity increases. Otherwise, the targets will be submerged during strong inflationary periods and of little relevance in periods of slow increase of monetary demand.

(5) As we have noted, the targets for wage and nonwage incomes depend not only on the relationship between the rate of increase of money incomes and the rate of increase of productivity but also on the assumption that is made about the appropriate longer-run share of wage and nonwage incomes in total incomes. The usual assumption that the shares can be expected to be constant requires further examination. Economic models of growth have been constructed in which the share does not change, but there is nothing in economic theory which indicates that this *must* be the case.

The theoretical implications of this assumption will be noted briefly. They may be seen more clearly in terms of the previous, simple example using a single product in a closed economy. The target that both real and money wages should rise at the same rate as productivity means that a producer will be willing to increase wages in line with the increase in the output-labour ratio, i.e., in line with the rate of increase of the average product of labour. Economists have long pointed out, however, that it is the marginal or additional – not the average – product of labour, together with the additional revenue from the sale of the product, that is important in determining wages if producers are trying to maximize profits. Thus, the assumption implies that the rate of increase of the marginal product of labour will be equal to the rate of increase of the average product of labour. If the rate of increase of the return to labour is to equal the rate of increase of the return to capital, it implies a similar rate of growth of the marginal and average products of capital and a kind of technical progress that is neutral in its effect on changing distributive shares of income. There are economic models with these characteristics but few would suggest that, given the special assumptions in them, they are a sufficiently realistic representation of growth processes to be used confidently for prediction and policies. The usual defence of the assumption, however, is not theoretical but simply on the grounds that historically there have not been large shifts in the distribution of the major forms of income. The difficulty with this argument, apart from the danger of generalizations about the future based simply on observing the movement of time series in the past, is that there have been some shifts and these may have been an important ingredient of the growth processes. Targets that served to slow up even these small shifts in the future may be damaging to growth. The seriousness of this danger will, of course, depend on how rigidly and effectively these targets are implemented.

CRITERIA OR GUIDEPOSTS FOR WAGE AND PRICE DECISIONS

The previous section examined the broad targets for the movement of prices and the main aggregates of income in the economy. Given these targets, it is necessary to develop criteria or guideposts that are consistent with them and that are also relevant for individual wage and price decisions.

Since the emphasis in recent incomes policy discussions has been on avoiding detailed intervention in the economy, such as would be required under an elaborate system of wage and price controls, the criteria or guideposts which have usually been suggested have been quite general in nature. On the other hand, the criteria are to be used in judging specific wage and price changes and are expected to influence individual decisions. There may be a conflict between keeping them simple enough to be easily understood and having them complex enough to make economic sense.

(a) Productivity by Industry as a Guide

Let us first examine one possible set of criteria that would be consistent with the aggregate targets, but that on closer inspection clearly turns out to be inappropriate. If a condition for price stability in the whole economy is to have average wages and average nonwage incomes rise at about the same rate as average national productivity, this same principle could be applied to individual industries. If average wages and average nonwage incomes rise at the same rate as productivity in each industry, conditions for price stability in the economy would be maintained if it is assumed import prices are not rising. Some serious difficulties for these criteria are immediately apparent.

First, if the criteria were followed strictly, prices would be expected to remain roughly unchanged among industries and thus relative prices would tend to be fixed. Such a situation would be impossible to defend either in theory or in practice. Changes in the relative prices of final products are an essential condition for the functioning of an economy. As a result, it may be proposed that the criteria be amended to apply only to wages or compensation to employees. Other more complex criteria could be developed to apply to nonwage incomes, or prices could be left freer.

Second, application of a productivity criterion only to wages still does not make sense. Rates of productivity increase vary widely by industry, and if average wage increases in an industry were tied to the rate of increase of productivity in that industry, the rates of wage increase would diverge widely throughout the economy. Apart from the highly unpopular results if a policy based on this criterion succeeded, there would be good economic reasons to oppose it. Such factors as demand conditions for the product, supply conditions for labour in the industry, and the level of wages in other industries are all important in determining wages. Basing wages on productivity alone could produce serious distortions in the allocation of economic resources. Apart from possible differences in the rate of increase of marginal and average physical product of labour, the rate of increase in revenue from the sale of the products should clearly have a bearing on increases in wages. For example, in many western countries productivity in agriculture has been rising more rapidly during the post-war period than in many other industries. If incomes in agriculture were geared to productivity, they would have risen much faster, but this in turn would have greatly expanded the labour force in agriculture and led to more serious problems of surplus output. In fact, the percentage of the labour force in agriculture has been declining in western countries because of the relatively more rapid demand for labour in other sectors.

Third, there are measurement problems in developing a productivity criterion to apply to industry or branches of industry. As we shall note later, this point was well demonstrated in the experience of the Netherlands when a modified industry-productivity criterion was introduced in 1959. Serious difficulties can be expected in getting agreement by management and labour on a single set of estimates of productivity within an industry or branch of industry.

(b) National Productivity as a Guide

It is not surprising that linking incomes to productivity by industry or branch of industry has received little support in discussions of incomes policy. A more popular approach, adopted, for example, in both recent British and U.S. policy, has been to link the movement of earnings to the trend in national productivity, although some modifications to this rule are also added. For example, if it is estimated that the trend rate of increase of productivity in the economy is about 3 per cent, the criteria or guidepost for the rate of increases of wages, or, more accurately, of compensation to employees, should be 3 per cent in all industries.

Separate criteria are then generally developed for prices. The approach has been to suggest that in industries where productivity has been rising more rapidly than the national average, prices should fall, and where productivity has been rising less rapidly than national productivity, prices should rise. Thus, the ratio of prices to unit labour costs of production would remain approximately constant, but this would be consistent with considerable variation in relative prices. In addition, it would mean that nonwage incomes could be expected to grow at about the same rate as compensation to employees. It is not often suggested that these criteria should be followed rigidly, but, since they do frequently provide the basic set of criteria in recent discussions of incomes policy, it will be important to examine some of the implications and problems associated with them before proceeding to a discussion of possible modifications.

With respect to wages or compensation to employees, the guide that wages should all move at about the same rate as the trend in national productivity has been defended on various grounds. Underlying most of the arguments, however, is the belief that relative wage movements do not in fact play the role, traditionally assumed in economic theory, in inducing labour to move to jobs of greater economic returns from jobs with lower economic returns.

A number of studies have lent support to this position. Some have emphasized past rigidities in the wage structure. In the United Kingdom a study by Dicks-Mireaux and Shepherd pointed to the small variation in the wage structure in the past and concluded that incomes policy would do little to to make it more rigid:[1]

> . . . it is often said that an incomes policy would make the wages structure too rigid. But it seems that this structure in the past ten years has been fairly rigid anyway. There has been little response in the movement of relative wages to changing economic pressures. An incomes policy, it seems, would add little to the rigidity already imposed by the present system of wage settlement.

Evidence that the wage structure has not changed very much despite substantial shifts in employment does not necessarily undermine the traditional economic theory of the role of relative wages in inducing labour movement. It could mean that mobility is indeed highly sensitive to small changes in relative wages since the movement of labour in response to changes in wage differentials tends to eliminate the changes. There are other measurement difficulties in using wages or earnings for examining labour mobility: expected rather than current earnings will be important, financial incentives through fringe benefits and upgrading play a role, and relative costs as well as relative gross returns from labour movement must be considered. A major study of the role of wage differentials in labour mobility, which did not tackle all these issues but which is the most important recent work on international comparisons of wages and labour mobility, was sponsored by the Organisation for Economic Co-operation and Development. The general vein of the study's conclusions is that relative wages or earnings do not have much effect on labour mobility, but an important list of qualifications is given.[2] It is recognized that in the United States and Canada there was a somewhat stronger association between changes in relative earnings and shifts in employment than in the rest of the ten OECD countries reviewed.[3]

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[1] L. A. Dicks-Mireaux and J. R. Shepherd, "Wages Structure and Some Implications for Incomes Policy", *National Institute Economic Review*, XXII (November 1962), p. 45.

[2] For a summary of them see, Organisation for Economic Co-operation and Development, *Wages and Labour Mobility* (Paris, 1965), p. 16.

[3] See also, George Saunders, *Wage Determination in Canada*, Occasional Paper No. 3, Economics and Research Branch, Department of Labour, Canada, (Ottawa: Queen's Printer, 1965). This study emphasizes the responsiveness of the wage structure in Canada to shifting labour demand and supply conditions.

The association was stronger among professional groups than production workers and it was also pronounced on a regional basis in some countries. Movements in relative wages were also more important when there were very large shifts in employment by industry. These qualifications point to some role for relative wages in allocating labour, but the report played down its importance: "... it is our main finding that there is no evidence of a strong systematic statistical relationship between changes in earnings among individual industries and variation in relative employment."[1]

The implications of these findings for incomes policy were drawn by Professor P. de Wolff in a Foreword to the report. An earlier OECD report, *Policies for Price Stability,* had stressed the importance of the guide that earnings should rise at the same rate as national productivity but also noted the possible importance of modifications in order to reallocate labour. The findings of the report on wages and labour mobility were interpreted as meaning that the importance of these modifications was not great. Thus, Professor de Wolff stated:[2]

> The working Party's first report on *Policies for Price Stability* noted that exceptions to the general guideline that earnings should rise in line with the national trend rate of productivity growth might be called for "on the grounds that changes in relative wages have a function in reallocating labour between different industries and occupations," (paragraph 33). The evidence in the Expert Group's report that labour deployment has on the whole been rather insensitive to changes in relative wages suggests that it would be easy to exaggerate the need for exceptions on these grounds.

This evidence of the short-run insensitivity of relative wages as an allocation device, combined with the common observations of the use of market power in gaining wage settlements, has been an important basis for recent interest in centralized criteria for wage settlements. A rate of increase of earnings in each industry approximately in line with the rate of increase of national productivity has emerged as a very popular criterion, but it is not the only one. Especially in countries such as Sweden and the Netherlands, as we shall discuss more fully later, there has been much interest in narrowing wage differentials, in making wages correspond more to the technical rather than economic characteristics of the job, and of inserting equity criteria into national wage settlements.

But there are also serious dangers of underemphasizing the role of relative wages in allocating labour to its best economic use. Not only do recent studies suggest they make some difference but also the difference is likely to be greater in the longer run. Economic adjustment mechanisms

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[1] OECD, *Wages and Labour Mobility,* p. 16.
[2] *Ibid.,* p. 9.

often work slowly, and to impair their working in the short run may lead to more serious longer-run economic difficulties. Also, a stronger relationship has been found in the short run between large shifts in the wage structure and employment,[1] and the criteria for incomes policy are likely to affect mainly the large, rather than small, shifts in wage structure. Further, if wages all advance at about the same rate there may be some adverse effect on the unemployment rate, particularly if there is a high degree of regional specialization of industry. As K. Lancaster has argued:[2]

> . . . a policy of this kind will, except in special cases, lead to excess demand for labour in some industries, and excess supply in others, leading to regional unemployment or increases in earnings relative to nominal wages . . . , or both.

In part, at least, this effect on unemployment could be offset by state subsidization of the movement of labour and this would provide the financial incentives for the reallocation of labour.

Another difficulty with the criterion of equal rates of increase of earnings is that of obtaining accurate measurements of pay settlements. Especially where fringe benefits are an important component of settlements, exact measures of the rate of increase in earnings will not always be very easy to obtain.[3]

In view of these many difficulties with the rigid application of a criterion for equal rates of increase of earnings by industry, there has been in practice a recognition of some necessary qualifications. In both *tne United States and United Kingdom,* for example, statements of criteria or guideposts for earnings have emphasized this basic principle but have also included a list of modifications. Generally, it has been suggested that departures from this basic criterion could be justified on grounds of securing a major shift in the distribution of manpower, or correcting what are viewed as unjust wage differentials, particularly for low-wage groups, or of providing incentives for increased effort by workers. The most frequent criticism by economists is that these modifications have still not adequately incorporated the role of relative demand and supply conditions in labour markets.

With respect to the criteria or guideposts for prices and nonwage incomes, a number of difficulties are also encountered in a rigid application of the rule that prices should fall in industries with above-average rates of

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[1] One of the members of group that prepared the OECD report developed this point more fully in an article on U.S. experience. See, Lloyd Ulman, "Labour Mobility and the Industrial Wage Structure in the Postwar United States", *Quarterly Journal of Economics*, LXXIX (February 1965), pp. 73-97.

[2] Kelvin Lancaster, "Productivity-Geared Wage Policies", *Economica*, XXV (August 1958), p. 200.

[3] For a discussion of some of the issues here, see Peter Henle, "What Role Can Statistics Play?" *American Statistical Association, 1962 Proceedings of the Business and Economic Statistics Section,* pp. 50-52.

increase of productivity and rise in industries with below-average rates of increase of productivity. General agreement on the appropriate productivity data by industry or branch of industry is difficult to obtain in practice. Allowance must be made for rises in nonlabour costs, and, for the country as a whole, import prices will thus be important. The criteria do not allow for substitutions between capital and labour and the relative needs by industries to attract capital. Shifts in demand conditions will also be important. For example, if there is a shift in demand away from a product, market adjustments will tend to put some downward pressure on its price, but this may also be the time when productivity increases will fall and according to the criteria prices should rise. Conversely, with a shift in demand towards a product, market pressures will be in the direction of increasing the price, but this may also be accompanied by a more rapid rise in productivity in the industry and according to the criteria prices should fall. Professor B.R. Williams has pointed to some of the difficulties of a strict application of the criterion:[1]

> Nor is the change in output per man necessarily a good guide to pricing policies in individual industries. It is possible for output per man to rise without any fall in cost per unit of output, even at the old wage rates. This would happen when a substitution of capital for labour proved not to be cost-saving, or when cost-savings due to such a substitution were offset by a rise in the prices of materials and components (due, say, to higher import prices or the failure of productivity increases in other industries to keep pace with their wage increases). Conversely costs per unit of output could fall without any increase in productivity.

It is likely that some modifications to the criteria will thus have to be made. In both the United States and the United Kingdom, for example, explicit recognition has been given to both changes in nonlabour costs and the relative needs to attract capital as justifying deviations from the price guides. Again, however, economists have been concerned about the insufficient attention paid to the influence of relative demand and supply conditions on prices. In addition, the stipulation of an appropriate price for an industry leads to some awkward questions of the compatibility of the criteria with government legislation on restrictive practices. In view of this, some have suggested that the criterion should apply to enterprises rather than to industries. But due to the variety of rates of increase of productivity among firms within an industry, divergent price movements among firms in that industry could be expected. This result is also highly unrealistic.

The use of a national productivity criterion for earnings and of industry productivity in relation to national productivity as a criterion for prices

[1] Bruce R. Williams, "Prices and Incomes", *District Bank Review* (June 1965), pp. 6-7.

thus can be expected to lead to a number of difficulties that may only in part be overcome by the addition of a number of modifications. It may be possible to work out more sophisticated modifications than have been formulated up to this point, but there is an important constraint; if they become too numerous or complicated, problems of implementation increase greatly.

The seriousness of these problems in working out principles for wage and price decisions depends on how the criteria are used. Some people may feel that, regardless of their imperfections, the guides or criteria at least provide a starting point for public discussion and education of "how wages and prices *would* behave in a fairly smoothly functioning competitive market economy subject neither to major excess demand nor major deficiency of demand".[1] It may not be the intention to apply them rigorously in individual cases. They may be advanced simply as a reasonably good beginning for improving public understanding of the general role of economic factors in wage and price decisions and for getting greater public support for government efforts to curb serious abuses of market power. But incomes policy has recently meant more than this; it has involved attempts to implement directly, and often quite rigidly, the announced criteria or guideposts.

PROBLEMS OF IMPLEMENTING THE CRITERIA OR GUIDEPOSTS

The working out of national targets for earnings and prices and the translation of these into criteria for individual wage and price decisions are interesting exercises, but if they are to be anything more than this they must be expected to have some influence on decisions. What are the routes through which the influence may be felt? What are the devices which might be used to strengthen the influence?

(a) Reliance on a Voluntary Acceptance of the Criteria

If the publication of criteria or guideposts does alter wage and price decisions from what they would otherwise have been, it must mean that people have perceived certain personal economic or noneconomic gains from following them, or that they fear that due to some form of public sanctions there are losses from not following them.

The importance of the former route is likely to be quite limited although it need not always be insignificant. The publication of the criteria may have an effect on changing future expectations about wage and price movements and this may bring about smoother individual adjustments if, for example, the government is attempting to lower the rate of increase of prices. The publication of the criteria, especially in times of national economic crisis,

[1] Robert M. Solow, "The Case Against the Case Against the Guideposts," in Shultz and Aliber, eds., *op. cit.*, p. 45.

may also induce some people to forego private economic gains because of their interest in the over-all welfare of the country.

The country's economic situation will be important in both these cases. If the country is suffering, for example, from a severe balance-of-payments crisis, people will tend to be more aware of the government's need to alter the rate of wage and price increases. They will be more prepared to believe that the guideposts are an indication of what the government will have to bring about through the aid of other policies as well. In times of a national crisis there also tends to be a closer identification of individual economic gains with the national interest in surmounting the crisis. For such reasons, many stress that incomes policy without sanctions may have some effect in meeting a temporary crisis. Further, if the policy is only to be used as a short-run expedient, there will be no need to work out and gain acceptance of appropriate long-run criteria for relative wages and prices.[1] But presumably even in this short-run case not too much can be expected from an appeal for a purely voluntary change in behaviour. Not all will respond to the appeal and growing evidence of a relative loss in economic position for some groups will tend to weaken the policy quickly. Particularly if the government does not succeed in altering the general movement of wages and prices in line with the criteria, the influence of the policy through expectations is likely to be short-lived.

Frequently, the hope is expressed that the criteria of an incomes policy will be voluntarily adopted over the longer run because people will see more clearly the feedback relationships between changes in money incomes and prices, and will understand better the economic determinants and functions of the various forms of income. Thus, the real economic gains from a higher money wage in one sector will be erased if higher money wages in other sectors as well lead to a general rise in the price level. If prices rise in proportion to the rise in money wages, there is no increase in the real wage. If, on the other hand, the higher costs mean the present level of output is less profitable and there is a cut-back in production, higher unemployment will result. By showing more clearly the futility of pressing for general money wage rate increases in excess of the increase of national productivity, incomes policy, it is argued, may have some direct effect.

Undoubtedly, incomes policy could serve an important educational function, although, as will be discussed later, other routes may be equally or more suitable. There are many public myths in wage and price determination and an incomes policy may help to expose them. But it is surely unrealistic to expect a spontaneous acceptance in particular cases of the appropriateness of an official set of criteria for income and price changes. For this

[1] The difference in gaining acceptance of a wage policy to meet an acute inflation problem in the short run as compared to the longer run is discussed, for example, in Erik Lundberg, *Business Cycles and Economic Policy* (London: George Allen & Unwin Ltd., 1957), pp. 234-5.

reason, many point out that a closer identification of private interests with the criteria of an incomes policy will require a broad political, social and economic programme aimed at achieving a national consensus on the appropriate longer-run distribution of income. Past experience dispels any illusions about the ease of achieving voluntarily and for long a consensus in sufficient detail to guide wage and price decisions.

Institutional conditions will have an influence. Knowledge of the interrelationships among general movements of wages, profits, prices and employment is important but it is unlikely to have much direct impact in a decentralized bargaining situation. There is no guarantee that all others will adopt revised rules of the game and there is typically little direct relation between the wage settlement in a particular sector and the general prices of consumer goods bought by people in that sector. In a country with a highly centralized set of labour market institutions the chances are greater for some effect. If there is centralized labour leadership in the country with power to lead and co-ordinate wage negotiations throughout much of the economy, the effect of the money wage rate on such things as changes in prices or the balance-of-payments position will be more clearly seen. Even in this case, the position of the leaders will depend on the support of the groups they represent and if the criteria make little sense to these groups their effect will be limited.

The central problem is that the criteria derived from national targets may appear to have little relevance for private decisions. Professor Dunlop made this point in discussing the U.S. wage-price guideposts:[1]

> The wage and price guideposts are not expressed in criteria that are meaningful to private decision makers. The "trend rate of overall productivity increase" and the relative rate of an industry's increase in productivity compared to the average are scarcely standards which are meaningful to decision makers on wages and prices. These concepts are not congenial or directly applicable in their operating experience. Wage decisions are typically argued in terms of comparative wages, living costs, competitive conditions, labour shortages, ability to pay, specific productivity, job content and bargaining power. Negotiators and their constituents understand these concepts. Pricing decisions are considered in terms of specific competitive prices, quality, advertising, market prospects, responses to changes in other prices, costs and the like. The diffuse structure of collective bargaining and pricing makes the standards of the guideposts appear remote and unrealistic. The guideposts simply "do not come through". The macro-standards not only have

[1] John T. Dunlop, "Guideposts, Wages and Collective Bargaining", in Shultz and Aliber, eds., *op. cit.*, p. 86.

no simple application to specific wage or price decisions, they do not appear relevant, controlling or decisive to micro-decision makers. You cannot effectively prescribe micro-decisions with macro-precepts. I suggest that unless guidepost standards are formulated in terms much more directly applicable and specific for decision makers, in terms they ordinarily utilize, the guideposts will command neither respect nor application.

(b) The Use of Sanctions

It is thus not surprising that the development of incomes policy has been accompanied, in each country that has been interested in it, by some form of sanctions. The sanctions may vary from mild ones designed to give offenders little more than a public scolding, through to stricter punitive devices.

One approach is to develop a means for systematically reviewing the application of the criteria and for publicly exposing and censuring important cases where the criteria either have been or are about to be violated. The method rests on public acceptance of the criteria as good for the country and on mustering public opinion to condemn deviations from them. Many variations are possible to this approach. There may be simply an *ad hoc* selection of important cases, or a prices and incomes review board may be established to report on cases that should be condemned as a violation of the incomes policy. There may be the requirement of advance notification of major wage and price changes, or the review may take place after the changes. This general approach has been a popular one in recent discussions of incomes policy. It does not require complex machinery for intervention in wage and price decisions nor does it involve the legal problems of imposing penalties. To a public suspicious of the exercise of market power by large economic organizations in the society, an occasional public scolding of a few of them may be a popular move for a government.

A number of problems associated with this approach can be noted:

(1) The degree of public acceptance of the criteria or guideposts will be important in rallying public opinion to censure deviations from them.

(2) Arguments for this approach to implementing incomes policy are frequently based on the belief that there are only a few key wage and price decisions that can be easily identified and which have a large effect on other wages and prices. The accuracy of this view requires further empirical testing.

(3) There will be many wage and price decisions that are not easily handled by this approach. In highly decentralized industries— for

example, construction–there are not the major wage and price decisions that gain national attention or that the public as a whole is likely to be very interested in.

(4) The effect of public exposure may be different for producers than for union leaders. For the former, unfavourable national publicity of a price change may adversely affect sales and profits. For the union leader a wage settlement in excess of the criteria may strengthen his position with the member of his union and thus gain him greater popularity. The wage criteria may thus become a base from which union leaders attempt to gain higher settlements in order to show their bargaining strength.

(5) Although the guides indicate conditions under which industry prices should decline, it is likely that only cases of price increases will gain much national interest. This feature too may cause an uneven impact.

(6) There are likely to be disputes over the measurement of actual changes in earnings and prices in the light of the guides. In addition, in a number of West European countries there is the important phenomenon of wage drift – the difference between changes in earnings rates and in negotiated wage rates – and this reduces greatly the significance of the terms of national wage settlements for the actual increase in earnings.

(7) Reliance on rallying public opinion to censure deviations from the guides means that there are important limits to the number of cases of violation of the criteria which the government can try to expose. The more frequent are the attempts to rally public opinion, the more quickly the public is likely to tire of the procedure.

In an attempt to remedy some of these problems and to strengthen the general effectiveness of incomes policy a variety of stronger measures may be considered. Through its role as a large employer, the government may seek to impose the criteria for the rate of increase of earnings in the public sector in the hope of setting an example that will be followed in the private sector. Attractive as this approach may be on first consideration, it can produce serious difficulties. Wages in the public sector are not usually regarded as leading those in the private sector and to control them more severely may only distort the wage structure without affecting wages in the private sector. The chief problem in applying the national productivity criteria in a wages policy is to keep wages from rising at a more rapid rate than national productivity in those sectors experiencing above-average increases in productivity. Generally in the public sector the rate of productivity increase is not above average and thus, as K. Lancaster has pointed out, "if the central authority has no control over wages in the 'go ahead' sector – and it rarely has in an uncontrolled economy – then it may well make things worse by attempting to exercise control over a lagging sector''.[1]

There are many other devices which the government may attempt to use to support its incomes policy. As an important purchaser of goods and services from industry it may shift its purchases in an attempt to punish offenders of the incomes policy criteria. In its commercial policy it may use selective tariff and subsidy changes in the same manner. In the administration of its legislation governing monopolistic practices the government may ask for investigations in those industries where violations of the incomes policy criteria have been noted.

It is also sometimes proposed that a systematic use of tax rates could be used to back up incomes policy. As J. Garbarino pointed out:[2] ''Sumner Slichter once suggested that part of the costs of a wage increase that exceeded a policy guideline might not be allowed as a business expense for tax purposes.'' The Swedish economist Bent Hansen proposed an intricate plan whereby the government would lower real disposable income for wage-earners if the wages policy was not followed. He summarized his approach for a centralized bargaining situation as follows:[3]

> The method suggested here is that the State makes a declaration of its plans concerning future fiscal and monetary policy for the realization of full employment and a stable value of money with *alternative* future money wage rates. This declaration will include a promise that fiscal and monetary policy will be constructed in such a way that at one certain money wage rate, namely the one that the State considers suitable, wage earners will achieve the highest real disposable income, whereas at both higher and lower money wage rates their real disposable incomes will be lower. Normally it ought to be possible to make the 'bribe' which is promised to the trade unions if they direct their wage claims according to the wishes of the State, so high that the trade unions prefer this money wage rate to all others.

There are a number of interesting possibilities in this area, but up to now there has been little interest in applying them in practice in view of the serious political and administrative difficulties.

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[1] Kelvin Lancaster, *op. cit.*, p. 212.

[2] Joseph W. Garbarino, ''Income Policy and Income Behaviour'', in Arthur M. Ross (ed.), *Employment Policy and the Labor Market* (Berkeley: University of California Press, 1965), p. 85.

[3] Bent Hansen, *The Economic Theory of Fiscal Policy* (London: George Allen & Unwin, Ltd.,1958), pp. 358-9.

If none of these sanctions are feasible or sufficiently effective and if it is felt that there are compelling reasons to try to make an incomes policy work, a government may turn to more direct controls with legal powers to determine wages and prices. But, the focus of recent incomes policy discussions has been on the usefulness of less drastic steps.

SOME INSTITUTIONAL FACTORS

The implementation of an incomes policy – as well as the value of one – will be affected by institutional features of a country. From the discussion in this and the preceding Chapter a number may be suggested but their importance will have to be examined in relation to country experiences.[1]

First, if both union and management organizations are highly centralized, not only may the concentration of economic power make a national incomes policy more important but also the potential for obtaining general labour and management agreement on the criteria of incomes policy may be greater. The macro-economic implications of general violations of the criteria may be appreciated more fully by centralized organizations, and the leaders may in turn be able to help implement the policy through their influence over members of the organizations.

Second, the degree of public support for a greater control over income distribution in line with the criteria of an incomes policy will be important. Solidarity among workers on what is regarded as a more just system of relative wages than what market forces have tended to produce will influence support for a more central direction of the wage structure.

Third, relations between labour and management organizations and the government, and the general public confidence in the administrators of an incomes policy, will have some influence. For example, it will be easier to get labour support for incomes policy if the political party in power has close links with the main union organizations, but this may make it more difficult to get management support.

Fourth, the centralized power of the national government and the degree to which the government is already involved in economic processes will

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[1] A number of important institutional differences between European countries and the United States which have a bearing on the feasibility of an incomes policy are discussed in Mark W. Leiserson, "A Brief Interpretive Survey of Wage-Price Problems in Europe", Study Paper No. 11, Joint Economic Committee, Congress of the United States, *Study of Employment, Growth, and Price Levels* (Washington: U. S. Government Printing Office, 1959). Some of the institutional problems of a wage policy in Canada are discussed in John H. G. Crispo, "Organized Labour and National Planning", in Abraham Rotstein (ed.), *Prospect of Change: Proposals for Canada's Future* (Toronto: McGraw-Hill, 1965), pp. 197-219.

affect the forcefulness with which the government can try to implement incomes policy.

Fifth, the degree of integration of the economy with foreign economies will generally limit the extent to which a country can follow an independent incomes policy. High labour and capital mobility into and out of the country and close business and labour ties with foreign counterparts can reduce both support for and the effects of an independent national effort to develop incomes policy criteria that affect wage and profit structures.

Sixth, the degree of national cohesion in achieving the objectives of an incomes policy will be important. If there is a general public awareness of the need to reduce the rate of increase of prices, a strong general opposition to increases in the unemployment rate, and a mutual confidence among economic groups that one sector or region will not try to benefit more than the others from general wage and price restraint, it will be easier to implement an incomes policy. While these factors will vary among countries, they will also probably tend to be stronger in a country that is suffering from a severe economic crisis.

If these institutional features are important in influencing support for an incomes policy – and they will require closer examination in later chapters – it is of interest to note here that Canada would not score highly as a country in which it would be easy to implement an incomes policy at present.[1] The labour and management organizations are highly decentralized;[2] there is little evidence of a solidarity among workers for a more central direction of and revision to the wage structure, the central government's economic power is weak in relation to many other countries, there is a high degree of economic integration with the United States, and, at least under current economic conditions, there does not appear to be a strong national unity and mutual confidence among economic groups by sector and region.

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[1] An important statement of the willingness of organized labour in Canada to explore an incomes policy, if it is sufficiently comprehensive in terms of all incomes, is contained in Canadian Labour Congress, *Labour Costs in Canada* (Ottawa: 1966), pp. 20-4.

[2] It is of interest to note also the lower percentage of workers in unions and the recent more rapid rate of increase of the labour force in Canada than in the other countries reviewed in this study. See Tables 3-1 and 3-2.

TABLE 3-1

Unionization in Selected Countries, 1964

Country	Union Membership	Total Labour Force	Nonagricultural Wage Earners and Salaried Employees	Union Membership in Per Cent of Labour Force	Union Membership in Per Cent of Nonagricultural Wage Earners and Salaried Employees
	(000's)	(000's)	(000's)		
Canada	1,493	7,052	5,368	21.1	27.8
Netherlands(1) ..	1,430	4,482	3,887(2)	32.0	36.8(3)
Sweden(4).......	2,119	3,779	2,991	56.1	70.8
United Kingdom	9,320	25,780	22,761	36.2	40.9
United States ..	16,841	76,971	58,736	21.9	28.7

(1) 1965 membership.

(2) Total nonagricultural employment.

(3) Per cent of total nonagricultural employment.

(4) 1963-64.

Note: Because of the difficulties of getting comparable data on union membership and manpower, these comparisons should be regarded as only approximate.

Source: Bureau of Labor Statistics, U.S. Department of Labor.

TABLE 3-2

Growth of Labour Force and Labour Force Participation Rates, 1950-62, in Selected Countries

Country	1950			1962			
	Total Labour Force (thousands)	Males in Labour Force as Per Cent of Male Population (per cent)	Females in Labour Force as Per Cent of Female Population (per cent)	Total Labour Force (thousands)	Males in Labour Force as Per Cent of Male Population (per cent)	Females in Labour Force as Per Cent of Female Population (per cent)	Increase in Total Labour Force 1950 to 1962 (per cent)
Canada........	5,215	59.0	16.5	6,735	52.7	19.5	29.1
United States[a] .	64,749	61.0	24.5	74,681	54.5	25.9	15.2
United Kingdom	23,526	65.7	28.8	25,486	64.9	31.4	8.3
Netherlands[b]. . .	3,915	59.8	17.7	4,538	58.8	18.2	15.9
Sweden........	3,105	65.2	23.2	3,405	61.9	28.2	9.7
France........	19,511	63.3	31.2	19,860	57.9	27.4	1.8
Germany (F.R.).	21,950	63.8	30.2	26,185	64.2	33.1	19.3

[a] Excludes Alaska and Hawaii in 1950.

[b] Labour force figures based on man-years.

Source: B. Mueller, *A Statistical Handbook of the North Atlantic Area*, (New York: Twentieth Century Fund, 1965).

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PART II

EXPERIENCES WITH INCOMES POLICIES

Chapter 4

The United States: Guideposts for Wages and Prices

The United States approach to wage-price policy in the post-war period has varied. It has included direct wage and price controls during the Korean War period, frequent public exhortation to wage and price restraint, particularly in the late 1940's and late 1950's, and, since 1962, the development of guideposts for noninflationary wage and price behaviour. The last is currently attracting most interest in U.S. wage-price policy.

The guideposts for wage and price behaviour were first enunciated in the 1962 Annual Report of the President's Council of Economic Advisers, a report which is published each January along with the Economic Report of the President. In each subsequent report there has been a reaffirmation and elaboration of the guideposts by the President and his economic advisers. The guideposts were not introduced as a very dramatic innovation to economic policy, but they have achieved a prominence in public economic debates that was probably not contemplated at the time of their introduction. Further, many economists feel they have received attention out of proportion to their economic significance. To some, however, they deserve serious attention either because it is alleged they have had a significant, useful effect or to others because they have had dangerous side effects.

Very simply, the guideposts are a set of guides which, if followed by management and labour in the determination of wages and prices, would lead to approximate price stability. They represent more than mere exhortation for they involve more than a general plea for wage and price restraint. They are a set of criteria not only for the appropriate average rate of increase of earnings for the whole economy but also for individual industries. They also serve to indicate when industry prices should rise or fall. They have been the basis on many occasions for governmental intervention in wage and price determination. The guideposts have thus been a form of incomes policy.

The nature and use of the guideposts have changed in important repects since 1962 and they are now undergoing further modifications. In view of the current re-examination of them in the United States, their future is particularly difficult to predict at this time and a more complete assessment of their past value requires further research and a longer historical perspective. But an attempt will be made to examine them under five headings:

(1) factors that appear to have influenced their development;

(2) the nature of the guideposts;

(3) the use of the guideposts since 1962;

(4) some special features of the U.S. approach;

(5) the usefulness and problems of the U.S. approach.

INFLUENCES ON THEIR DEVELOPMENT

Why did the United States develop these guideposts? What was it that their development was expected to achieve?

First, the guideposts were advanced in 1962 at a time when U.S. policy was not directed primarily at fighting inflation; there had been a high degree of price stability in recent years. They were initiated as one part only of an over-all strategy for an expansionary policy that would be threatened if more rapid price increases and more serious balance-of-payments difficulties emerged. The new Kennedy Administration was seeking support and public acceptance of policies to lift the economy towards full-capacity levels. The unemployment rate over the four-year period 1958–61 had averaged 6.1 per cent while the consumer price index had been rising by only a little over 1 per cent a year and the wholesale price index had not risen at all.

An obstacle to the programme of expansionary policies was a strong public suspicion of the inflationary consequences. Not only have there long been strong political pressures for price stability in the United States, but these pressures were intensified in the early 1960's; the balance-of-payments position was weak and there was little hope of handling it by an immediate revision of international liquidity arrangements or a more flexible exchange rate policy. It was felt that a more forceful official statement to the effect that prices were not going to be overlooked might help allay fears and win popular and legislative support for the Administration's basic programme of making aggregative policies, particularly fiscal policy, more expansionary.

Second, the thinking behind the guideposts was, and continues to be, strongly influenced by a view of market imperfections that was stressed in a number of studies of the experience of the United States during the last half of the 1950's. The inflationary spurts during the immediate post-war years and the Korean War period appeared to have a simple explanation in terms of excess demand conditions and they posed no serious problems for price policy in a peacetime economy, if monetary and fiscal policies were managed properly. Following a period of price stability from 1952 to 1955, however, prices started to rise, despite the fact that there did not appear to be any general excess demand in the economy. More serious questions were raised about the ease of maintaining price stability at acceptable full-employment levels.

The experience stimulated a large number of economic studies. The most influential in terms of their impact on economic policy thinking of the next few years were those conducted at the end of the 1950's under the auspices of the Joint Economic Committee of the U.S. Congress.[1] The studies were wide-ranging and a number of them provided support for the argument that price stability could not be handled by general aggregative policies if reasonably high employment levels were also to be maintained. Emphasis was placed on the greater inflexibility of money wages and prices downwards than upwards and on the consequent levering up of prices as demand shifted among sectors.[2] Further, key industries, particularly steel, were pin-pointed as having played an important role in the inflation, largely as a result of the economic power they exercised,[3] and the importance of the prices of their products in affecting costs of production for a wide range of other industries. Further, it was argued that not only could a few key industries be relatively insensitive to economic conditions in their wage and pricing policies, but also that wage settlements in these industries tended to be emulated in other industries and thus set a pattern of wage settlements throughout the economy.

These related arguments, that much of the upward pressure on wages and prices could be explained in terms of imperfections in the working of economic markets and that there were a few key industries in which wage and price decisions had a pattern-setting effect on the rest of the economy,

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[1] A summary report based on these studies is: U.S. Congress, Joint Economic Committee, *Staff Report on Employment, Growth, and Price Levels* (Washington: U.S. Government Printing Office, 1959). A recent indication of the importance of these studies for the Administration's economic policy is in *Economic Report of the President, January 1966, Together With The Annual Report of the Council of Economic Advisers* (Washington: U.S. Government Printing Office, 1966), p. 179.

[2] See C. L. Schultze, "Recent Inflation in the United States", Study Paper No. 1, U.S. Congress, Joint Economic Committee, *Study of Employment, Growth, and Price Levels* (Washington: U.S. Government Printing Office, 1959).

[3] A particularly influential study that attached great importance to the behaviour of the steel industry was: Otto Eckstein and Gary Fromm, "Steel and the Postwar Inflation", Study Paper No. 2, U.S. Congress, Joint Economic Committee, *Study of Employment, Growth, and Price Levels* (Washington: U.S. Government Printing Office, 1959).

did not go unchallenged by other economists.[1] But the arguments appear to have exercised a considerable influence on the thinking of the Administration's economic advisers – to have provided an intellectual basis for some new form of wage-price policy in which benefits could be expected from focusing on the behaviour of a few key industries without becoming involved in wage and price decisions throughout the economy. The early use of the guideposts as the basis for government intervention in the steel industry is not surprising in view of the blame placed on the steel industry in some of these studies for much of the inflation in the latter part of the 1950's.

Third, before 1962 there had been considerable interest in developing a wage-price policy that would not involve direct wage and price controls. There are passages in the Economic Reports of the President in the late 1940's that sound very much like vaguer versions of the guideposts. For example, the 1950 mid-year Economic Report contains this statement: "The Council of Economic Advisers, in January, committed itself to the desirability of a wage-price policy which sought to stabilize prices and to gear wage increases to general advances in productivity."[2] But the Korean War intervened and the United States implemented a system of direct wage and price controls. These were not viewed as a success; the experience strengthened general opposition to such controls except under extreme emergency conditions.[3] Again, at the end of the 1950's, under the Eisenhower Administration the President and his economic advisers stressed wage and price restraint and formulated these pleas in terms that were not too dissimilar from the guideposts. One of the members of President Eisenhower's Council of Economic Advisers published in the January-February 1962 issue of the *Harvard Business Review* a formula for wage-price policy that was remarkably similar to the guideposts set out at about the same time by President

[1] A defence of an explanation of the inflation in terms of monetary forces for this period was made, for example, by R. T. Selden, "Cost-Push versus Demand-Pull Inflation, 1955-57", *Journal of Political Economy*, LXVII (February 1959), pp. 1-20. For examples of arguments that questioned the role of an industry like steel in constantly pushing up prices, see M. A. Adelman, "Steel, Administered Prices and Inflation", *Quarterly Journal of Economics*, LXXV (February 1961), pp. 16-40; E. R. Livernash, *Collective Bargaining in the Basic Steel Industry* (U.S. Department of Labor, 1961), Chap. 11.

[2] *The Midyear Economic Report of the President, July 1950 Together With The Economic Situation at Midyear 1950 by the Council of Economic Advisers* (Washington: U.S. Government Printing Office, 1950), p. 44.

[3] For a critical evaluation of the U.S. experience with controls in the Korean War period, see B. C. Roberts, National Wages Policy in War and Peace (London: George Allen and Unwin, Ltd., 1958), pp. 66-82.

Kennedy's Council.[1] The United States had thus been experiencing for some time and on a politically bipartisan basis a search for a new form of wage-price policy that would not involve controls.

NATURE OF THE GUIDEPOSTS

The guideposts were announced in the 1962 Economic Report.[2]

Guidepost for wages:

> The general guide for noninflationary wage behaviour is that the rate of increase in wage rates (including fringe benefits) in each industry be equal to the trend rate of over-all productivity increase. General acceptance of this guide would maintain stability of labour cost per unit of output for the economy as a whole – though not of course for individual industries.

Guidepost for prices:

> The general guide for noninflationary price behaviour calls for price reduction if the industry's rate of productivity increase exceeds the over-all rate – for this would mean declining unit labour costs; it calls for an appropriate increase in price if the opposite relationship prevails; and it calls for stable prices if the two rates of productivity increase are equal.

Thus, one guide was that employee compensation should rise in line with the trend increase in the average productivity for the nation and this would keep unit labour costs a constant average. The second was that prices should fall in those industries experiencing a higher-than-average rate of increase of productivity and rise in those industries experiencing a lower rate of increase of productivity. Thus, prices would remain a constant average.

It was clear that these guides were suggested not as a basis for detailed government intervention throughout the economy but as a standard upon which to judge whether particular key wage and price decisions that have special national significance were in the public interest. These key decisions were defined as follows:[3]

> Individual wage and price decisions assume national importance when they involve large numbers of workers and large amounts of output directly, or when they are regarded by large segments of the economy as setting a pattern.

The Report recognized that a number of difficulties would be encountered in using these guideposts. First, it pointed to difficulties in measuring

[1] Henry C. Wallich, "Can We Stop Inflationary Wage Increases?" *Harvard Business Review* (January-February 1962), pp. 6-12, 160-161. As noted below, however, the two chairmen of President Eisenhower's Council of Economic Advisers have been foremost critics of their development.

[2] *Economic Report of the President, January 1962, Together With The Annual Report of the Council of Economic Advisers*, p. 189.

[3] *Ibid.*, p. 185.

productivity and in selecting the appropriate time period for a trend measurement of productivity. In fact, no specific figure was suggested in this first statement of the guideposts. Second, with respect to difficulties of implementation, there was a strong denunciation of direct controls and a rather vague statement about the benefits to be expected from a more informed public. Third, the guideposts, as enunciated, would call for the proportion of labour to nonlabour incomes to remain fixed. There was a recognition that the distributive shares need not be constant over time, but there nevertheless appeared to be an implicit theory of economic growth in which distributive shares could be expected to remain approximately constant in the long run. The guideposts were viewed not as a simple arithmetic exercise, but as a general description of "how prices and wage rates would behave in a smoothly functioning competitive economy operating near full employment".[1]

In addition it was pointed out that due to equity and efficiency considerations several modifications to the guideposts are necessary when they are applied to individual industries. The most important of these were:

(1) If an industry was having difficulty attracting sufficient labour, wage increases in excess of the guidepost figure would be justified, but, if there was surplus labour in the industry, a wage increase below the guidepost figure was called for.

(2) If wages are exceptionally low in particular labour markets because of the weak bargaining position of workers, an increase in wages above the guidepost figure would be justified, but, if wages are exceptionally high in some markets because of a strong bargaining position of workers, a change below the guidepost figure would be important.

(3) Price changes above the guidepost figure could be justified in an industry if costs other than labour costs had risen or if profit levels were inappropriate to attract sufficient capital.

(4) Price changes below the guidepost figure would be called for if costs other than labour costs had fallen, if it is desirable to have an outflow of capital from the industry, or if profit rates had been exceptionally high as a result of excessive market power. In addition, it was recognized that there might be other modifications such as additional compensation to employees as an incentive for greater effort.

The guideposts, as announced in 1962, thus consisted of two general guiding principles for wages and prices. There were no specific figures attached to them. There was a recognition of rather complex modifications that should be taken into account in a particular case. No formal machinery was proposed for implementing the guideposts.

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[1] *Ibid.*, p. 188.

Although subsequent annual reports have repeated the basic outline of these guideposts, there have been some interesting changes in their presentation. In the 1964 Report a more specific and tougher line was taken on their use. A table on trend changes in productivity, calculated on the basis of five-year averages, was included, showing the recent trend figure of 3.2 per cent. This was widely interpreted as the number appropriate for the application of the guideposts. More importance was attached to the scope of the guideposts. While the 1962 Report had emphasized only wage and price decisions of national importance, the 1964 Report emphasized that the guideposts "can cover the vast majority of wage and price decisions".[1] Less importance was attached to the modifications contained in the 1962 Report: "These modifications of the general guideposts still apply, but it must be emphasized that they are intended to apply to only a relatively few cases."[2] In addition, greater stress was placed on price reductions where the guideposts called for them, and the Report complained that "large industrial enterprises thus far have not widely heeded this advice".[3]

The 1966 Report provides further elaborations in four directions. First, throughout the Report the guideposts are given a more important role among the various types of economic policy. Strong claims are made for their past effect; increased emphasis is placed on the need for a wide application of them in the U.S. economy. A number of industries posing serious problems for wage-price policy, particularly the construction industry, are discussed. Second, with respect to the criticism that the guideposts tend to favour a fixed relationship between labour and nonlabour incomes, there was again the denial that they should be interpreted this rigidly, but it is pointed out that over the whole post-war period the share of labour and capital in total income has "remained virtually unchanged".[4] The implication is that attempts by labour or management to change their share of total income are unlikely to have much effect and are likely to lead only to more inflation.

Third, the modifications or exceptions to the two basic guideposts are reviewed. Apart from changes in wages related to changes in work rules or changes in prices related to changes in nonlabour costs, the Report finds all the other modifications "rarely applicable" or "not widely applicable in the present environment".[5]

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[1] *Economic Report of the President, January 1964, Together With The Annual Report of the Council of Economic Advisers*, p. 119.

[2] *Ibid.*, p. 119.

[3] *Ibid.*, p. 120.

[4] *Economic Report of the President, January 1966, Together With The Annual Report of the Council of Economic Advisers*, p. 90.

[5] *Ibid.*, p. 91.

Fourth, the appropriate figure for trend productivity in the economy is treated more explicitly. It is pointed out that the figure of 3.2 per cent has been viewed as appropriate in preceding reports and that this figure was based on a five-year average which, when recalculated for the current year, would yield 3.6 per cent. The Council clearly faced the dilemma of whether to stick to its method of calculating a trend change in productivity or to stick to its figure of 3.2 per cent. It decided on the latter. It had become rather more rigidly committed to a figure, correct to one decimal place, than was probably originally intended.

The two basic principles in the guideposts have retained their original form in the 1966 Report:[1]

> Wages: ... the annual rate of increase of total employee compensation (wages and fringe benefits) per man-hour worked should equal the national trend rate of increase in output per man-hour.
>
> Prices: ... prices should remain stable in those industries where the increase of productivity equals the national trend; that prices can appropriately rise in those industries where the increase of productivity is smaller than the national trend; and that prices should fall in those industries where the increase of productivity exceeds the national trend.

Yet, in their original context they were somewhat vague and tentative, surrounded by an important set of modifications. Through time they have emerged in the Council Reports in a more permanent and specific form, shorn of much of their protective coating.

USE OF THE GUIDEPOSTS

The guideposts were originally advanced as an exercise in public persuasion. No specific techniques for implementing them were suggested. Instead it was stated:[2]

> An informed public, aware of the significance of major wage bargains and price decisions, and equipped to judge for itself their compatibility with the national interest, can help to create an atmosphere in which the parties to such decisions will exercise their powers responsibly.

To the extent that they have had an effect, however, it appears that this has been due to various forms of government intervention rather than to a voluntary change in behaviour. A variety of open and hidden devices

[1] *Ibid.*, pp. 89-90.

[2] *Economic Report of the President, January 1962, Together With The Annual Report of the Council of Economic Advisers*, p. 185.

have been employed by the U.S. Administration to try to gain some measure of adherence to the guideposts. A brief review of some of the major events in the use of the guideposts will help to demonstrate this point.

The first major application of the guideposts in April 1962 resulted in the well-known, dramatic confrontation between President Kennedy and the business leaders of the steel industry. On April 10, the U.S. Steel Corporation announced price increases averaging about 3.5 per cent, and this was followed the next day by similar increases by five other major steel companies. On April 11, President Kennedy charged that the increase in prices was "a wholly unjustifiable and irresponsible defiance of the public interest".[1] The wage contract signed in March was not viewed as being out of line with the guideposts, productivity improvements in the industry were expected to be high, and nonlabour costs, it was argued, were actually declining. The price increases were not in line with the guideposts or covered by any of the modifications to them and they followed on a wage settlement within the guideposts which the Administration had worked hard to get.

The President acted quickly to bring the full force of his executive office to bear on rallying public opinion against the increases. He also announced that inquiries would be conducted by Congress. The Department of Justice on the following day announced that a grand jury investigation of the price increases under the Sherman Anti-Trust Act would be made. The next day it was announced that the Department of Defence would try to award defence contracts to those producers who had not raised prices. The steel industry retreated before this onslaught and rescinded the price increases. Thus, the immense prestige of the executive's office, the anti-trust law, and the buying power of the government on its defence expenditures were all brought to bear in order to win compliance.

Reliance simply on general appeals for responsible action as defined by the guideposts has clearly not led to compliance in important cases. Thus, for example, in 1964 the wage settlement in the automobile industry was in excess of the national trend increase in productivity. While it was argued that the increase was not excessive in terms of the higher growth of productivity in this industry, the guideposts clearly call for wage increases not in excess of the national trend. Further, the higher rate of increase in productivity in the industry has led to a higher rate of increase of profits rather than to the decline of automobile prices that would be called for under the guideposts.

In other cases there was greater success when there was a direct involvement of the President or the use of some form of penalties. In

[1] For a summary report, see U.S. Department of Labor, *Monthly Labor Review*, 85 (May 1962), p. 178.

October 1965, the aluminum producers announced price increases. The Council of Economic Advisers prepared an analysis showing these were not in conformity with the guideposts. The Administration brought pressure to bear on the companies and indicated that the huge government stockpiles of aluminum would be used to affect market supply conditions of aluminum. The companies then rescinded the price increases. In the case of the steel wage negotiation in the summer of 1965 the Administration also played an important role. In May the Council of Economic Advisers had prepared a study arguing for wage and price decisions in line with the guideposts. The Administration helped in achieving the final wage settlement which appeared to be quite close to the 3.2 per cent figure of the guideposts, depending on the method of calculating the effects of the various terms of the agreement. The case did highlight the difficulties of precise measurement in this area as another study by Professor Jules Blackman suggested that the Council's estimate of productivity increase in the steel industry was too high. Despite this wage settlement one of the major steel companies, Bethlehem Steel Corporation, announced at the end of 1965 a price increase of $5 a ton on structural steel and pilings. The Administration immediately opposed this increase publicly, fearing that it would trigger a general price increase in the steel industry, and censored the move on patriotic as well as economic grounds. Victory was gained when the U.S. Steel Corporation announced a smaller price increase on the items at issue along with price reductions on some other steel products, and Bethlehem Steel drew back on its increase to remain in line with U.S. Steel and other companies in the industry.

In the case of the civil service and postal employees it appeared that Congress was willing in the fall of 1965 to grant wage increases that were substantially in excess of the guideposts. President Johnson intervened and threatened to use his veto power if Congress passed the increases. An increase within the guideposts was concluded. In the case of the Steamship lines the government planned to reduce subsidies in view of what were regarded as excessive wage increases in the past. Although the Secretary of Commerce reversed this ruling for special reasons, there was a clear indication that the government was prepared to use its power over import and export tariffs, subsidies, and controls to back up the guideposts.

While there are undoubtedly many other cases of government intervention that have received little publicity, these cases illustrate clearly that the government has not relied on a voluntary change in behaviour induced by the publication of the guideposts. Instead, the guideposts have been backed up by an assortment of devices including public denunciations by the President and threats to use anti-trust investigations, to switch defence orders, to manipulate government stockpiles of materials, to employ commercial policy, and to make use of the presidential veto over legislation.

The difficulties of maintaining the approach have become, however, more apparent in 1966. Despite the opposition of the Administration, steel prices were increased. The settlement of the airlines machinists' strike, in which the government played a role, involved about a 4.9 per cent increase in wages and fringe benefits. The mounting number of violations of the guideposts led to the announcement in the summer by members of the President's cabinet that the 3.2 guidepost figure would not be as rigidly interpreted in the future.

SOME SPECIAL FEATURES

Several special features of the recent U.S. approach to wage-price policy are of particular interest.

In comparison to other countries examined in this study there was not a serious involvement of labour or management groups in the formulation and implementation of incomes policy. The guideposts were developed by the President and his advisers. It appears that representatives of employers and unions have on occasion been called to the White House to discuss the guideposts, but even these meetings have been largely for the purpose of explaining them. The President's Labor-Management Advisory Committee, on which there are representatives of labour and management, does not appear to have had a significant part in the development of the guideposts, although it is currently expected to play a larger role in the future on wage-price policy. Representatives of national labour and employer associations have generally attacked the guideposts.

At least in part, this lack of direct involvement stems from the much greater decentralized nature of labour and employer institutions. About 85 per cent of union members in the United States are affiliated through their unions with the AFL/CIO Federation. But the Federation has little formal power over the unions. It does not attempt to formulate a centralized wage policy nor does it take any direct part in the collective bargaining of its affiliates. Also, the union movement has been less closely linked to national party politics than in a number of European countries.

In collective bargaining, power on the labour side has been centred more in the national unions, and has been exercised either through leaders of the national union directly participating in industry-wide negotiations or in assisting local unions in their bargaining. Despite some increase over the post-war period, industry-wide negotiations are still not common and thus bargaining at the local level remains a more important feature of the U.S. system than of the West European. The great detail with which the contracts are worked out also means that the difference between changes in negotiated and actual earnings, which has attracted so much attention in West European discussions of incomes policy has been relatively small.

On the employers' side the approach to collective bargaining is also not centralized to the extent that it is in the United Kingdom, the Netherlands or Sweden. On an industry level a number of employer associations have been formed either on a continuing or *ad hoc* basis for industry negotiations, but formal organization even on the industry level remains comparatively rare.

The more decentralized structure of collective bargaining in the United States has thus reduced the scope for collaboration between government, management, and labour leaders in the working out and implementation of incomes policy. There is, on the other hand, a feature of U.S. collective bargaining which has probably eased the administration of the guideposts. The greater prevalence of long-term labour contracts extending over two or more years has permitted less-frequent involvement in the key bargains that are regarded as being of national significance.

Another feature of the U.S. system has been the co-existence of a strong aversion to direct controls along with support for strong centralized leadership and a high tolerance for government interference in markets if such interference is advanced in the name of helping to promote more competition. The large size of the domestic market and the strong spirit of economic opportunism have made controls such as those of the Korean War period extraordinarily difficult to administer and strongly opposed under most conditions. Perhaps in part because of the U.S. position in world affairs, however, there has not been, as in Canada, major pressures for decentralization of the government's economic power. There appears to be considerable support for the argument that stronger positive government leadership can help to make the U.S. economic system work better, an important argument advanced often in the context of the country's foreign policy. The federal government has, as a result, had surprisingly little resistance to a variety of new measures that stop short of direct controls, such as the wage-price guideposts, the guidelines over international capital outflows, the attempt at a "twist" of the interest rate structure, the interest equalization tax and so forth. With respect to U.S. price policy a British economist recently observed:[1]

> One way or another the American government tries to exert pressure on price formation to a greater extent than, on the whole, did British governments before the creation of the National Board for Prices and Incomes.

Another feature of the U.S. approach should be noted. The guideposts have not been introduced or developed with formal machinery for reviewing

[1] *Non-Wage Incomes and Prices Policy, Trade Union Policy and Experience* (Paris: OECD, 1966), p. 169. This is a background report by D. Robinson for an international trade union seminar.

and enforcing adherence to the guideposts. There is evidence that government departments have assisted in providing information on important price and wage developments, but the guideposts have been administered through the President's Office on a largely *ad hoc* basis. This means a highly time-consuming involvement of the President's Office in this area, an involvement which would appear to be onerous for a long-term and serious application of the guideposts, and one which would commit the President perhaps too strongly and continuously to details of wage and price decisions in the economy.

EFFECTS, PROBLEMS AND PRESSURES FOR CHANGE

It is extremely difficult to measure the effect that the U.S. wage and price guideposts have had in recent years. Claims have been made, particularly in the 1966 Economic Report of the President and his advisers, that the guideposts have had a significant effect. It has been pointed out that the record of wage and price stability during the expansion of the first half of the 1960's has been an impressive one. In the private economy the annual rate of productivity advance from 1960 to 1965 has averaged 3.6 per cent while compensation per man-hour has increased at an annual rate of 4.2 per cent which means unit labour costs have increased by only 0.6 per cent a year.[1] Over the same period the consumer price index has risen about 1.3 per cent a year and the wholesale price index at less than 0.4 per cent a year. The guideposts have been exceeded on both employee compensation and prices, but the record is still viewed as an excellent one.

There is no doubt that the President has had success in influencing a number of key wage and price decisions. In addition to the confrontations with management and labour that have received much publicity, there have been many less well-known attempts to use the guideposts to affect decisions. It has also been argued that they have indirectly helped to affect general wage and price expectations, to increase the price consciousness of government purchasing agencies, to resist extravagant demands for minimum wage legislation, to interject economic criteria more into labour conciliation, to reduce the popularity of escalation clauses in labour contracts that tie wages automatically to the cost of living index, and to focus more attention on improvements in productivity.

Several econometric studies have confirmed that the rate of increase of wages and prices was lower after 1962 than would have been expected

[1] *Economic Report of the President, January 1966, Together With The Annual Report of the Council of Economic Advisers*, p. 79.

on the basis of earlier post-war economic relationships.[1] This experience may reflect the use of the wage-price guideposts, but other important explanations have been suggested too. They have included the effect on expectations of the fairly long period of high unemployment of resources prior to 1962, the moderate rate of general economic expansion during the period, and the continuance during the period of more "hidden" unemployment relative to earlier post-war years.[2] Thus, while the evidence is consistent with the view that the guideposts have had some effect, it has been extremely difficult to establish it conclusively.

A number of problems have also emerged which may affect the usefulness of the guideposts for facing more serious tests of inflationary pressures.

First, there have been measurement problems in applying the guideposts. With respect to the trend increase in national productivity, the Council of Economic Advisers has encountered some difficulty in deriving the appropriate figure. The best data to use in measuring productivity is not a settled matter; in addition, in calculating a trend, the Council began with a five-year moving average but in 1966 abandoned this method without substituting another formal method. While the issues here do not appear to be insurmountable, more serious questions are raised about comparing trend increases in productivity for a particular industry with the national average. Under the guideposts, productivity figures for industries are required to justify price changes. In the confrontations with the steel industry in both 1962 and 1965 the steel companies have objected to the Administration's estimates of productivity for the industry. In addition, disagreements can be expected to arise on how to classify an industry. Agreement on the appropriate measures of productivity will not therefore always be an easy matter to solve.

Second, there have been important conceptual problems. Is the economic reasoning behind the guideposts sound or would adherence to them adversely affect the economy? As noted earlier the guideposts appear to imply a view of the growth process in which the marginal and average contributions of labour and capital to output grow at equal rates over time and in which technological change will not tend to alter the ratio of returns to labour and returns to capital. This is a possible course of economic growth but not a necessary one. Further, the guideposts imply that little attention should be paid to shorter-run variations in either market power or general

[1] See G. L. Reuber, R. G. Bodkin, E. P. Bond, and T. R. Robinson, *op.cit.*, ch. 7; Frank Brechling, "Some Empirical Evidence on the Effectiveness of Price and Incomes Policies," paper read to the Canadian Political Science Association Meetings, June 1966; Robert M. Solow, "The Case Against the Case Against the Guideposts," in Shultz and Aliber, eds., *op. cit.*, pp. 45-7.

[2] Frank Brechling, *op. cit.*

demand and supply conditions, although the modifications, stressed particularly in the first proposal of the guideposts, provide some flexibility on the latter. The economic case for this approach has not been endorsed by all economists.

The guideposts have been strongly criticized, for example, by two former chairmen of the Council of Economic Advisers. Professor R. J. Saulnier, who was chairman from 1956 to 1961, has referred to them as "arbitrary", "inequitable", "ineffective as an anti-inflationary measure" and "harmful to the economy".[1] Professor A. F. Burns, who was chairman from 1953 to 1956, attacked the consequences of adherence to the guideposts.[2] He charged that the guideposts would freeze the ratio of prices to unit labour costs and that this would tend to reduce the mobility of economic resources in response to demand and supply conditions, reduce competition and slow economic growth. He further fears that since it is not necessarily in the private economic interest to follow them, the government may be driven to more serious controls in order to try to make them work.

There are a number of other issues. Industry and national productivity data will be based on past experience, whereas wage and price decisions reflect in part expectations about the future. The guideposts are formulated in terms of behaviour of industries rather than of firms but when is a decision by a firm to change prices to be disregarded by the government or when is it to be taken as important for the whole industry? Defenders of the guideposts have argued that they are supposed to affect behaviour only in administered price sectors where price decisions tend to be industry-wide. It is also argued that the economic case for a strict application of the guideposts may not be strong but that the intention has always been to apply them flexibly. Some modifications to them have always been viewed as desirable.

Thus, the formulation of the guideposts poses a familiar dilemma in the attempt to develop wage-price policies. Complex criteria that would be regarded as more defensible on economic grounds are difficult to apply in practice because they tend to provide everyone with arguments about their special position. As noted earlier, successive reports of the Council of Economic Advisers have tended to play down the modifications or exceptions to the guideposts because they weakened their effectiveness. On the other hand, simple criteria that are more easily applied do not make as

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[1] Raymond J. Saulnier, "On the Dangers of Wage-Price Guideposts: Present and Future," *Business Economics*, I (Spring, 1966), pp. 7-9.

[2] Arthur F. Burns, "Wages and Prices by Formula?", *Harvard Business Review*, 43 (March-April 1965), pp. 55-64. See also the reply by Gardner Ackley, Chairman, Council of Economic Advisers, in *Harvard Business Review* (September-October 1965), pp. 41-42.

much economic sense and may impose new rigidities, especially over the longer run.

Third, there have been problems in gaining compliance with the guideposts. Labour and management have not in general endorsed them and have shown little enthusiasm to conform voluntarily. Application of the guideposts in the past has thus not rested on private support. From the beginning the guideposts have been a creation of the Executive Office of the President and have been backed up by a variety of threatened sanctions by the President. The longer-run viability of this approach has been questioned on several grounds. It has meant a degree of involvement of the President's Office in specific aspects of the functioning of the economy that is viewed by many as undesirable as well as too time-consuming. Some participation by Congress has been supported on both constitutional and administrative grounds.[1] Also, while through the periodic intervention of the President there have been notable successes in gaining adherence to the guideposts, the approach has not been a comprehensive one. Little success has been achieved in getting price reductions called for under the guideposts, and there have been particular difficulties in applying them in some key industries such as construction, because of its highly decentralized nature. Problems of administering the guideposts will become more serious in periods of strong inflationary conditions when market pressures for wage and price increases in excess of the guideposts become greater. Earlier in the use of the guideposts when the economy was moving out of a period of high unemployment, these problems were not as serious. But now the administrative machinery for reviewing and analyzing wage and price developments and for trying to gain compliance with the guideposts does not seem to be well adapted at this stage to conditions of stronger inflationary pressures.[2]

Thus, the pressures for change in the approach, coupled with the particularly large wave of key wage settlements scheduled for the near future, will make the next few months a crucial testing time. With the growing number of violations of the guideposts and the official announcement in the summer of a less rigid use of the 3.2 per cent figure in the future, many have forecast an end of the guidepost policy. But there is clearly a search for ways to modify rather than scrap it. For example, the President's Labor Management Advisory Committee, on which there are quite a few critics of the past guidepost policy, has indicated recently a

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[1] See Phillip B. Kurland, "Guidelines and the Constitution: Some Random Observations on Presidential Power to Control Prices and Wages", in Shultz and Aliber, eds., *op. cit.*, pp. 209-41.

[2] For a fuller discussion of these difficulties see John T. Dunlop, "Guideposts, Wages and Collective Bargaining", in Shultz and Aliber, eds., *op. cit.*, pp. 85-92.

willingness to participate in the development of a revised formula and in reviewing problems in its implementation. This would mean a greater involvement of labour and business leaders in the policy than in the past. The future of the policy is, however, highly uncertain. At this time, the guideposts are at cross-roads in their development.

TABLE 4-1

Some Economic Indicators for the United States

Year	Consumer Price Index	Wholesale Price Index	Implicit Price Index GNP	Industrial Production	GNP in Constant Prices	Per Capita GNP in Constant Prices	GNP per Person Employed in Constant Prices	Hourly Earnings	Unemployment Rate
	Annual per cent change from preceding year								Annual average
1951	7.9	11.4	8.9	8.5	7.3	5.2	5.4	8.4	3.3
1952	2.3	- 2.8	1.0	3.4	3.7	2.0	3.2	5.6	3.1
1953	0.8	- 1.4	1.0	8.7	4.1	2.8	2.6	5.3	2.9
1954	0.3	0.2	1.0	- 6.0	-1.6	-3.4	0.0	2.0	5.6
1955	-0.2	0.3	1.0	12.8	8.0	6.0	4.7	4.9	4.4
1956	1.5	2.9	3.4	3.5	1.9	-0.2	-1.0	4.9	4.2
1957	3.5	3.6	3.7	0.9	2.1	0.6	2.0	5.8	4.3
1958	2.7	2.3	2.5	- 7.0	-1.6	-3.2	0.0	2.2	6.8
1959	0.8	- 0.2	1.7	12.6	6.6	4.6	4.0	4.3	5.5
1960	1.5	0.8	1.6	3.0	2.7	1.4	1.0	3.1	5.6
1961	1.1	0.0	1.3	0.9	1.6	-0.2	1.4	3.0	6.7
1962	1.1	0.3	1.0	7.8	6.1	4.8	4.5	2.9	5.6
1963	1.3	- 0.3	1.4	5.1	3.8	2.5	2.3	2.8	5.7
1964	1.4	0.4	1.6	6.4	5.6	3.5	2.7	2.8	5.2
1965	1.6	1.8	1.9	8.3	5.5	4.5	2.9	3.6	4.6

Source: OECD, *General Statistics* and *Main Economic Indicators;* Bernard Mueller, *A Statistical Handbook of the North Atlantic Area* (New York: Twentieth Century Fund, 1965); ILO, *Year Book of Labour Statistics;* 1964 and 1965 data are largely based on preliminary estimates from various country sources

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Chapter 5

Attempts to Develop an Effective Incomes Policy in the United Kingdom

A variety of experiments with incomes policy has been a distinctive feature of post-war British economic policy. The long search for an effective form has received many set-backs but it has been maintained more because of the practical problems of resolving the recurrent balance-of-payments difficulties than because of strong ideological belief in the desirability and efficiency of such a policy.

The disappointing results of a voluntary form of the policy and the strong opposition from some who have regarded the approach as "nothing more than medieval incantation relying on magic" have not dampened the interest in this type of policy. Since 1961 there has been a sustained attempt to make the policy work, which has involved the development of more complex administrative machinery, more specific criteria for appropriate wage and price developments, and a move towards stronger sanctions for gaining adherence to these criteria. These developments are reflected in the threat of tough control measures, introduced this year along with the appeal for a short-term incomes and prices freeze. But some important questions remain about the longer-term form the policy will take.

Periodic balance-of-payments problems have been a key factor in stimulating an interest in incomes policy which, it has been hoped, could help alluviate the problems without devaluing the pound and without imposing as serious deflationary policies. Thus supporters of an incomes policy have felt that it can be a useful stabilization-policy instrument to help meet the conflicts that have occured between a low unemployment rate and a fixed exchange rate, on the one hand, and price stability and a satisfactory balanceof payments, on the other. Another element in the support of an incomes policy, which has been more important than in the other countries reviewed in this study, has been the concern with rigidities, particularly in the behaviour of labour market institutions, that have impaired economic growth processes. Many argue that in trying to implement incomes policy more attention will be focused on the need for improvements in productivity, and, as a result, labour and management will be induced to abandon some of their practices which have inhibited the growth of productivity. To some, an incomes policy must be an integral part of stronger over-all economic planning in the system, and it is not an accident that the recent more serious attempts to make an incomes policy work have coincided with a deeper interest in economic planning. However, in the United Kingdom there has been less interest than in other countries, such as the Netherlands and Sweden, in incomes policy as a means of affecting the long-run distribution of income.

The varied attempts to develop incomes policy in the United Kingdom and the large body of relevant literature cannot be reported and appraised in detail in this brief chapter, but a short survey may help to throw some light on the questions discussed in earlier chapters. First, the main economic and noneconomic arguments for and against incomes policy are explored. Second, problems encountered over the post-war period in developing an acceptable and effective system for implementing direct policies over wages and prices are examined. Finally, some of the special features of the British approach which affect its relevance for other countries such as Canada are summarized.

THE CASE FOR AN INCOMES POLICY

(a) The Economic Problems

A sense of failure achieving the economic goals of a society breeds interest in new approaches to economic policy. It is true that an actual economic performance below what is felt to be desirable may lead instead to a re-evaluation of the goals and perhaps to less-ambitious ones, or it may lead to a closer scrutiny and perhaps a better use of existing approaches to economic policy. But it is unlikely that a call for more moderate goals or an admission of inefficient use of recent policies will be a politically popular line for a government, especially if it can convince the electorate that a bold, new approach is the best answer.

In the United Kingdom concern about the country's failure to attain the desired standard of economic performance has been a more regular and important feature of post-war public debates than in any other major industrial country, although in historical perspective the post-war economic experience has not been too bad.

Unemployment: The maintenance of full employment has not been a problem. The unemployment rate averaged under 1½ per cent in 1951-57, a little over 2 per cent in 1958-59, about 1½ per cent in 1960-61, about 2¼ per cent in 1962-63, and a little over 1½ per cent in 1964-65. The post-war average rate has been low in relation to the long-run historical average, and a rate of 1½ per cent in the United Kingdom has been estimated to be a little under 2½ per cent in terms of North American definitions of unemployment rates.[1] Thus Britain has had a much lower unemployment rate than the United States or Canada, but it has not been particularly low relative to several European countries, including the Netherlands and Sweden.

Economic growth: Much dissatisfaction has been expressed over the growth rate being too low. Table 5-1 shows estimates of average annual growth rates of output per man-hour between 1870 and 1960 for a number of countries. The annual rate of growth of productivity in the United Kingdom during the 1950's of 2 per cent is a little above, rather than below, the long-run historical average. The rate has fallen, however, in relation to many other major countries. The growth rate of the United Kingdom is below that of all other countries shown in the table for the 1950's, and other estimates to not suggest a reversal of this position during the first half of the 1960's. Much of the British concern over the growth rate stems from the fact that other countries have been able to take greater advantage of the generally favourable growth conditions in the post-war world, and that for some reason the British economy has not shared in the expansion as much as people feel it should have.

TABLE 5-1

Annual Average Growth Rates of Output per Man-Hour for Selected Countries, 1870-1960
(Per cent)

	1870-1913	1913-1950	1950-1960
Canada	2.1	2.1	2.5
France	1.8	1.6	3.9
Germany (F.R.)	2.1(1)	0.9	6.0
Italy	1.2	1.9	4.1
Netherlands	1.1(2)	1.1	3.7
Sweden	2.7	2.0	3.5
United Kingdom	1.5	1.7	2.0
United States	2.4(1)	2.4	2.4

(1) 1871-1913

(2) 1900-1913

Source: Angus Maddison, *Economic Growth in the West* (New York: Twentieth Century Fund, 1964), Table 1-7, p. 37.

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[1]See tables in Arthur F. Neef, "International Unemployment Rates, 1960-64", *U.S. Monthly Labor Review* (March 1965), p. 258.

Price stability and the balance of payments: Price increases have been a persistent source of concern over the post-war period. Over the past decade the average annual rate of increase of consumer prices in the United Kingdom has been above that of both the United States and of Canada, but it has not been high in relation to some other European countries. The series for the GNP implicit price index show a similar pattern.

TABLE 5-2

Annual Average Rates of Increase of the Consumer Price Index for Selected Countries, 1955-65
(Per cent)

	1955-60	1960-65
United Kingdom	2.4	3.0
Canada	1.9	1.6
France	5.8	3.8
Germany (F.R.)	1.8	2.8
Netherlands	2.6	3.6
Sweden	3.5	3.8
United States	1.8	1.3

Source: National Institute of Economic and Social Research, *National Institute Economic Review*, August 1966; Dominion Bureau of Statistics, *Canadian Statistical Review*, various issues; United States Department of Commerce, *Survey of Current Business*, various issues; Organisation for Economic Co-operation and Development, *General Statistics*, various issues; *idem*, *Main Economic Indicators*, various issues; Deutsche Bundesbank, *Monthly Report*, July 1966.

Another indicator of inflationary pressures, regarded as particularly important for a country's international competitive position, is the change in unit labour costs, i.e. the change in hourly compensation to employees divided by the change in productivity. Table 5-3 shows average annual percentage increases in unit labour costs in manufacturing for a number of countries since 1950, both before and after adjustment for changes in foreign exchange rates. Again, the percentage increase in the United Kingdom was higher than in North America from 1950 to 1964. From 1950 to 1957 it was also higher than in Germany and the Netherlands but lower than in France and Sweden. From 1957 to 1964 it was lower than in any of the other West European countries on an unadjusted basis but, when adjusted for currency revaluations, the U.K. rate of increase was slightly above that of France.

TABLE 5-3

Annual Average Percentage Increase in Unit Labour Cost (All Employees) in Manufacturing, Unadjusted and Adjusted for Currency Revaluations

	Unit Labour Costs Unadjusted for Currency Revaluations		Unit Labour Costs Adjusted for Currency Revaluations	
	1950-57	1957-64	1950-57	1957-64
Canada	3.1	-0.4	5.0	-2.1
France	8.5	4.9	7.8	2.2
Germany (F.R.)	1.2	3.5	1.2	4.4
Netherlands	4.0	3.4	4.0	4.5
Sweden	7.3	2.5	7.3	2.5
United Kingdom	5.0	2.3	5.0	2.3
United States:				
(a) Based on Federal Reserve Board Index	2.6	-0.2	2.6	-0.2
(b) Based on Dept. of Commerce estimates	3.5	0.6	3.5	0.6

Source: Dominion Bureau of Statistics, *Annual Supplement to the Monthly Index of Industrial Production* (Catalogue 61-005), Table 3, p. 77 (revised series); DBS, *Canadian Statistical Review, Historical Summary* (1963 Edition), Table 13; DBS, *Estimates of Labour Income*, March 1966 (Catalogue 72-005), Table 2; Bank of Canada, *Statistical Supplement 1964*, p. 133; John H. Chandler and Patrick C. Jackman, "Cost Trends in Nine Industrial Nations", *U.S. Monthly Labor Review*, September 1965.

Although price increases in the United Kingdom have not been much out of line with other West European countries, pressures for better control of prices have been stronger because of the recurrent balance-of-payments difficulties. Serious balance-of-payments problems have occurred with depressing frequency: in 1947, 1949, 1951-52, 1955-57, 1961, and 1964-66. Attempts to develop incomes policies have been closely associated with these dates.

(b) The Variety of Proposed Remedies

To some, these problems of a relatively slow growth rate and recurrent payments crises can be explained by factors that are unrelated to those over which an incomes policy is supposed to have some effect. To others, the explanation does involve factors over which an incomes policy might have an effect, although many who take this second position have little enthusiasm for such a policy on the grounds that an acceptable form is mere window-dressing and an effective form involves unacceptable controls.

The first position – that the difficulties are due to factors which incomes policies will *not* remedy – encompasses a number of arguments. One position is that the unemployment rate has been kept too low.[1] If demand pressures were moderated and the unemployment rate allowed to remain closer to 2½ per cent than 1½ per cent, it is argued that the pressures on prices and the balance of payments would be sufficiently contained and that the economic benefits to the country would justify this modest increase in unemployment. Some increase in the growth rate might be expected from the removal of the unsettling "stop-go" policies that have been necessary to meet the balance-of-payments crises. In addition, it is sometimes argued that a less persistent strain on the productive capacity might introduce more flexibility and contribute to higher growth.

Opposition to this argument has sprung from various sources. Greater importance has been attached to the desirability of low unemployment rates in the United Kingdom than in North America, reflecting in part the highly uneven regional incidence of an increase in unemployment and the fears of returning to pre-war conditions when high unemployment was much more prolonged than in North America. The opposition is also based on the argument that a little higher unemployment is likely to reduce rather than increase the growth of productivity. The difficulty here is in distinguishing the short-run from the long-run effects on productivity of moving to a higher unemployment rate. The short-run deflationary policies which have been introduced periodically to meet balance-of-payments difficulties have meant some loss of output at that time, and they have not been accompanied by improvements in productivity. As some argue, however, the deflationary policies have been viewed as temporary and have thus not been accompanied by a revision of longer-run expectations about the tightness of product and labour markets. As a result, the short-run checks to expansion in output have appeared to have a greater adverse effect on the growth of productivity because firms have understandably been reluctant to release workers it would be costly to rehire again in boom conditions. Since prices are influenced by longer-run expectations of demand conditions, it is also argued that it is not surprising that prices have not been too sensitive to the short-run deflationary policies. Thus, the 'stop' policies have not been a fair test of the longer-run effects of a little more slack in the economy. But it should be recognized that the effect of a modest increase in the unemployment rate on the rate of growth is not a settled matter; to many economists, the plus and minus signs are close to cancelling out.

Explanations of the country's difficulties have also emphasized the rigidity of the exchange rate since 1949 and the pressures that have been

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[1]See, for example, F. W. Paish and J. Hennessy, *Policy for Incomes* (London: Institute for Economic Affairs, 1964).

placed on sterling because of its key position as an international currency. It is argued that improvements in international liquidity arrangements would relieve many of the periodic speculative pressures on sterling that have been associated with the balance-of-payments crises. Also, a more flexible exchange rate system has been called for by some as an important means of alleviating the periodic short-run balance-of-payments difficulties.

Some explain the difficulties by a number of other rigidities that have impaired the international competitive position of the economy and hampered growth. The United Kingdom "ranks among the high tariff countries"[1] and this protection is viewed as having sheltered inefficiency and reduced competitive adjustments. Much of the support for British entry into the European common market has been based on the view that the shock of sudden tariff reductions might stimulate a new competitive spirit. Concern about the rigidities has also been reflected in the arguments for stronger anti-monopolies policy, and exhortations to adopt improved social attitudes for change has long been a common theme of public speeches.

Of particular concern in recent years has been the structure of labour market institutions. The long gradual evolution of trade unions has produced a diverse and complex system which includes pure craft unions, multi-craft unions, a few industrial unions and two large general unions. At the end of 1962 there were 623 unions, although about two thirds of union members were in the 18 largest unions and there were a number of federations organized for collective bargaining in particular industries. Most unions are affiliated with the Trades Union Congress (TUC) which is the central body of the trade union movement. The TUC's power over its members is largely moral rather than constitutional and its principal functions have been to provide advice to members and to represent them at the national level. Employers have been organized in a very large number of associations, most of which are affiliated with the central organization, the Confederation of British Industry, which was formed in 1965 by the merging of the British Employers' Confederation and the Federation of British Industries.

The system of industrial relations that has emerged is viewed by many as a weakness in the economic system. It has been described as one of "haphazard fragmentation"[2] owing its form "to the needs and times very different from those of today".[3] The collective agreement is not legally binding on the parties and generally has no fixed term although in recent years more regular longer-term agreements have been emerging.

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[1]Council on Prices, Productivity and Incomes, *Fourth Report*, July 1961 (London: H.M.S.O., 1961), p. 25.

[2]W. Fellner, *et al., The Problem of Rising Prices* (Paris: OEEC, 1961), p. 419.

[3]Council on Prices, Productivity and Incomes, *Fourth Report*, July 1961, p. 27.

Time lost through industrial disputes is not particularly high in relation to a number of other industrial countries, but considerable uncertainty is created by the large number of unofficial strikes: "it is estimated that over 90 per cent of all strikes and about 70 per cent of the time lost through strikes are the result of the unofficial and usually unconstitutional action of the comparatively small groups of workers in single firms."[1]

Frequently it is argued that the machinery of incomes policy will help to bring greater order to the structure of collective bargaining. More broadly, it is also often claimed that the co-operation and economic education associated with the implementation of incomes policy can contribute to new attitudes that will permit more rapid economic adjustments in the economy.

(c) The Cost-Push Versus Demand-Pull Debate

The theoretical case for incomes policy has been contained principally in the extensive debates over whether the rise in wages and prices has been due largely to excess demand conditions or to cost-push forces. Many of the relevant arguments were explored in Chapter 2 of this study and only a brief resumé is made here of a few of the central features of the British debate.

With regard to the movement of money wages, a number of studies have emphasized the role of demand conditions. For example, A. W. Phillips showed that if the unemployment rate is taken as a proxy for the excess demand for labour, there has been a good statistical fit between the rate of increase of wages and excess demand for labour over a long period of British economic history.[2] The research of R. G. Lipsey further strengthened this conclusion although he acknowledged that the evidence was consistent with some weak versions of the cost-push thesis. These versions are (a) "unions do have some power to raise wages in response to price rises, independent of the state of excess demand, but not sufficient power to raise them by the full amount of any price rise";[3] (b) "unions push hard when business activity is high and less hard, or not at all, when business activity is low."[4] These concessions do not give much importance

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[1]*Labour Relations and Conditions of Work in Britain* (London: H.M.S.O., 1965), pp. 30-1.

[2]A. W. Phillips, "The Relation Between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1862-1957", *Economica*, XXV (November 1958), pp. 283-99. For an early criticism of the extent to which the unemployment rate can explain the rate of increase of money wages in the United Kingdom, see K.G.J.C. Knowles and C. B. Winsten, "Can the Level of Unemployment Explain Changes in Wages?" *Bulletin of the Oxford University Institute of Statistics*, XXI (1959), pp. 113-20.

[3]Richard G. Lipsey, *An Introduction to Positive Economics* (London: Weidenfeld and Nicolson, 1963), p. 440.

[4]*Ibid.*, p. 437.

to cost-push factors since the first would not support the existence of a never-ending wage-price spiral, and the second merely recognizes that unions may affect the speed with which wages adjust when there is excess demand. Neither supports the view that unions can cause a persistent upward rise in wages and prices. However, it is recognized that the post-war relationship between excess demand and the rate of increase of money wages is slightly different than in earlier British experience. As Lipsey notes, "except for 1949 and 1950, there is evidence of a more rapid increase in wages in response to demand and prices in the period since the second world war than in the period prior to the first world war."[1]

Other economists have taken a much stronger view on the role of cost-push factors. A study by L. A. Dicks-Mireaux and J.C.R. Dow found that, in addition to pressure of demand for labour, there appeared to be an independent tendency for wages to rise which might be attributed to trade union pressure.[2] More recently, A. G. Hines has related wage changes to the proportion of trade union members in the labour force and to changes in this proportion – indicators of what is referred to as "trade union push-fulness" – and found a statistical fit which accounted for about 80 per cent of variation in the rate of change of wages.[3] The fit is not as obvious on the basis of Canadian data[4] which may mean cost-push factors have been stronger in the British case. The significance of Hines' finding for the United Kingdom has been questioned, however, since the wage structure does not appear to have been influenced by this relationship.[5]

The argument about the importance of cost-push factors has also been supported by the clustering of similar wage increases – referred to as wage rounds – and the role of key wage negotiations in affecting settlements in other industries. Thus L. A. Dicks-Mireaux has pointed out:[6]

> Yet, on balance, wage rounds in which broadly uniform wage settlements are negotiated and reached throughout British industry, do emerge as a feature of wage determination in the post-war years.

[1]Richard G. Lipsey, "The Relation Between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1862-1957 – A Further Analysis", *Economica,* XXVII (February 1960), p. 30.

[2]L. A. Dicks-Mireaux and J. C. R. Dow, "The Determinants of Wage Inflation: United Kingdom 1946-56", *Journal of the Royal Statistical Society,* 122, (1959), pp. 145-74.

[3]A. G. Hines, "Trade Unions and Wage Inflation in the United Kingdom, 1893-1961", *Review of Economic Studies,* XXXI (October 1964), pp. 221-52.

[4]Peter T. Banwell, "The Relation Between the Rate of Change of Money Wage Rates and the Percentage of the Labour Force Unionized in Canada, 1922-1964", (unpublished Bachelor of Arts thesis, Queen's University, 1966).

[5]L. A. Dicks-Mireaux, "Cost or Demand Inflation?" *Woolwich Economic Papers, No.* 6 (London, 1965), pp. 15-16.

[6]*Ibid.,* p. 14.

> ...On the one hand industries where labour is scarce may tend to lead in the round of claims and settlements striking 'key bargains' followed, on the other hand, by industries where the demand for labour is not excessive but where unions are able to press for similar wage settlements on the grounds of equity treatment. It is possible that the British system of wage negotiation by separate industries or groups of workers lends itself to this kind of "leap-frogging" process.

Similarly, the timing and size of wage changes in the United Kingdom and the role of key negotiations in setting the pattern have been emphasized in many studies. The 1961 OEEC study of rising prices referred to the "synchronisation in the timing of collective agreements and uniformity in the main contents".[1] Edelman and Fleming stated: "National bargaining is clearly influenced by certain key industries or pace setters."[2]

These factors play an important part in the general case presented by supporters of incomes policy. It is argued that their existence means that incomes policy need focus only on a few key wage negotiations and that this will have a large effect, without the necessity of a comprehensive approach designed to affect directly the majority of wage negotiations.

In an important study, K.G.J.C. Knowles and D. Robinson have questioned the accuracy of this view. On the basis of a detailed review of wage changes they point to the "unrealism of many current assumptions about wage rounds and wage leadership".[3] They do not argue against the use of incomes policy, but only that its coverage should be much broader than is usually assumed on the basis of arguments about wage rounds and wage leaders.

Further, the significance of nationally negotiated wage rates has been questioned because of the importance of wage drift – the difference between the actual increase in wage earnings and the increase due to wage negotiations. Thus actual earnings determined at the plant level may, for a variety of reasons, diverge from what would be expected from the major wage settlements. Many studies have been made of wage drift in the United

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[1] W. Fellner, *et al., The Problem of Rising Prices* (Paris: OEEC, 1961), p. 430.

[2] Murray Edelman and R. W. Fleming, *The Politics of Wage-Price Decisions* (Urbana: University of Illinois Press, 1965), p. 165.

[3] K.G.J.C. Knowles and D. Robinson, "Wage Rounds and Wage Policy", *Bulletin of the Oxford University Institute of Statistics,* XXIV (May 1962), pp. 269-329.

Kingdom.[1] It is a complicated problem, but the present consensus appears to be that the size of wage drift has varied with the degree of excess demand for labour although the evidence does not support an extreme position that control of negotiated wage rates would be completely nullified by wage drift. Thus while an incomes policy that tries to affect the terms of national wage settlements may have some effect on the movement of earnings, there is a significant part of the actual increase in earnings which is not determined by these settlements and which could reduce the effectiveness of the policy.

In contrast to the work on the determination of wage changes, price determination has received less attention in economic studies. However, some work has been done which stresses the apparent lack of sensitivity of profit margins to demand conditions and the role of fairly fixed profit margins over costs. For example, R. R. Neild in a major study of British post-war experience concluded:[2]

> The pricing results seem to be consistent with the view that manufacturers' prices are set by reference to costs when operating at some normal level of capacity and that they are not sensitive to moderate fluctuations in demand.

While such findings may simply point to longer-run factors in pricing decisions, they, along with frequent popular expressions about the lack of competitiveness of British industry, have influenced thinking on incomes policy. Some support a greater focus on wage costs; this would have the desired effect on prices if profit margins over costs are more or less fixed. Others have given price determination a more important, independent role. Thus, R. L. Marris has argued that criteria to judge the appropriate rate of profit are needed since "in the prevailing conditions of 'oligopolistic' competition, there is no guarantee whatsoever that average profit

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[1]See, for example, E. H. Phelps Brown, "Wage Drift", *Economica* XXIX (November 1962), pp. 339-56; S. W. Lerner and J. Marquand, "Workshop Bargaining, Wage Drift and Productivity in the British Engineering Industry", *The Manchester School* XXX (January 1962), pp. 15-60; L. A. Dicks-Mireaux and J. R. Shepherd, "Wages Structure and Some Implications for Incomes Policy", *National Institute Economic Review*, XXII (November 1962), pp. 38-48; E. H. Phelps Brown and M. H. Browne, "Earnings in Industries of the United Kingdom, 1948-59", *Economic Journal* LXXII (September 1962), pp. 517-49; H. Turner, "Wages, Productivity and the Level of Employment: More on Wage Drift", *The Manchester School*, XXVIII (January 1960), pp. 89-123.

[2]R. R. Neild, *Pricing and Employment in the Trade Cycle*, National Institute of Economic and Social Research, Occasional Paper XXI (Cambridge: Cambridge University Press, 1963), p. 51.

margins will tend to any particular norm, or that 'administered' price increases could not play a positive role in the inflationary process."[1]

From the preceding it is clear that important differences persist in the explanations of British inflation, a not-unexpected situation in view of the conceptual and statistical difficulties encountered everywhere in debates about cost-push and demand-pull. But few would deny completely some role for cost-push factors in Britain, and these factors have probably had a somewhat greater influence than in North America. There may, of course, still be opposition to incomes policy because a better control of general demand conditions is regarded as sufficient, because it may be felt that incomes policy will be ineffective or dangerous, or because it is argued that there are other types of policies which will be better in affecting the process of wage and price determination.

POST-WAR DEVELOPMENTS IN INCOMES POLICY

Despite the widespread interest in incomes policy over most of the post-war period the actual measures that have been taken have been intermittent and varied. A number of the difficulties discussed in Chapter 3 – the difficulties of developing acceptable and effective forms of incomes policy – have been encountered in British experience since the end of the war.

(a) From 1948 to 1961

The first major experiment was in 1948. The serious domestic reconstruction problems at the end of the war and the critical balance-of-payments conditions made restraint of wages and prices a matter of national urgency. In February 1948, the government published the *Statement on Personal Incomes, Costs and Prices* which called for a halt to the increase in incomes in excess of increases in production unless necessary for shifting resources to an undermanned industry. The appeal proved to be surprisingly successful despite the complaint from unions that they were not consulted prior to the appeal and that the criteria for wage changes were too rigid. During the next two and a half years wages rose by only about 5 per cent and retail prices by about 8 per cent.[2] Much of the success in achieving union co-operation in curbing wage claims has been attributed to the personal role played by three important union leaders, Deakin, Lawther, and Williamson, and to the close ties between the unions and the

[1] R. L. Marris, "Incomes Policy and the Rate of Profit in Industry", Reprint Series No. 238, Department of Applied Economics, University of Cambridge, (1965), p. 1.

[2] J. C. R. Dow, *The Management of the British Economy 1945-60* (Cambridge: Cambridge University Press, 1964), p. 35.

Labour Party which was in power. During this period industry also voluntarily curbed the expansion of dividend payments. As noted earlier, economic studies have shown that the rate of increase of wages and prices was significantly lower than would normally have been expected for this period.

The experiment crumbled in 1950, however, and a wage and price explosion followed. The breakdown has been attributed to the pressures on wages and prices that developed with the 1949 devaluation and the outbreak of the Korean War in 1950. It appears, however, that there was little chance of long-term success with the policy anyway. Some wages and prices continued to advance and there was increasing resentment at the alleged unfairness of the system. There had been little agreement among the unions on the appropriate criteria for the longer-run movement in relative wages, and there was no formal machinery to induce compliance with the policy. In 1948 the national crisis conditions could have been expected to bring about a closer identity between private and national interest, but with improvements in conditions the forgoing of private gains seemed to be less important. In the fall of 1950, the Trades Union Congress voted against the wage-restraint policy.

In October 1951, the Conservative Party returned to power and early in 1952 the Chancellor of the Exchequer proposed that union and management should co-operate through a national advisory council in working out methods for keeping wage changes in line with the growth of production. The proposal was rejected by the Trades Union Congress, and apart from trying to take a little harder line to wage increases in areas over which the government had some control, the government took no further steps towards an incomes policy at this time.

Following the re-emergence of balance-of-payments difficulties in the mid-1950's the Conservative Government again showed interest in this area of policy. In 1956 private employers and the nationalized industries were asked to refrain from raising prices for at least a year – to maintain a "price plateau" – and the unions were asked to restrain increases in wage demands. But the Trades Union Congress rejected the proposal. Again the government had failed to get beyond a general plea for restraint.

In 1957 the government established the Council on Prices, Productivity and Incomes "to keep under review changes in prices, productivity and the level of incomes (including wages, salaries and profits) and to report thereon from time to time".[1] The Council consisted of three prominent independent members; there were no representatives of employees or employers. Its principal influence was through a series of four annual reports in the years 1958-61. In the first report the Council gave little

[1]From the terms of reference published in Council on Prices, Productivity and Incomes, *First Report* (London: H.M.S.O., 1958), p. 1.

encouragement to a stronger form of incomes policy. Its emphasis in explaining inflation was on excess demand and it was critical of the advantages to be gained from incomes policy. The report stated:[1]

> While we appreciate the attractions of the suggestion that a percentage figure should be announced by which average money wages could increase during a year or other period without damage to the national interest, we have pointed out certain objections to the adoption of this proposal. . . .

Several objections to fixing targets for wage increases were contained in the report. First, it was pointed out that there is "a real danger that the prescribed average would always become a minimum, and the process of wage inflation therefore built into the system".[2] Second, the Council argued that there may be advantages to having long periods of "gently falling" prices, and thus felt that the announcement of figures for average wage increase would "involve too definite an endorsement of the doctrine that in a progressive community the general level of prices should never be permitted or encouraged to fall as an alternative to a rise in money incomes".[3] Finally, emphasis was placed on not adding to the rigidity of the wage structure since the "flexibility of relative wages is the chief means on which the country must rely to ensure the best distribution of its labour force".[4]

In its final report in 1961, the Council, whose membership had changed since 1958, shifted its position from that of the 1958 report. It placed more emphasis on the importance of cost-push elements in causing inflation and recognized advantages of some limited form of incomes policy. It stated:[5]

> How can inflation be stopped? It has sometimes been due to the pull of excess demand, but experience has shown that removing excess demand is not of itself enough. We have been brought to the conclusion that inflation has another cause, an upward push as rates of pay are raised and profit margins are maintained by raising prices. This "cost push" comes into play through a myriad decisions on wages, salaries and prices. The need is to ensure that these decisions do not raise money incomes faster than production. One way of doing this is to restrict demand so as to harden the climate in which the decisions are made, but we do not think this will work unless the restriction goes so far that the remedy is worse than the disease. The alternative can only be to find ways of adjusting the

[1] *Ibid.*, p. 53.
[2] *Ibid.*, p. 45.
[3] *Ibid.*, p. 45.
[4] *Ibid.*, p. 53.
[5] Council on Prices, Productivity and Incomes, *Fourth Report* (London: H.M.S.O., 1961), p. 3.

> rise of money incomes at the points where the decisions are taken. We believe that this is necessary for the success of any policy for full employment and economic growth without inflation.

It recommended economic policies "along three lines – raising productivity; adjusting the rise of demand; adjusting the rise of money incomes – both pay and profits."[1] With respect to the last it proposed a longer-term projection of the rise in productivity and direct efforts to keep the rise of money incomes approximately equal to this figure:[2]

> The projection would indicate the limits within which movements of pay and profits must lie if they are to be consistent with stable prices. It would not be prescribed as an absolute limit but its object would be rather to make clear – what is not clear now – the line beyond which particular decisions or settlements cannot go without the risk of being inflationary or else gaining at the expense of others.

The appropriate criteria for relative wage or price movements was not too clear:[3]

> In the settlement of wage claims particular industries would remain free to go beyond the limit, and some might do so with good reason, but what their decisions meant for others would be apparent.

With regard to gaining adherence to the projected productivity figure, emphasis was on affecting expectations, on moral suasion and on creating the appropriate "frame of mind", but there should also be the threat that "if pay and profits did rise more than productivity the Government would take steps promptly to check spending".[4] With regard to prices, the Council supported, in addition, a lowering of import duties and action against agreements for price maintenance.

(b) From 1961 to 1964

In the summer of 1961 the Chancellor of the Exchequer, Mr. Selwyn Lloyd, announced a number of short-term measures to meet a serious balance-of-payments situation and indicated, at the same time, that new longer-term proposals would be forthcoming in the area of economic planning and incomes policy. Among the short-term measures was his request for a "pay pause". He appealed for a temporary halt to increases in wages, salaries and dividends. The government decided to lead the way, and in

[1] *Ibid.*, p. 3.
[2] *Ibid.*, p. 28.
[3] *Ibid.*, p. 28.
[4] *Ibid.*, p. 28.

August the civil service was informed that there would be no pay increases in the near future. Some moderation in wage increases was achieved from the time of the announcement of the "pay pause" until its end in the spring of 1962, but the over-all effect seems to have been slight. Only in the public sector were wage increases effectively curbed, and this led to a great deal of unrest in this sector. The example which the government attempted to set in the public sector did not have the desired effect on the private sector and tended to distort the relation of wages in the public and private sectors.

The Trades Union Congress opposed the "pay pause" and rejected the government's invitation to help work out in early 1962 more permanent machinery for incomes policy, although it willingly co-operated at this time in the establishment of the National Economic Development Council which was to provide a modest step towards long-term economic planning. The government nevertheless went ahead and published in February 1962 a White Paper, *Incomes Policy: The Next Step,* which set out a number of principles for its incomes policy.

In it the government proposed a target for average increases in wages and salaries of 2 to 2½ per cent, in line with the recent trend increase in productivity. The criteria for specific wage and salary proposals were vaguer: it rejected arguments for wage increases based on productivity or profit increases in a particular industry or on increases in the cost of living. Wage increases based on a shortage of labour were not justified unless a shift of labour from one industry was "plainly necessary". Special increases might be justified for those who "made a direct contribution, by accepting more exacting work, or more onerous conditions, or by a renunciation of restrictive practices, to an increase in productivity and a reduction of costs".[1] Arguments for wage increases based on comparisons with wages in other employments should not receive as much weight in the future, and the government indicated it would emphasize more general economic considerations in its negotiations with its own employees. With regard to dividends and profits the government pointed out that the White Paper was mainly concerned with wages and salaries but repeated an earlier warning of the Chancellor that "appropriate corrective action would have to be taken if aggregate profits showed signs of increasing excessively compared with wages and salaries".[2]

The means were limited for ensuring that wage claims did not exceed the limits of its "guiding light" of 2 to 2½ per cent and were consistent with the general criteria for relative wage movements. The government hoped that in the national agreements in which there was arbitration – these agreements covered about 6 million employees – the arbitrators

[1] *Incomes Policy: The Next Step* (Cmnd. 1626), p. 4.
[2] *Ibid.*, p. 6.

would be guided by the government's proposals. The government also indicated it would publish more factual information that would be helpful in negotiations. The basic approach, however, was to appeal for a voluntary change in wage and price determination in line with the government's proposals, but, although some suggest a slight modification to the upward movement of wages and prices occurred, the hourly wage rate rose by about 4½ per cent in 1962 – double the average increase proposed by the government.

More formal machinery to assist in making the policy work was, however, soon established. In July the government stated that it would create a permanent body to provide "an impartial and authoritative view on the more important or difficult pay questions".[1] In November the membership and terms of reference of the National Incomes Commission (NIC) were announced. The five-man Commission was not designed to include representatives of either employer or employee organizations, a selection which appeared to be forced on the government because of the steadfast refusal of the Trades Union Congress to support it. The terms of reference were that the Commission could examine and report its views on pay claims referred to it by both parties (in special cases the government might ask the parties to do this); the government could refer pay claims where the cost would be borne in whole or in part by the Exchequer (nationalized industries or cases subject to arbitration were excluded and these, in fact, covered most of the employees paid by the Exchequer); the government could ask for any pay settlement in the private sector to be examined retrospectively although there was no power to alter the settlement. During the next two years the Commission reported retrospectively on three settlements referred to it by the government, and on one claim referred to it in advance of a settlement – that of the university teachers. In all but this last case, employee organizations refused to assist in giving evidence.

It was hoped by the government that through the publicity associated with the Commission's hearings and reports, public opinion would be aroused and this would help to contain the rise of incomes. But the Commission's effectiveness was severely limited by a number of difficulties. The unions opposed its work from the beginning and the hearings and reports were thus taken less seriously. The Commission focused more on wages than on nonwage income or prices, and this aroused opposition from employees. It was not equipped with a technical research staff and its reports were slow in appearing – in one case its final report was published a year after a wage settlement had been concluded. This delay weakened the expected impact on public opinion, on which the approach relied; the Commission was not equipped to enforce any of its recommendations. The

[1]Quoted in J. C. R. Dow, *op. cit.*, p. 402n.

functions of the Commission and the criteria it was to use in judging a particular pay claim were not very clear.

With wage rates rising well in excess of the limits of 2 to 2½ per cent proposed by the government, and the National Incomes Commission clearly in trouble from the start, the government shifted its emphasis somewhat in 1963. In the report of the National Economic Development Council, published early in 1963, a rate of growth of total output of 4 per cent, or about 3¼ per cent in output per worker, was proposed as an appropriate target for the economy through to 1966. As a result of this report the National Incomes Commission stated in a report that it viewed 3 to 3½ per cent as a more appropriate "guiding light" than 2 to 2½ per cent. The government endorsed this change and it thus shifted from a figure based on historical data to one based on the projections and goals of the Council. In 1963 it was also apparent that the government was beginning to rely more on the NEDC, which had representatives of employer and employee organizations, to help in the fight against inflation.

(c) New Steps Since 1964

With the election of a Labour Government in October 1964, incomes policy entered a new phase. Against the background of a serious balance-of-payments position the government initiated a number of steps to strengthen incomes policy. The most notable have been the achievement of an agreement by union and management leaders to support the government's incomes policy; a greater emphasis on tackling prices along with wages; a clearer specification of the appropriate criteria for individual wage and price movements; a new board that would give faster public reports on individual wage and price changes; the development of an early warning system for advance notification of individual wage and price changes; the announcement in July 1966, of a short-term standstill or freeze on incomes and prices and the threat of strong control measures to back it up.

In December 1964, the *Joint Statement of Intent on Productivity, Prices and Incomes* was signed by representatives of the government, the Trades Union Congress, and various employer organizations. In it management and unions agreed

> ...to co-operate with the Government in endeavouring, in the face of practical problems, to give effective shape to the machinery that the Government intend to establish for the following purposes:
>
> (i) to keep under review the general movement of prices and money incomes of all kinds;
>
> (ii) to examine particular cases in order to advise whether or not the behaviour of prices or of wages, salaries or other money incomes

is in the national interest as defined by the Government after consultation with management and unions.

In return, the government pledged itself to some general undertakings, including the preparation of a general plan for economic development and the more vigorous pursuit of policies to increase productivity and facilitate the mobility of labour.

In a White Paper in February 1965, the government announced its new machinery for incomes policy.[1] The existing National Economic Development Council was asked to carry out the reviews of general movements of prices and incomes in the economy. To replace the National Incomes Commission for examining particular cases, the government established a National Board for Prices and Incomes which was to consist of two divisions, the Prices Review Division and the Incomes Review Division. (In practice, the Board has not maintained these divisions for its work.) The government would refer to the Board cases of price changes or wage settlements that it wished to have the Board review. The Board's status was similar to that of a Royal Commission until it was given a statutory basis by the Prices and Incomes Act in the summer of 1966.

The board differs from the National Incomes Commission in a number of respects. Unlike NIC it has representatives from business and the trade unions (at present one from each). More emphasis was placed on investigating prices. Whereas NIC held its hearings in public, the Board has emphasized more informal and private work. Reports by the Board were to be issued more quickly than had been the case with NIC and in its first fifteen months, eighteen reports were issued. The Board was to have its own staff including accountants, experts on industrial relations, economists and statisticians. Under the new system the government would be responsible for making all the references to the Board, whereas before references could come from both private parties to a pay settlement, as well.[2]

In a White Paper in April 1965, the government set out more specifically than ever before the criteria which it regarded as appropriate for judging individual pay settlements and price changes. It reiterated the earlier target for the rate of increase of average earnings of 3 to 3½ per cent, but also listed four possible exceptions:[3]

Exceptional pay increases should be confined to the following circumstances:

(i) where the employees concerned, for example by accepting more exacting work or a major change in working practices, make a

[1] *Machinery of Prices and Incomes Policy* (Cmnd. 2577), February 1965.

[2] A particularly useful summary of the Board's work during its first fifteen months is contained in National Board for Prices and Incomes, *General Report April 1965 to July 1966*, Report No. 19 (Cmnd. 3087), August 1966.

[3] *Prices and Incomes Policy* (Cmnd. 2639), April 1965, pp. 8-9.

direct contribution towards increasing productivity in the particular firm or industry. Even in such cases some of the benefit should accrue to the community as a whole in the form of lower prices;

(ii) where it is essential in the national interest to secure a change in the distribution of manpower (or to prevent a change which would otherwise take place) and a pay increase would be both necessary and effective for this purpose;

(iii) where there is general recognition that existing wage and salary levels are too low to maintain a reasonable standard of living;

(iv) where there is widespread recognition that the pay of a certain group of workers has fallen seriously out of line with the level of remuneration for similar work and needs in the national interest to be improved.

It was emphasized that these deviations from the norm should be kept to a minimum and should be balanced by lower-than-average increases elsewhere. With respect to other forms of income the White Paper noted that incomes of farmers and landlords were already "to a considerable extent determined by Government policy". It also noted that the incomes of self-employed persons differed in some respects from those of employees but stated that "those who are responsible for determining or are capable of influencing the incomes of self-employed persons should be guided by the considerations relating to the settlement of incomes and, where appropriate, to the criteria for price behaviour. Increases in these incomes may therefore be referred to the National Board". With regard to profits, it was argued that the criteria for price changes should determine them, but the government also pledged "to use their fiscal powers or other appropriate means to correct any excessive growth in aggregate profits as compared with the growth of total wages and salaries, after allowing for short-term fluctuations".

On prices, the White Paper stated the government's aim of a stable general level of prices and set out the following guidelines for individual price increases and decreases:[1]

Enterprises will not be expected to raise their prices except in the following circumstances:

(i) if output per employee cannot be increased sufficiently to allow wages and salaries to increase at a rate consistent with the criteria for incomes... without some increase in prices, and no offsetting reductions can be made in non-labour costs per unit of output or in the return sought on investment;

[1]*Ibid.*, p. 7.

(ii) if there are unavoidable increases in non-labour costs such as materials, fuels, services or marketing costs per unit of output which cannot be offset by reductions in labour or capital costs per unit of output or in the return sought on investment;

(iii) if there are unavoidable increases in capital costs per unit of output which cannot be offset by reductions in non-capital costs per unit of output or in the return sought on investment;

(iv) if, after every effort has been made to reduce costs, the enterprise is unable to secure the capital required to meet home and overseas demand.

Enterprises will be expected to reduce their prices in the following circumstances:

(i) if output per employee is increasing faster than the rate of increase in wages and salaries which is consistent with the criteria for incomes. . .and there are no offsetting and unavoidable increases in non-labour costs per unit of output;

(ii) if the costs of materials, fuel or services per unit of output are falling and there are no offsetting and unavoidable increases in labour or capital costs per unit of output;

(iii) if capital costs per unit of output are falling and there are no offsetting and unavoidable increases in non-capital costs per unit of output;

(iv) if profits are based on excessive market power.

These criteria for earnings and prices bear a close resemblance to the U.S. wage-price guideposts, announced in 1962. In both cases the target is stable prices with average earnings rising at the same rate as productivity. Deviations of earnings from this norm would only be justified if there was clear evidence of a need to shift manpower, of extra effort by workers, or of earnings which appear to be seriously out of line with those elsewhere or which are below a reasonable standard of living. Increases or decreases in specific prices should depend on the growth of productivity relative to the national average, on the change in nonlabour costs, and on the need to attract capital. The United States and the United Kingdom guides differ in this respect: the U.S. price guides are to apply to industries, while in Britain they are to apply to enterprises, although in practice this difference has not so far been significant.

The U.K. government hoped that the agreement obtained with unions and management, the new machinery incorporated in the National Board for Prices and Incomes, and the setting out of more specific criteria for judging individual cases would be sufficient to have the desired effects on incomes and prices. There was no intention to go beyond these voluntary methods unless it was clear they had failed. "The Government intend to give the voluntary method every chance of proving that it can be made to work.... The Government would resort to other methods only if they were convinced that the voluntary method had failed."[1]

By the end of the summer of 1965, it was apparent, however, that there had been little effect on the rise in wages and prices. In addition, despite the more rapid processing of reports by the National Board for Prices and Incomes – three appeared during the summer – than by the National Incomes Commission, only a small number of cases could be handled. The government apparently considered the possibility that the central organizations for management and the unions could voluntarily set up an apparatus for examining and reporting on price changes and pay claims. Recognizing the difficulties of achieving this in private institutions that have not had the tradition of strong central control of members, such as has been the case in the Netherlands, the government announced in September that it was prepared to introduce a compulsory system requiring advance notification to the government of proposed pay settlements and price changes.

At the annual meeting of the Trades Union Congress, held a few days after this announcement, it was proposed that the TUC operate its own early warning system which, while it was unlikely to head off the government's proposed legislation, might modify its implementation. Although the motion for this was carried – a significant achievement in view of the weak constitutional position of the TUC over its members and past union opposition to incomes policy – about 40 per cent of the 8½ million votes were against it. The dominant management organization, the Confederation of British Industry, decided not to try its own system, but reluctantly agreed to recommend to members that they co-operate with the government on the government's early warning system.

The government moved slowly on its legislation for an early warning system. It first proposed a nonstatutory scheme in a White Paper, *Prices and Incomes Policy: An "Early Warning System"*, in November 1965. Businesses, including public enterprises, were asked to notify the appropriate government department at least four weeks in advance of a price change, and to provide an explanation. A provisional list of goods and services, subject to this prior notification, was published, the aim being "to include goods and services which are of particular economic significance, or consumer goods which are important elements in the cost of living". The system was to "apply primarily to manufacturers' prices and only to manufacturers' prices for the home market". If the government department did not take any action within four weeks, the business was entitled to go

[1]*Machinery of Prices and Incomes Policy* (Cmnd. 2577), p. 4.

ahead with the price change. If the government department felt that an enquiry into the price change was justified, it would refer the case to the National Board for Prices and Incomes, and the business was expected not to change its price until the Board reported. The emphasis was on scrutinizing price increases. Cases where price decreases should occur – for example, if productivity had been increasing more rapidly than the national average – were not as likely to receive as much attention under this system.

On pay and conditions of employment, unions affiliated with the Trades Union Congress were asked to forward all claims to the TUC, and not take action on them until the General Council of the TUC had an opportunity to review the claim – a procedure which might take up to five weeks. In turn, the TUC was expected to keep the government informed of developments on pay claims. The Ministry of Labour was to be notified of pay claims by employees organizations not affiliated with the TUC. Also, employers were asked to notify the Ministry of Labour about pay claims, either directly or indirectly through the Confederation of British Industry. Regardless of the route for notification, if the government felt a reference to the National Board for Prices and Incomes was justified, it was expected that settlements would not be concluded until the Board had made a report, usually within two or three months.

The basic features of this early warning system were incorporated in a bill introduced into Parliament in February 1966.[1] It did not pass prior to the spring election, but the system was included in the Prices and Incomes Act passed in the summer.[2] Briefly, it means that by order in council the government can require advance notice of 30 days before a wage settlement or price change becomes effective. Also, if there is a referral by the government to the National Board for Prices and Incomes a further delay is required until the Board reports, which may take another two or three months. There will be no obligation to follow the Board's recommendations on pay and prices, although if the government invokes the temporary stronger provisions of the Act for a standstill on incomes and prices it can more directly restrict incomes and prices.

Despite the steps since the end of 1964 to strengthen incomes policy, the effects have been disappointing. Statistical studies have suggested that the rate of increase of weekly wage rates from the end of 1964 was a little lower than might have been expected on the basis of earlier post-war economic relationships.[3] Weekly wage rates rose by about 4½ per cent in 1965. The policy has also been credited with having had some direct restraining

[1] *Prices and Incomes Bill,* Bill 77, February 1966.

[2] *Prices and Incomes Act, 1966,* Chapter 33 (London: H.M.S.O., 1966).

[3] See, G. L. Reuber, R. G. Bodkin, E. P. Bond, and T. R. Robinson, *op. cit.,* Chap. 7; Frank Brechling, *op. cit.*

effect on prices.[1] Due to a marked shortening of the normal working week, however, hourly wage rates rose much faster than weekly rates, and this change, combined with a large wage drift, meant that average hourly wage earnings rose by about 10 per cent from the 4th quarter of 1964 to the 4th quarter of 1965 (see Table 5-4). Some have suggested that incomes policy actually had a perverse effect at this time; since workers believed the government was determined to make the policy work, they felt it was important to try to get into a better relative wage position at the outset, if in the future all wage rates would have to move at a similar rate. Further, it was argued that the effects of the policy would emerge with a longer lag.

TABLE 5–4

Per Cent Increases in Wages, Prices and Industrial Production, 1962-65, in the United Kingdom
(Per cent increase in 4th quarter over 4th quarter of previous year)

	1962	1963	1964	1965
Average Hourly Wage Earnings.......	4.1	4.1	8.2	10.1
Average Hourly Wage Earnings Excluding the Effect of Overtime...	4.4	3.6	8.1	9.5
Average Hourly Wage Rates	4.2	2.3	5.7	7.2
Consumer Prices....................	2.7	2.1	4.4	4.6
Wholesale Prices	1.2	0.7	3.6	3.4
Industrial Production	1.0	7.7	5.4	2.5

Source: H.M. Treasury, *Economic Report on 1965* (London: H.M.S.O., 1966); OECD, *Main Economic Indicators*, various issues.

As in the past, however, the demands on incomes policy have been closely linked with the pressures on the pound. Faced with a serious balance-of-payments position, the government in July 1966 supplemented deflationary measures taken earlier in the year with stronger ones and also appealed for a standstill on prices and incomes, including dividends. The increased fiscal and monetary restraint in 1966 is expected to be an important check on increases in prices, output and employment, but a freeze on incomes and prices was defended on the grounds that it would affect prices more rapidly with less serious adverse effects on unemployment than would otherwise be the case.

The nature of the standstill was set out in a White Paper:[2]

The broad intention is to secure in the first six months (which can be regarded, for convenience, as the period to the end of December

[1] H. M. Treasury, *Economic Report on 1965* (London: H.M.S.O., 1966), p. 23.
[2] *Prices and Incomes Standstill* (Cmnd. 3073), July, 1966, p. 2.

> 1966) a standstill in which increases in prices or in incomes will so far as possible be avoided altogether. The first half of 1967 will be regarded as a period of severe restraint in which some increases may be justified where there are particularly compelling reasons for them, but exceptional restraint will be needed by all who are concerned with determining prices and incomes.

The appeal was for a voluntary observance of the standstill, but the government showed it was prepared to use statutory powers. By Part IV of the Incomes and Prices Act, the government, through an order in council, could for a year reverse any price or pay increase since July 20, 1966, and Part IV was brought into force in early October when some cracks in the freeze began to emerge.

A temporary freeze, backed by the strong enforcement powers of the government, can produce greater effects, but serious short- and long-run problems for British incomes policy can be expected to persist. Any short-term halt to incomes and prices, even when backed by forceful controls, is difficult to maintain, especially if some tend to escape the effects and if the view spreads that the measures are having an unfair impact. The more significant issues are likely to arise, however, in converting the short-term standstill to a longer-term incomes policy. The pressures for large wage and price increases that build up in a period of sharp restraint are difficult to contain, but it is hoped that during the standstill greater agreement will be worked out on the longer-run criteria to guide incomes and prices.

SUMMARY AND GENERAL RELEVANCE OF BRITISH EXPERIENCE

Most would agree that British post-war incomes policy has failed to have much effect except in periods when short-run freezes have been used. To some this has suggested that longer-run incomes policy is really a fantasy. To others the lesson is that the mechanics have taken a long time to work out and that incomes policy can be expected to be a more effective part of over-all British economic policy in the future.

The sustained interest in incomes policy over the post-war period has been related primarily to the recurrent balance-of-payments difficulties. There has been a reluctance to sacrifice other economic objectives to meet the balance-of-payments situation because of the continual hope that incomes policy could be developed as an additional policy instrument to assist in achieving simultaneously a better performance on all the economic objectives. It has also been hoped that the process of reviewing wage and price decisions will help improve the growth of productivity although there is little evidence that it has had much effect so far.

To some economists the offer of this new remedy has smacked of economic quackery and they feel that the more permanent solution must be sought in such directions as a slightly higher longer-term unemployment rate, less protectionism, and more flexible exchange-rate arrangements. Considerable emphasis has been placed on reducing the rigidities and imperfections that have hampered growth in the United Kingdom; in particular, there is a widespread feeling that reform of labour market institutions and processes would be an important step in improving economic adjustment processes.

To others the popularity of incomes policy among various post-war British governments despite its small effects is evidence of its essentially political rather than economic basis. Incomes policy has helped to reduce the exposure of governments to the blame for periodic economic crises, to point the finger more at the behaviour of private groups and to reassure foreign bankers. It has helped to convey the message to the electorate and, at times perhaps more important, to speculators in foreign exchange, that the government was seriously concerned with maintaining price stability. But there has also been a continual effort to strengthen the economic effectiveness of this type of policy. The main trends and difficulties in working out the general targets for wages and prices, in developing appropriate criteria for individual wage and price decisions, and in gaining adherence to these criteria, are briefly summarized below.

First, until 1962, no fixed percentage figures were suggested for the appropriate average movements of wages and prices. There had been short-run appeals for a pay pause, a price plateau, wage and price restraint and so forth. In 1962 it was suggested that average wages should rise at about 2 to 2½ per cent, in line with the past trend increase in productivity, to achieve stable prices. In 1963 the target was shifted to 3 - 3½ per cent, since the National Economic Development Council's projection indicated that the economy could achieve this rate of increase of output per worker in the future. This norm has been re-affirmed in recent years. Basing the target on productivity trends has led to some questions about the feasibility and economic wisdom of trying to keep short-run wage movements on the trend lines. For example, in the summer of 1966 the norm was temporarily abandoned in favour of an incomes freeze, because of the balance-of-payments situation, which was once again the most important influence on the government's incomes policy.

Second, the problem of translating these over-all targets into appropriate criteria for individual pay settlements and price changes has not been easy to solve. In 1948, 1961 and 1966, when large short-term effects were hoped for, a fixed norm for all incomes was emphasized because more complex criteria are more difficult to administer and the policies were short-run in nature. For the longer run it has clearly been both important and difficult to develop criteria that would be generally understood, accepted, and sufficiently detailed to take into account the many factors that should bear on wage and price decisions. In the February 1962 White Paper, some discussion of principles for relative wages was included, but this was a problem which the National Incomes Commission clearly found difficult to solve in practice. The White Paper of April 1965 contained the most detailed statement of appropriate criteria, and they bear a close resemblance to those used in the U.S. wage-price guideposts. According to this statement, individual pay settlements are supposed to move in line with national productivity, and prices are supposed to fall in enterprises where productivity increases are above the national average, and rise where productivity increases are below the national average. Exceptions to these rules were listed but their use was to be kept to a minimum. In practice, these criteria have not been easy to apply, as the reports of the National Board for Prices and Incomes show. Nor have the criteria escaped serious criticism by economists. In his recent presidential address to the British Association, E. V. Morgan pointed some dangers:[1]

> There is no mention of changes in demand, either in the criteria regarded as justifying a price increase or in those under which "enterprises will be expected to reduce their prices". If these criteria were strictly adhered to, all prices would be "administered" and would change only with changes in costs; demand could have no direct effect, and would affect prices only in so far as it affected costs. This would introduce a most unhealthy rigidity; and it is not a danger that can easily be avoided.

Another thorny issue concerns the potential conflict between restrictive-practices legislation and the recommendations by the National Board for Prices and Incomes about appropriate price behaviour in an industry.

Third, difficulties have been encountered in gaining adherence to the criteria. The 1948 and 1966 experiments were aided by the extreme public awareness of the crisis conditions, the unusually strong support and leadership of some union leaders, and – in the latter year – by threats of strong sanctions. But the 1948 policy of restraint built up pressures that were later released in a wage and price explosion, and this result is also feared in the current freeze.

The hopes of achieving much in the longer run by a purely voluntary change in wage and price behaviour have not been fulfilled in the post-war period. The unions, usually more than the employer associations, have been extremely suspicious of government policy in this area. However, the degree of opposition has been much greater when the Conservative Party was in

[1]E. Victor Morgan, "Is Inflation Inevitable?" *Economic Journal*, LXXVI (March 1966), p. 14.

power, and the greater emphasis on price and nonwage incomes policy since 1964 has helped win more union support. In the case of both unions and management there has also not been the degree of centralization of power found in some other European countries which has limited the extent to which support by leaders of private groups will be transmitted to members. Further, the process by which earnings are determined has made control of earnings more difficult than much popular opinion had supposed. Because of the important element of wage drift, influencing the terms of national wage settlements has been recognized as insufficient for an effective incomes policy.

An important question is the extent to which sanctions will be used. With more teeth, incomes policy can be more effective, but it can also be more dangerous. The emphasis of the British approach has been on moral suasion but some forms of persuasion are stronger than others. In 1961-62 the government, as a large employer, made a serious attempt to set a pattern for the rest of the country by a pay pause to its own employees. The measure was not a success; the effect on others was relatively small, a distortion emerged between the private and public sectors, and government employees felt deep resentment. Since 1964 there has been little response to a purely voluntary appeal to labour and management but there has been a significant shift to focusing more on prices than wages since it is easier to have stronger forms of persuasion to affect the former and since it is expected that wages will in turn be influenced indirectly by strengthening the employer's resistance to wage claims. Public exposure and disapproval of particular price increases are likely to be more damaging to an employer, than similar action on a particular wage proposal by a union will be to a union leader. Other forms of sanctions, such as switching of government purchases and selective tariff cuts, have not been used but are possible devices which can strengthen the policy on the price side. An early warning system, which the government has the statutory powers to enforce, has been developed and may lead to delays of a few months in major wage and price decisions. Also, while the statutory powers that the government can use to gain compliance with its recent appeal for an incomes and prices standstill are due to lapse in July 1967, they are indicative of a willingness to use tougher measures to implement an incomes policy than were thought to be either possible or desirable a few years ago.

The record of British post-war experience is not encouraging to those who have felt that incomes policy is an effective, longer-run type of policy which can be easily developed on the basis simply of moral suasion. While its longer-run form in the United Kingdom is still not clear, concern about the persistent balance-of-payments difficulties and the lower growth rate in relation to other countries continues to maintain public support for arguments that incomes policy is one device that may yet bring more benefits.

TABLE 5–5

Some Economic Indicators for the United Kingdom

Year	Consumer Price Index	Wholesale Price Index	Implicit Price Index GNP(a)	Industrial Production	GNP in Constant Prices	Per Capita GNP in Constant Prices	GNP per Person Employed in Constant Prices	Hourly Earnings	Unemployment Rate: As Published	Unemployment Rate: Adjusted to U.S.A. Definitions
	Annual per cent change from preceding year								Annual average	
1951	8.8	16.9	8.4	4.3	1.9	1.6	1.1	8.6	1.2	
1952	9.5	2.4	8.9	-3.1	-0.3	-0.3	0.2	8.0	1.7	
1953	3.1	-2.1	2.0	5.3	4.3	3.6	3.3	5.3	1.7	
1954	1.8	0.3	2.0	8.0	4.1	3.4	2.4	7.0	1.4	
1955	4.5	2.6	3.9	5.6	3.0	3.3	1.5	8.3	1.1	
1956	4.9	4.6	6.2	0.0	2.2	1.3	1.6	8.0	1.2	
1957	3.8	3.8	4.0	1.1	1.7	1.3	1.4	6.4	1.5	
1958	3.0	1.2	4.5	-1.1	1.0	0.4	1.6	3.1	2.0	
1959	0.5	0.7	1.5	5.7	3.6	3.6	2.6	3.6	2.2	3.1
1960	1.0	1.5	1.5	7.5	4.5	3.3	2.6	8.1	1.6	2.4
1961	3.4	2.7	3.2	0.0	3.3	2.3	2.1	7.0	1.5	2.3
1962	4.3	1.3	3.5	1.0	0.2	-0.2	-0.5	4.1	2.0	2.9
1963	2.0	0.7	1.8	4.0	3.6	3.0	3.4	4.1	2.4	3.4
1964	3.3	2.7	1.8	7.6	5.3	4.6	3.9	8.2	1.8	2.4
1965	4.8	3.8	4.5	2.7	2.2	1.5	n.a.	10.4	1.5	2.2

(a) For Gross Domestic Product from 1956.

Source: See Tables 4–1 and 2–4.

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Chapter 6

Post-War Changes in Incomes Policy in the Netherlands

All countries are unique in their approach to wage-price policy but some are more unique than others. The Netherlands experience in relation to that of other countries justifies some licence in the use of the word 'unique'.

Other countries have been groping in the direction of something more in the area of incomes policy. The Netherlands has moved in the opposite direction, from more to less. Over much of the post-war period it has had the most extreme form of government-supervised, centrally determined wages and prices of any western democratic country. The system of wage and price determination, however, has continually changed, the over-all trend of the past decade being in the direction of greater liberalization. In the past several years the wage policy disintegrated when a wage explosion occurred. Despite the recent difficulties, there is strong support for salvaging some elements of their incomes policy. The announcement in May 1966 of measures to curb prices and wages demonstrated the strong legal powers the government retains to control prices and wages and the willingness to use them to meet economic difficulties, such as a deterioration in the balance of payments. Now there are important discussions about whether it is possible to retain a strong form of incomes policy over the longer run in the face of recent pressures for liberalization of the system.[1]

The example of the Netherlands raises several questions about incomes policy. Does the experience shed some light on the kinds of economic conditions and institutions and on the economic or noneconomic reasoning

[1] The Social and Economic Council of the Netherlands has been asked by the government to prepare a report on a new system for wage policy and some preliminary views were contained in Sociaal-Economische Raad, 7 *de Halfjaarlijks Economisch* Rapport (November 12, 1965).

that affect support for, or opposition to, incomes policy? What problems of mechanics are encountered in a stricter form of incomes policy? Does a prolonged use of it tend to build up intolerable pressures and dangerous side effects? Can a small, open economy, heavily dependent on international trade, expect much effect from a policy that attempts for a while to chart an independent course for its wage and price level and structure?

There are, of course, serious dangers in trying to draw conclusions from the Dutch experience. The changing post-war economic circumstances of the country, the particular set of institutions, the attitudes to economic, social and political affairs, have all shaped both the form and the effects of the country's incomes policy.

GENERAL INFLUENCES

Dutch post-war incomes policy did not simply spring from an attempt to reduce inflationary pressures in a full-employment economy. The origins are complex, but a number of factors have been of special importance.

In its early post-war form the policy was greatly influenced by the enormous economic dislocations which the country suffered as an aftermath of World War II. The serious destruction of productive capacity during the war had left the country with productivity not much more than half the pre-war level. Under such conditions it was argued that market mechanisms could not effectively handle the serious allocation problems and that quite detailed planning of both output and incomes would more speedily restore the economy. In addition, the government expected a serious world-wide depression within a few years after the war, and felt that too rapid a rise in prices would be disadvantageous in view of the heavy dependence of the economy on international trade and the difficulties a depression elsewhere would quickly cause for the country. The necessary co-operation in support of controls by both employees and employers was strengthened by the mutual confidence that had developed between them during the German occupation and the solidarity among most of the unions in opposing the growth of communist unions. The severe economic situation and the common interest of labour and management in post-war reconstruction produced a tolerance for controls which has faded over time as more prosperous, peacetime conditions emerged, as strong demand pressures on the labour market continued, and as fears of a return to the high unemployment rates of the thirties receded.

The support for incomes policy has also been influenced by an aversion to leaving the distribution of income to market forces. Prior to World War II, controls had been placed on rural rents when the heavy demand for land was driving up rents to levels judged socially unacceptable. After World War II, there was a stronger interest in lessening the *economic* competition over the distribution of incomes and in imposing what many felt would be a better distribution from a *social* standpoint. Thus, after the war, all workers were divided into three skill classes. The unskilled wage was based on what was regarded as a social minimum. The semi-skilled wage was fixed at 110 per cent, and the skilled wage at 120 per cent of the unskilled wage. This rigid wage structure was later modified by an important, though not fully adopted, nation-wide job evaluation scheme in which jobs were assigned points according to their technical characteristics of the job, such as knowledge required and self-reliance, and wage differentials were related to the ranking of jobs.[1] Acceptance of the social desirability of such an approach to determining relative incomes from work removed much of the economic competition for higher wages and made a stronger form of incomes policy easier to administer. Recently, however, there has been less support for this approach and a trend towards more aggressive economic competition over wages.

The attitudes of the people are very important but difficult for a foreign observer to appreciate fully. Even a cursory survey of post-war experience in the Netherlands reveals, however, a remarkable homogeneity amidst heterogeneity. Institutions in the country are sharply divided along religious and ideological lines. Amongst unions – apart from the relatively minor communist unions – there are three main movements. The Protestant Federation of Labour (CNV) has about 16 per cent of the organized workers; the Catholic Workers' Movement (KAB) about 30 per cent; the Netherlands Federation of Labour (NVV), a socialist union, about 36 per cent. On the employers' side there is a similar division of organization among protestant, catholic and nondenominational associations. There are, for example, the Federation of Protestant Christian Employers, the Netherlands Roman Catholic Confederation of Employers and the nondenominational Central Employers' Association (CSWV). Among employer associations in industry the denominational associations are smaller in comparison to the nondenominational than is the case for the unions. Similar divisions pervade many aspects of the organization of political and social life in the country.

These divisions have, it is argued, produced tolerance and moderation through the co-operation among the various denominational unions and employer groups in political parties, a *willingness to negotiate*, and a *desire* for compromise that has made a national unity on incomes policy easier. It also seems to be true that since organization is not so much along economic interest lines there has been less aggressive pressure for sectional economic gains.

With more than half of its national income earned through exports, the need to maintain low costs in the Dutch economy in order to compete in

[1] See, Martin P. Oettinger, "Nation-wide Job Evaluation in the Netherlands", *Industrial Relations*, IV (October 1964), pp. 45-59.

export markets, and to prevent a rise in imports out of line with export earnings, has conditioned much of the thinking on economic policy and is an important argument for gaining public support for national economic policies. On the other hand, the openness of the economy presents limits to an independent incomes policy. Persistent surpluses of international receipts over expenditures must be corrected as well as persistent deficits, and thus attempts to have prices and money wages follow a much lower rate of increase than abroad will set up difficulties unless there are continual revaluations of the currency. In addition, when wage structures have moved out of line with those of neighbouring countries, there has been an increased attractiveness of some jobs outside the country. The move to closer European economic integration, which is also expected to increase somewhat the labour mobility among a number of West European countries, may be particularly important in reducing the scope for an independent incomes policy in the Netherlands.

Both the size of the country and the population pressures have also had some effect. The small size of the country – a maximum length of about 175 miles and maximum width of about 115 miles – reduces the regional problems in the administration of an incomes policy that would be faced by a country such as Canada. In addition, the population of a little over 12 million has been growing at a rapid rate of about 1.4 per cent a year, which is high in relation to most other European countries. It has undoubtedly contributed, for example, to continued support for controls over some incomes, such as rent. The problems raised by the high density and growth of population appear also to have unified rather than divided the country on the need for strong centralized economic policies.

Finally, the approach to incomes policy has been influenced by the kind of macro-economic models – developed, for example, by the eminent Dutch economist Professor J. Tinbergen – and policies in the country.[1] Over the post-war period an annual forecast has been prepared, based largely on aggregative econometric models used in the government's Central Planning Bureau. The expected problems in achieving the country's economic objectives are examined, along with the implications of various alternative government economic policies. Control over incomes has been viewed as one important instrument that can assist in reconciling the targets and the forecasts. No attempt has been made to formulate a set of automatic guides for incomes; rather, desirable income developments are examined in terms of the over-all economic situation. The importance of surrendering some freedom over wage bargaining, as a price worth paying to make it easier

[1] A fuller discussion of the approach to planning in the Netherlands is in L. A. Skeoch and David C. Smith, *Economic Planning: The Relevance of West European Experience for Canada* (Montreal: Private Planning Association, 1963), pp. 33-42.

for a government to maintain full employment, has had a considerable impact on trade union thinking over the post-war period.

THE 1963 SYSTEM FOR WAGE AND PRICE DETERMINATION

The system of mechanics for developing and implementing incomes policy has not been static. As noted earlier, it has changed continually over the post-war period and is currently in the process of further change. In order to achieve some understanding of the kind of approach that has been used, however, and the factors that have been important for inducing change, it is perhaps best, first, to examine the new system which was adopted in 1963. Then it will be necessary to explore the reasons for adopting this system, which is more liberal than the ones which existed in earlier post-war years, and the difficulties that have been encountered in its use.

The principal participants in the post-war system – the role of each has varied over time – have been:

The Foundation of Labour: This is a private organization of labour and management representatives which had its origin in a clandestine association of employees and employers during World War II and which was formally established in May 1945. It consists of an equal number of representatives of trade unions and employers' organizations, assisted in their work by a group of experts. While it has played a key role in wage policy, its function also extends to such problems as social insurance, technical training, and health and safety in industry.

The Social and Economic Council: This is a powerful, national advisory body that comments on the broad social and economic problems of the country. Established in 1950, it consists of 45 members – one third appointed by employers' organizations, one third by employee organizations, and one third by the Crown, not as representatives of the government but as experts on economic and social questions. Although the government appoints the president of the Council, the Council has a large measure of independence and is financed directly by a levy on all enterprises in the Netherlands. The scope of the Council's deliberations are wide, and, under the terms of the Act establishing it, ministers in the government must ask the Council for advice on all important economic and social measures unless such a request would be contrary to the national interest. In practice, matters of wage, price and employment policies have been the main area in which the Council's advice has had a large effect.

Board of Government Mediators: Although it had earlier antecedents, this board was established in a 1945 Act as a kind of wage control board with wide powers, including the approval of all collective agreements. While it could in effect set wage rates and back up its decisions with court action, it was limited in its power by being responsible to the Minister of Social Affairs, who was, in turn, responsible to Parliament, and by the requirement that it had to consult with the Foundation of Labour prior to all its major decisions. Under the 1963 system it has been reduced in importance from earlier post-war days.

The government exercises its influence through a variety of channels. The Minister of Social Affairs is primarily responsible for the conduct of wage policy, and the Minister of Economic Affairs for the conduct of price policy. In addition, the Central Planning Bureau, which is responsible to the Minister of Economic Affairs, has played an important role in the preparation of general economic forecasts and economic studies.

As of the beginning of 1963, the system of incomes policy took the following form.[1] The Social and Economic Council prepares every six months an economic report which reviews the general state and problems of the economy, and discusses the possibilities for over-all wage changes that would be consistent with the national interest. The reports are influenced both by the economic estimates prepared by the Central Planning Bureau and the policies being pursued by the government. Although the reports are expected to cover many aspects of social and economic problems, they are intended to provide a basic framework within which specific wage adjustments can be worked out.

Consultations are then held between the government and the Foundation of Labour about desirable developments in labour costs in light of the Council's reports. Should it be clear that the government and the Foundation of Labour hold widely divergent views about the desirable developments, the government has the power to call a short-term wage freeze or to revive the power of the Board of Government Mediators to issue directives about permissible wage increases and to approve all collective labour agreements.

Consultations are also held between the central and member organizations of employers and employees. The intention is that through the Foundation of Labour, employees and employers will be made aware of the national implications of their collective bargaining. Once these internal deliberations within labour and management organizations are concluded, negotiations for the renewal of collective labour agreements will commence. When the negotiations within branches of industry have led to a proposed collective agreement, a copy of it must be sent both to the Foundation of Labour and to the Board of Government Mediators. In addition, if the proposed agreement is expected to influence prices, a communication to this effect must be sent to the Foundation of Labour and passed along to the Ministry of Economic Affairs. The Foundation of Labour must review

[1] A description of the 1963 system is in, Social and Economic Council, "The Application of the New System of Wage Determination in the Netherlands" (mimeo., 1965).

the agreement before it can become effective, and the Foundation is expected to consider the proposal in the light of the over-all desirable development of labour costs.

If the Foundation of Labour is unable to reach a decision on a particular collective agreement, it must submit it to the Board of Government Mediators for a decision. In addition, this Board, after receiving a copy of a proposed agreement, can ask the Foundation to make a special examination of any parts of it which appear inconsistent with general wage policy. Also, even though the Foundation may have approved a particular collective agreement, the Board of Government Mediators, after notice has been given to the Foundation of Labour, can rule that certain conditions of the contract are not binding, and thus has the reserve power to invalidate collective agreements. At any time the government has the power, when general wage developments are judged to be a serious threat to the national economy, to declare a wage stop for one or two months and to increase the power of the Board of Government Mediators to approve all collective agreements, although it was intended that these powers would be used only rarely.

Thus the system involves a dual route for attempting to interject national economic issues into wage settlements. First, the desirable wage developments are judged in the light of general projections for the whole economy. There is then a process of attempting to convey the importance of these over-all considerations down the line through the central organizations of employers and employees to the industry or sector level. Proposed wage settlements in individual sectors must then be sent back up along the line for approval both by the central employer and employee associations and also by a government board. The government maintains a veto power should there be disagreement between the government and private parties, or if a settlement cannot be agreed upon within the Foundation of Labour. The formal powers of the government are large, but the emphasis is on trying to reach agreement through the role of centralized employer and employee organizations.

The approved collective agreements fix the maximum wage which employers can pay. Violators can be prosecuted. The payment of higher wages – referred to as "black wages" – has not been an easy matter to control, however, especially since there are various devices that have been used to circumvent the restriction in times of tight labour markets.

With respect to price policy, there is not the same kind of elaborate structure for trying to influence price decisions.[1] In general, price policy has relied more on the working of foreign competition in the product markets and on the indirect effects of the government's general economic policies.

[1] For a brief statement on price policy at this time, see OECD, *Policies for Prices, Profits and Other Non-Wage Incomes* (Paris, 1964), pp. 63-65.

The government does, however, have considerable legal powers of price control and does have a system for reviewing and directly influencing price decisions, based on 1961 legislation which replaced an even stronger law of 1939.

Price increases of all goods and services sold on the home market must be reported to the Minister of Economic Affairs along with an explanation. For some commodities – bread, milk, margarine, and fuel, which are of prime importance for the cost of living – the Ministry of Economic Affairs must be consulted before a price increase. If the Minister believes that a price increase is not justified, he has the power to fix maximum prices for all goods sold on the home market and can thus order any price increases to be rescinded. In addition, he has the power to issue regulations about the accounting methods used in explaining the basis of price changes and about the labeling of prices.

In practice, the government's price policy appears to have been based on achieving voluntary agreement between the government and business. The number of maximum price orders has been limited and numbered only eight in the autumn of 1963, although price pressures at the end of that year led to a significant increase.

Several working principles appear to have emerged with respect to prices. First, wage increases are not regarded as justification for price increases unless the government has announced that a general change is to be made in wages and prices in the whole economy. Second, increases in costs of purchases of materials could justify a price increase, but decreases in such costs should lead to price decreases. Third, while increases in costs could justify price increases, it was expected that the margin for profits should only be maintained in absolute money terms, meaning a decline in the margin in percentage terms. Some leeway on these principles is permitted in practice, and there is regular consultation between the government and business on price developments. It is of interest that there is no specific rule relating price behaviour to productivity as is found in the U.S. price guideposts.

In addition to the direct regulations over prices and the indirect effects of general aggregative policies, price policy has been strengthened since the mid-1950's by a stronger cartel policy. On this a recent OECD report stated:[1]

> Price policy is supported by cartel policy. The Economic Competition Act of 1956 authorizes the Government to declare unenforceable agreements restricting competition which it considers are incompatible with the public interest. In the context of price policy, the recent decision

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[1] *Ibid.*, p. 64.

to declare collective forms of resale-price maintenance non-binding is particularly significant.

Also, in 1964, the government announced its opposition to fixed retail prices in the case of a large number of consumer durables.

THE INFLUENCE OF EARLIER POST-WAR DEVELOPMENTS

The system of wage and price determination introduced in 1963 was an adaptation of an earlier post-war system and reflects an attempt to handle some of the problems encountered in earlier experience. Three periods are usually distinguished in the earlier development of incomes policy – 1945-54, 1954-59, and 1959-63.

During the first period, 1945-54, incomes policy was dominated by the problems of post-war reconstruction and the inflationary pressures of the Korean War period. Emphasis was placed on a rigid control of the general level of wages and on working out a "harmonious" wage structure.

The legal foundation of the policy was the Extraordinary Decree on Labour Relations (Buitengewoon Beshuit Arbeidsverhoudingen) of October 1945. The power of the Board of Government Mediators was extensive:[1]

> The functions of the Board have been to establish the general principles governing wage changes; to validate collective agreements; to declare agreements binding and to determine their scope; to fix general wage levels, establish differentials and lay down other conditions of employment.

The Board was required, however, to consult the Foundation of Labour on all matters of general importance. This route for the expression of private economic interests was later supplemented in 1950 with the establishment of the Social and Economic Council. The Council, which had broad terms of reference on national social and economic questions, confined itself, in the area of wage policy, to broad principles, while the Foundation of Labour continued a useful role in advising on more specific matters of wage determination.

The wage structure was fixed in 1945 in terms of three categories. A social minimum wage was established, based on what it was felt a worker, his wife and two children would require as necessities of life, with some allowance for regional differences in the cost of living. It was felt that a controlled wage could not be below the amount necessary to use the rationing coupons. Wages for unskilled workers were fixed at this wage, wages for semi-skilled workers at 110 per cent of this level, and wages for skilled workers at 120 per cent. This structure was refined, beginning

[1] B. C. Roberts, *National Wages Policy in War and Peace* (London: George Allen and Unwin, Ltd., 1958), p. 119.

in 1948, on the basis of a nation-wide system of job classification and evaluation. Acceptance of this national system of job evaluation was not made compulsory, but, since wage control consisted of maximum as well as minimum wages, any change in wage structure, including all forms of employee compensation, had to be approved by the Board of Government Mediators. As B. C. Roberts noted, "every aspect of wage determination in Holland has been made subject to regulation and settled in accordance with national policy".[1]

The price controls that were in force after the end of the war were relaxed in 1948 and general movements in wage levels from 1948 to 1950 were closely linked to changes in the cost of living. This pattern was broken in 1951 when the balance-of-payments position had become serious as a result of an adverse shift in the terms of trade. In that year an important example of the power of Dutch wage controls occurred when wages were allowed to rise only 5 per cent despite a 10 per cent rise in prices, meaning real wages for all workers were cut by 5 per cent. Despite some subsequent increases in wages, wage increases by 1953 had only been sufficient to restore the purchasing power of the worker to 1950 levels.[2]

The remarkable national unity over the wage policy pursued during this period appeared to be based largely on the serious national problem of reconstruction and the strong support at the end of the war for a wage structure that would remove much of the economic competition over wage differentials. With time and the passing of national economic crisis conditions, there was a growing demand for more freedom in wage determination. By the end of 1953, pressures mounted for more generous general wage increases and for permission for more differentiated wage increases; more concern was expressed about the stricter controls over wages than prices; there was stronger support for reducing the power of the Board of Government Mediators and elevating the role of the Social and Economic Council on wage policy. In the next period, 1954-59, some modest steps were taken in all three directions.

In January 1954, a general increase in wages of 5 per cent plus an additional 2 per cent for skilled workers was announced, and, in October, the Board of Government Mediators agreed to a further 6 per cent increase that was clearly not related to changes in the cost of living. Further, in March 1956, the Board approved a 3 per cent increase and also announced industries were permitted to raise wages by a maximum of 6 per cent as long as the wage increases were not passed along in higher prices. Several important new factors were apparent in these increases. General wage increases became more related to the scope for expansion of real wages;

[1] *Ibid.*, p. 128.
[2] *Ibid.*, p. 122.

room for wage differentiation was increased with conditions for demand of labour in various industries now becoming more important; there was a closer linking of price policy to wage policy with the principle that wage increases in excess of the statutory rates could not be used as justification for price increases. The allowance for differences in wage increases by industry, announced in 1956, had been based on a somewhat divided report prepared by the Social and Economic Council, and the government clearly relied heavily on the Council for advice on wage policy.

Despite the evidence of slight relaxation in wage controls, wage policy remained an important part of the government's economic policy. In 1957 when the country was faced with balance-of-payments difficulties, the government got agreement on a slower increase in wages than prices which meant, as in 1951, a cut in real wages. The difficulties of retaining wage controls were becoming, however, more apparent. National union leaders who had gone along with the cut in real wages in 1957 were exposed to stronger attacks from workers, and the dual role of union leaders as representatives of the interests of groups of workers and as participants in government wage policy was becoming increasingly difficult to maintain.

In 1959 when a new government was formed – the first since 1939 without socialists in the cabinet – an important revision took place in the system of wage determination. The system of periodic rounds of general wage increases was replaced by a system that permitted increases in employee compensation when productivity improvements in industries or branches of industry justified them. Thus, wage changes were to be closely linked to productivity improvements within sectors of the economy. This system also had implications for price policy. Since wage increases were only to be justified on productivity grounds, price stability was to be maintained unless there were rises in external costs. In industries where productivity improvements were particularly high, wage increases were not supposed to be as high in order that some reduction in prices in these industries could take place. As a result, some room would be provided for wage increases in branches of industry with low or no increases in productivity.

This new system did not work well. First, it was hoped that by providing a productivity guide for wage changes, the role of the government would be substantially reduced and productivity would be stimulated. Serious difficulties were encountered, however, in measuring productivity changes within sectors of the economy. These difficulties weakened the system; parties to negotiations often appeared to select productivity data to justify changes agreed upon on other grounds; disputes over productivity data meant continual reference to government bodies, especially the Board of Government Mediators. Second, since it was often clear to workers that employers were willing to pay increases in excess of the productivity guide, there was still disillusionment with the role of the central employee and employer organizations which supported the productivity guide. Third, the linking of wage changes to productivity changes by industry or branch of industry does not make much economic sense. For example, industries that have quite rapid productivity increases are not always expanding industries and there may not be any need to attract more labour through higher wages. Also adherence to such a guide could exaggerate wage differentials beyond that which the freer play of economic forces would establish. Difficulties in the system led the government to seek the advice of the Social and Economic Council, and in 1963 a new system, based largely on the Council's report of 1962, was adopted.

Thus the 1963 system, outlined in the previous section, was adopted in response to a variety of pressures that developed over the post-war period. The system has moved away from the rigid system of wage rounds for all workers that was characteristic of early post-war years. It does not consist of a set of objective productivity criteria for judging wage claims. It does, however, attempt to interject national economic problems into wage negotiations through the centralized structure of employee and employer organizations and to give these organizations some power in approving changes, while the government retains important powers for disallowing particular agreements and for reverting, if necessary, to stronger general government controls over all wages. Price policy is also no longer linked to productivity, it remains somewhat more informally controlled than wages, a number of working principles have evolved that are supposed to guide price decisions, and the government, though attempting to retain compliance on price policy more through consultations directly with business, does have important powers to disallow price increases.

FURTHER DEVELOPMENTS

The 1963 system has also run into serious problems in its operation. It was launched during a period of strong inflationary pressures and its early test was not regarded as very encouraging. As one observer has pointed out:[1]

> At the end of 1963 . . . something happened that the highbrows called 'socio-psychological' but that to more hard-headed observers looked like the outcome of the law of demand and supply. Briefly, the Netherlands economy had shared too fully in the expansion of the European Economic Community, and though it remained in external equilibrium it had got into a state of over-full employment,

[1] J. J. Klant, "Holland after the Wage Explosion", *The Banker*, CXV (January 1965), pp. 26-27.

reflected in an extremely tight labour market. In such a situation any system of wage control aiming at keeping the rise in money wages within the bounds set by productivity was certain to break down. Consequently 1964 started with a bang, generally called 'the wage explosion', which not only shattered the hopes of keeping the economy on an even keel but also had profound repercussions on the underlying philosophy of policy.

In the fall of 1963, as consultations were being held for the appropriate wage increases for 1964, a number of employers, led by a shipbuilding firm, openly defied the government's wage policy by offering higher wages to attract labour. Despite attempts by the Board of Government Mediators to intervene in the approval of contracts submitted to the Foundation of Labour, wage increases in excess of the general wage target were concluded. Once a dam has begun to break, it is extraordinarily difficult to contain the pressures. Similarly, with a system of wage restraint, if there are strong pressures for wages above a government's norm and there are some major break-throughs above this norm, containment becomes difficult.

Pressures for wage increases mounted throughout the economy and trade union representatives, with their leadership over the rank and file threatened, pressed for an immediate 5 per cent increase in wages in 1964 which was followed by another 5 per cent in 1964 and further scope for some wage differentiation. In fact, compensation to employees increased by the remarkable figure of about 15 per cent in 1964. Despite earlier gloomier forecasts, 1964 turned out to be a boom year which did much to convince union members that the official views of appropriate wage increases tended usually to be on the pessimistic side.

In 1965 the government indicated that wages should not rise above 7 per cent, but within the Foundation of Labour, opposition grew to implementing this norm. The trade union members announced that they could no longer participate in controlling wage claims and thus the 1963 wage determination system that had relied on the policing of wage claims by the Foundation of Labour failed. The Foundation now regarded its functions as limited mainly to discussions of working hours, inclusion of cost-of-living indexes in labour contracts, and equal pay for women. More weight on wage policy was shifted to the Board of Government Mediators but it could not stop the wage pressures. Also, the government's general economic policies were not strongly deflationary, and in 1965 members of the Labour Party once again entered the coalition cabinet, strongly in support of a substantial increase in the government's budget. Thus, the government appeared to be reconciled to a substantial increase in wages and prices, at least while the balance-of-payments position permitted it, and wages rose by more than the official target. During the three years 1963-65 it is estimated that earnings rose by about 38 per cent – more than twice the government's target.[1]

A number of reasons appear to have been important for the failure of the system:

(a) It began at a time of strong excess demand for labour although in 1963 there had not been a public awareness of the strength of demand pressures.

(b) Money wages and prices were significantly below those of neighbouring countries and the discrepancy had been causing some unrest as well as a growing drain of Dutch workers to other countries.

(c) There was no serious balance-of-payments problem to make restraint on wage demands appear to be of great national importance, and the favourable international competitive position of the economy and the substantial increases in productivity have meant the wage increases did not lead to a serious deterioration in the balance-of-payments position.

(d) There was a growing suspicion that wage incomes had in the past been restrained more than nonwage incomes, and attention was drawn to cases of very high salaries.

(e) There was evidence that some workers were getting away with higher-than-authorized wages through various forms of hidden payments by employers.

(f) Under the new system greater responsibility had been placed on labour leaders for implementing national wage policy, but their position for leading on wage restraint had been undermined by the growing restlessness of workers. Due to a change in the cabinet in the summer of 1963, the responsible ministers were less experienced in handling the incomes policy.

(g) Desirable general wage developments were supposed to be based on annual forecasts of productivity increases by the Central Planning Bureau, but workers charged that historically these estimates had tended to underestimate the actual increases in productivity and had thus worked against wage incomes.

(h) The prolonged strong demand for labour has reduced fear of unemployment and the passing of early post-war reconstruction problems has reduced the solidarity among workers on wage policy and bred a greater individualism.

Despite these difficulties the system gives the government strong legal powers over wages and prices, and the willingness to exercise them in crisis conditions was demonstrated recently. Faced with a deterioration in the balance-of-payments situation, the government imposed in May

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[1] Economic Commission for Europe, *Economic Survey of Europe in 1965*, Part I, Chap. 2 (Geneva: ECE, 1966).

1966 a short-run ceiling of 7 per cent on wage increases and compulsory notification of price changes, along with a justification. With respect to the ceiling on wage increases the Foundation of Labour was first asked to implement it, but, when it refused to perform this task, the powers of the Board of Government Mediators were used.

The longer-term state of incomes policy is, however, particularly unclear at this time. Currently, important discussions are taking place about revisions to the system. If there are not serious economic problems, especially with respect to the balance of payments, it is doubtful whether the Dutch are prepared to go back for long to the past stringent form of incomes policy, but sentiment at present is not in favour of a complete abandonment of incomes policy.

CONCLUSIONS

A well-known Dutch economist wrote a few years ago about "The Strange Adventures of Dutch Wage Policy".[1] To a foreign observer, conditioned to the attitudes and institutions of his own country, some of the adventures seem even stranger. Yet, they are not entirely without relevance for discussions of wage-price policy in other countries.

Incomes policy in the Netherlands has been one of a number of types of policies which together have not been a failure if the whole economic record of the post-war Dutch economy is taken as the criterion. The country has had a very low unemployment rate throughout the post-war period. The growth rate has been higher than in such countries as Belgium and the United Kingdom, although it has been lower than in, for example, France and Germany. The country has not been faced with the seemingly intractable problems on its balance of payments such as the United Kingdom has had. Despite the tensions that have existed in its incomes policy the record of industrial peace is excellent. Price stability has not been achieved, but the timing of price increases has undoubtedly been influenced by wage-price policy. As a small open economy, heavily dependent on international trade, it is clear that the country cannot long follow an entirely independent course on prices. The country has been able to choose to some extent between following a line of greater price stability and allowing periodic revaluations of the currency or permitting wages and prices to move more closely in line with those of other European countries when balance-of-payments considerations permitted it. The Dutch have tended to choose the latter route. There was a revaluation of the currency in 1961, but this seemed to be largely the result of the revaluation at the same time in Germany, with which the Netherlands has close economic ties.

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[1] J. Pen, "The Strange Adventures of Dutch Wage Policy", *British Journal of Industrial Relations*, I (October 1963), pp. 318-330.

The fate of wage-price policy in the Netherlands is not clear at this time. The willingness to follow over much of the post-war period a rather stringent form of wage-price policy was strongly influenced by the conditions existing at the end of World War II, the great interest after the war in a wage structure that would be based on noneconomic factors, and a strong desire to maintain full employment even if this meant the sacrifice of considerable freedom in collective bargaining. But a number of difficulties have been encountered in working out a long-run viable system of wage-price policy. Some of the important features and difficulties of the Dutch approach that are of general relevance for discussions of wage-price policy will be noted.

(1) Difficulties have been encountered in working out an appropriate guide for general wage increases. Over much of the period the Dutch have attempted to calculate for the next year the desirable general movements in wages and prices in the light of the forecasts made by the Central Planning Bureau. Expected departures from economic goals and the possible use of alternative policy instruments have been taken into account to provide an over-all integrated approach to wage-price policy. But this approach has not proved entirely successful. It has tended to make the country's economic programme consistent on an aggregative level, but has still left the awkward questions about the appropriate implementation of wage-price policy on an industry or branch-of-industry basis.

(2) The appropriate criteria for the wage structure have been based over much of the post-war period on noneconomic factors. The attempt to work out a structure based on social considerations and a national rating of the technical characteristics of jobs has not been a great success. As one observer has pointed out:[1]

> The abstract conception of social justice which had been at the heart of the attempt to co-ordinate wages scientifically had evidently not provided either workers or employers with the satisfaction anticipated.

The attempt after 1959 to relate wages to productivity by branch of industry was also not successful. The problem of criteria for the wage structure which has caused difficulties for serious long-run wage-price policies in other countries has not been resolved in the Netherlands and has grown more difficult with the more individualistic spirit accompanying prolonged prosperous conditions.

(3) The Netherlands experience shows that enforcement of any desired pattern of wage increases becomes extraordinarily difficult in practice even under quite strong systems of wage policy. First, man develops ingenious routes for circumventing regulations that are not in his interest. Thus, the statutory system of wages that carried penalties for employers

[1] B. C. Roberts, *op. cit.*, p. 127.

paying more than the prescribed maximum wage still did not, in the experience of the Netherlands, win full compliance with wage policy. "Black wages" have not been an insignificant feature of the system for some time. Employers short of labour have devised schemes for offering indirectly higher wages such as bonuses for not taking sick leave. Another example of evading the system has been the development of labour brokers (Koppelbazen) who supply businesses with workers at wages higher than they could be allowed to earn as employees in the business, while the labour brokers are able to argue that they are not producers subject to the statutory wage determination system.[1] About 80 per cent of wage- and salary-earners are covered by the wage determination system, but this still leaves an important number outside it.

Second, enforcement is easier with simple rather than complex criteria for wage increases, but simple criteria are less defensible on economic grounds and tend to produce distortions that undermine the system. As the Dutch moved from a system of general wage rounds for all workers to more complex criteria that permitted differentiation in wage movements, problems of gaining compliance with wage policy increased substantially. The system of general wage rounds, on the other hand, was viewed as leading to long-run distortions in the allocation of resources.

Third, enforcement breaks down under general excess demand conditions for labour unless rigid government controls are implemented. The launching of the 1963 system of wage determination in a period of acute labour shortages meant an inevitable failure of the system. It is sometimes argued that incomes policy makes appropriate stabilization policies politically easier for a government to follow, but the recent Dutch experience suggests that too much faith may at times be placed on incomes policy and this can divert attention from the proper use of general aggregative policies.

(4) Integration of price policy and control over nonwage incomes with wage policy has been difficult to achieve in the Dutch experience. In general, there have been less serious efforts to control prices than wages. In part, this appears to have been based on the view that the enormous importance of international trade to the Dutch economy would help to keep prices competitive. However, there have been several lines of policy to affect prices more directly. A greater emphasis has been placed on competition policy as a result of stronger measures governing cartels and the action taken in 1964 against fixed retail prices in parts of the consumer-durables sector. The Minister of Economic Affairs has the power to fix prices in specific cases. Notification of all price changes must also be

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[1] Murray Edelman and R. W. Fleming, *The Politics of Wage-Price Decisions* (Urbana: University of Illinois Press, 1965), p. 260.

forwarded to his office, and a number of loose working principles governing justification for price changes have been emphasized. One type of price or source of nonwage income, rents, has been strictly controlled over the whole post-war period.

Yet, restlessness over Dutch incomes policy has been increased by evidence that some groups have not been affected as much as others. Thus, it has been noted that profits in the export sector have been high, that building contractors have tended to benefit, and that income distribution remains highly unequal.[1] This evidence, along with the feeling that productivity estimates by the government for wage policy have tended in the past to be biased against increases in wages, have led unions in the Netherlands to have become interested in new schemes for profit-sharing.

(5) In the long run, wage policy poses serious problems for union leadership. A wage policy cannot work for long without the support of private groups. In the Netherlands there has been a major effort to involve both labour and management leaders in the development and implementation of national policy. However, this often involves conflicting roles for the leaders. In recent years it has been clear that labour leaders, in particular, have been exposed to criticism for not representing sufficiently strongly the particular interests of workers.

(6) The Dutch economy is becoming more closely integrated economically with other European countries and this is limiting the extent to which an independent incomes policy is possible.

The major difficulties listed above, along with the prosperous economic conditions, have weakened incomes policy in the Netherlands in recent years. They appear to have led, however, to a search for further adaptations to the system of incomes policy rather than to demands for a complete abandonment of it.

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[1] J. Pen, "Income Policy in the Netherlands 1959-63", *Scottish Journal of Political Economy*, XI (November 1964), pp. 192-193.

TABLE 6–1

Some Economic Indicators for the Netherlands

Year	Consumer Price Index	Wholesale Price Index	Implicit Price Index GNP	Industrial Production	GNP in Constant Prices	Per Capita GNP in Constant Prices	Hourly Wages	Unemployment Rate
	Annual per cent change from preceding year							Annual average
1951	13.6	22.2	11.2	3.4	3.0	1.5	14.8	2.3
1952	0.0	- 2.2	3.0	0.0	2.0	0.8	11.6	3.5
1953	0.0	- 4.2	- 2.0	9.9	8.5	7.4	4.2	2.8
1954	4.0	1.4	4.0	11.0	7.1	5.8	11.0	1.9
1955	1.9	0.8	3.8	7.2	7.9	6.9	4.5	1.3
1956	1.1	0.0	3.3	6.8	3.9	2.5	5.5	0.9
1957	6.7	2.0	5.4	3.8	2.5	1.0	11.7	1.2
1958	2.1	- 1.0	2.0	1.2	0.5	-0.8	4.7	2.3
1959	1.0	0.0	2.0	8.5	5.3	3.5	2.2	1.8
1960	2.0	0.0	2.0	12.4	8.9	8.2	8.7	1.2
1961	1.0	0.0	1.9	3.0	3.1	1.7	6.0	0.9
1962	2.0	1.0	3.8	5.8	2.7	1.0	8.5	0.8
1963	3.9	2.0	4.5	4.6	4.5	3.2	8.7	0.9
1964	5.6	5.8	7.2	8.8	7.9	6.5	16.0	0.8
1965	5.3	2.8	6.0	7.3	5.0	3.6	10.3	0.9

Source: See Table 4–1.

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Chapter 7

Sweden: A Case of no Offical Incomes Policy

The fascination of the Swedish economy for people in other countries is often based more on fantasy than facts. This has been true with respect to incomes policy. Despite much popular opinion to the contrary, Sweden is *not* an example of a country which has been attempting to implement through the government a national incomes policy. As a recent government publication pointed out:[1]

> The Swedish government has little confidence in the usefulness of a direct incomes policy as an instrument of price stabilization, irrespective of whether this policy be executed by exhortation or by a special machinery set up for the purpose.

Recent Swedish experience does not therefore fall within the bounds of a definition of incomes policy that hinges on the development and implementation of the policy through the government. Yet, Sweden is frequently included in discussions of incomes policy because there has been a kind of national wage policy that has evolved largely through the private, highly centralized labour market institutions. Negotiations at the national level between the principal labour and employers' organizations would indicate a regular attempt to examine the appropriate average movement of wages from the standpoint of national economic conditions, to work out general criteria for relative wage movements, and to induce some measure of adherence to the national agreements in individual wage settlements.

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[1]Swedish Ministry of Finance, Secretariat of Economic Planning, "Inflation and Economic Development" (mimeo., July 1965), p. 6.

The direct role of the government has been limited. On occasion the government has expressed its views on the appropriate general wage developments in light of its forecasts of economic conditions for the coming year. Strong public support has been given to government stabilization policies that will provide a suitable economic environment for wage and price developments, and much importance has been attached to this indirect route to affecting wages and prices. The government has made available an important mediation service to assist private parties in collective bargaining. There has been strong resistance from private groups, however, to direct government encroachment on the process of wage determination. There has also been no attempt to integrate a direct policy governing prices and nonwage incomes with the centralized private wage policy.

It is important for this study to examine the case of a country in which direct involvement of the government in incomes policy has been resisted. Does it throw some light on our earlier questions about the economic and noneconomic arguments for and against government involvement in incomes policy? Does the development of a national wage policy through centralized private institutions reflect a useful, effective alternative approach worthy of consideration elsewhere or merely some peculiarities of the Swedish environment —— of interest but of little relevance to other countries? One must always keep in mind that the development of any country's approach to incomes policy may be suited largely to its own environment and may not survive transplanting elsewhere.

GENERAL FEATURES OF THE APPROACH TO ECONOMIC POLICY

The basic emphasis of Swedish post-war economic policy has been on the use of monetary and fiscal policies for economic stabilization, supplemented by more specific measures to increase the adaptability of the economy to economic change, such as policies for improving the mobility of labour, low tariffs, and encouragement of structural rationalization of industry. An extensive welfare programme has been developed through the government, but, despite frequent misinterpretations abroad, this has not been accompanied by extensive economic planning or government ownership of business. Over 90 per cent of Swedish industry and commerce is based on private enterprise.

There has been an interest in experimenting with new types of policies both in the area of growth and stabilization policies. In the case of the latter, for example, the development of a tax-free investment reserve system by which incentives are provided for companies to set aside some profits in boom periods and to use them for capital expenditures in recession periods has attracted much interest abroad, and inspired a measure introduced in the Canadian 1966 budget.[1] Yet, there has been no serious interest in experimenting with some form of incomes policy as a government policy instrument for affecting price stability. There are a number of reasons for this.

First, economic conditions have not recently been such as to cause serious disenchantment with the existing approaches of government policy. The unemployment rate during the first half of the 1960's, when converted to North American definitions, has been estimated by a U.S. Bureau of Labour Statistics Study at 1½ per cent or below.[2] The annual rate of growth of output per man-hour averaged about 3.5 per cent in the 1950's and was over 4.3 per cent during the first half of the 1960's. The country has not been faced with serious, persistent balance-of-payments difficulties since the 1940's although the consumer price index has been rising at an annual rate of about 3½ per cent since 1960 and the wholesale price index at about 3 per cent. There has occasionally been a fear of difficulties, but so far these have not materialized. There is considerable concern about price stability, but, since the indicators for employment, growth and the balance of payments have not been unfavourable and the national welfare schemes contain hedges against inflation, strong pressures have not emerged up to now for better measures to deal with wage and price increases.

Second, economists in Sweden have long debated the pros and cons of an official incomes policy and their writings have been among the most influential in the economic literature on the topic.[3] As in most debates among economists, important differences of views persist, but no strong theoretical support for an official incomes policy has emerged. This is an important point since economists and economic arguments have had a particularly important influence on the development of private and public policies in Sweden.

[1]Very simply, companies are permitted to deduct up to 40 per cent of their taxable income as an investment reserve, 46 per cent of which must be deposited with the central bank. If this reserve is used only when the National Labour Market Board, a government agency, has announced authorization on the basis of its assessment of general economic conditions, the amounts withdrawn do not become taxable income. The Canadian measure introduced in the 1966 federal budget differs in some important respects. For a fuller discussion of the Swedish approach, see Sven-Erik Johansson, "An Appraisal of the Swedish System of Investment Reserves", *International Journal of Accounting*, I (Fall 1965), pp. 85-92.

[2]Arthur F. Neef, "International Unemployment Rates, 1960-64", *Monthly Labor Review* (March, 1965), pp. 256-9.

[3]A translation of six papers by Swedish economists on this topic is in Ralph Turvey (ed.), *Wages Policy Under Full Employment* (London: Wm. Hodge & Co., 1952). See also Erik Lundberg, *Business Cycles and Economic Policy* (London: George Allen & Unwin Ltd., 1957). A theoretical argument for using tax policy to implement government wage policy was advanced in Bent Hansen, *The Economic Theory of Fiscal Policy* (London: George Allen & Unwin Ltd., 1958), pp. 320-87.

Third, freedom of collective bargaining from state interference has been a particularly important goal for some time. The evolution of highly centralized labour and management organizations has concentrated much economic power in a few groups. However, there has been a determined effort to show not only that this concentration is good for members of the organizations, but also that it will not be used to frustrate the national interest and thus invite government intervention. The reconciliation has not always been easy to achieve, as was demonstrated, for example, in early 1966 when the negotiations of the central labour and employer organizations were in danger of collapsing with serious disruptive results for the whole economy.

Sweden is much more highly unionized than any other countries reviewed in this study. It has been estimated that about 71 per cent of nonagricultural wage-earners and salaried employees belong to unions. In turn, the unions are highly centralized.[1] Forty-one national unions, representing about two thirds of organized employees and about 90 per cent of the manual workers, are affiliated with the Swedish Confederation of Trade Unions (LO). Thirty-seven branch unions, representing nearly 75 per cent of all salaried employees, are affiliated with the *Central Organization of Salaried Employees* (TCO). In addition, there are several other small central labour organizations, including the Swedish Confederation of Professional Associations (SACO).

The LO is clearly the dominant union federation and it has considerable power over its members. Member unions have considerable financial strength and independence, but the LO has wielded a degree of central control over member unions, especially since 1941, that is far greater than in the union federations of the United Kingdom, the United States or Canada. In part, *this derives* from constitutional power. For example, any union affiliated with the LO must obtain permission before it can call a strike that would involve more than 3 per cent of the union's members. More important, the power has developed as a result of a strong cohesion among workers in the pursuit of their aims —— there have not been the ideological and religious differences and the same degree of inter-union rivalry that have characterized most union movements elsewhere —— and as a result of the vigorous leadership of the LO. There is perhaps a danger of overemphasizing, however, the chummy atmosphere in the Swedish labour movement. A strong rivalry exists, for example, in the wage claims of the LO and the salaried workers.

On the employers' side the dominant organization is the Swedish Employers' Federation (SAF) which consists of a large number of affiliated associations whose members employ about 1,220,000 persons or about one

[1]An excellent study of the institutions involved in collective bargaining in Sweden and the whole process of collective bargaining is in T. L. Johnston, *Collective Bargaining in Sweden* (London: George Allen & Unwin Ltd., 1962).

third of total nonagricultural wage-earners and salaried employees. It has been organized to represent employers on labour matters. While there are also other associations for employers, the policies of the SAF have had an important influence on them. The SAF exercises strong control over its members as a result of a number of constitutional powers. There is a mutual insurance scheme operated through the SAF to compensate members for work stoppages, but members must notify the SAF about impending strikes and cannot use a lock-out of workers — an important weapon in the development of Swedish industrial relations — without SAF permission. Not only must an employer obtain approval from the SAF to use a lock-out but also the SAF can order member firms to use a lock-out. In addition, all collective agreements must be submitted to the SAF for approval, and rules of member associations require the approval of the SAF.

Thus, the LO and the SAF *have emerged as two extremely powerful organizations* on either side of the labour market, and their negotiations have a substantial influence on the other smaller organizations. Both the LO and SAF are also strongly equipped for bargaining, as was clearly shown in early 1966. The breakdown of negotiations between the organizations was followed by a threat from the LO to ban all overtime work, and the SAF replied with a threat of a general lock-out.

The emergence of this centralized private economic power in the labour market has raised important questions about the threat to the national interest through wage settlements and industrial strife. The danger has been reduced in several ways. The strong aversion to government interference that is likely if the power of these organizations is seriously misused has led the LO and SAF to agreements that reduce the danger of major conflict. There were important steps towards closer agreement during the inter-war period, when industrial relations had been particularly bitter, and they culminated in the famous Basic Agreement at Saltsjöbaden in 1938. The objective of this Basic Agreement was "to provide a functional basis for self-government in the labour market and, by the same token, to make further legislative proposals in this field wholly unnecessary".[1] In it, procedures were agreed upon for the settlement of labour disputes and the protection of neutral third parties. The harmonious labour relations of the post-war period have been influenced by this and other agreements to show that the activities of the LO and SAF need not be curbed by the state.

The danger that monopoly power in the labour market would be used to obtain wage settlements seriously out of line with economic conditions has also been curbed by general public policies to promote competitive adjustments in product markets. Employer resistance to excessive wages is strengthened by the need to maintain competitive prices in international and

[1]International Labour Office, *The Trade Union Situation* (Geneva, 1961), p. 78.

domestic markets. There is a low national tolerance for protection of industry. Tariffs are kept very low. As Professor Lundberg pointed out in his comparison of Swedish and Canadian stabilization policies before the Royal Commission on Banking and Finance: "Canada is a relatively protectionist country; Sweden has about the lowest tariff of all countries in the world."[1]

The general support of measures to promote the adaptability of the economy is strong. About one quarter of total income is earned through international trade, and public awareness of the importance of maintaining a competitive position on international markets seems to be particularly high. The small, homogeneous population of a little over 7½ million has had a strong sense of national identity and pride in the country's economic performance. It is widely accepted that the best way to deal with the economic adjustments that inevitably accompany growth is not to stifle change through protection but to welcome it and help those affected to adjust.

Finally, interest in a national wage policy formulated by the centralized private organizations has been stimulated by labour views that a better wage structure can be worked out centrally than through sectional bargaining. Since the inter-war period the principle of wage solidarity has been an important part of LO policy. The precise meaning has varied:[2]

> The meaning of the term 'solidarity policy' has undergone important modifications since it was first introduced. It originally meant a wage policy involving an attempt to eliminate inter-industry wage differentials based on purely historical factors; it now denotes one aiming at a wage structure such that there is equal pay for equal work and wage differentials reflect as much as possible the differences in the contents and nature of the job (e.g. heavy and dirty work should be paid relatively more than easy and pleasant work). A corollary of this is that differences in profitability or the capacity to pay as between industries and firms ought not to be reflected in wage differentials.

General support of this principle by workers has meant a willingness to surrender to the officers of the LO some of the freedom of decentralized bargaining. As pointed out in an earlier chapter of this study the problem

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[1] Erik Lundberg, "Problems of Stabilization Policy in Sweden and Canada", Memorandum to The Royal Commission on Banking and Finance, August 13, 1962, Vol. 29A (Toronto: mimeo.), p. 5.

[2] "Wage Negotiations and Wage Policies in Sweden: II", *International Labour Review*, LXXX (November 1959), p. 405.

of acceptable guides for wage structure tends to be one of the most difficult problems for a national wage policy, but, at least in the Swedish case, there were fairly strong feelings in the labour movement itself about the appropriate wage structure.

The economic rationale for a policy of wage solidarity has been discussed frequently. While the bases have to a considerable extent been social rather than economic, a number of Swedish economists have defended such a policy on economic grounds. First, there has been scepticism about the effect of wage differentials on the movement of labour.[1] If quite large wage differentials have to emerge to induce movement and there are serious inflexibilities downwards of wages, the process of reallocating resources brings general upward pressure on wages. While it is conceded that a reduction of differentials will lower mobility even more, it has been argued that an active policy to promote labour mobility is a more effective route than wage differentials. Second, it is argued that if wage differentials for similar jobs are reduced and are set more in line with long-run equilibrium conditions, inefficient firms will be squeezed out more quickly and resources can be reallocated to more efficient areas. Thus Professor Lundberg pointed out:[2]

> The underlying theory is that productivity-raising changes in the structure of the Swedish economy will be accelerated if labour, by being about as expensive as in the growth industries, is quickly squeezed out of firms and branches with low efficiency and by means of an active labour exchange policy, transferred to expanding fields of activity.

Neither of these arguments has been fully accepted. As Professor Lundberg has pointed out, such a policy can also have inflationary consequences:[3]

> Wage differentials, which are regarded as unjustified and unjust and therefore to be removed through a solidarity wages policy, give rise, however, in conditions of full employment to a special from of *wage rise momentum.* Considerable increases in relatively low wages tend to release extra wage demands in other sectors. This may occur in different ways. In an inflationary economy of the postwar type it cannot be assumed that there will be more opportunity for raising wages in branches of the economy where wages

[1]Gösta Rehn, "The Problem of Stability: An Analysis and Some Policy Proposals", in Ralph Turvey (ed.), *op. cit.*, pp. 44-5.

[2]Erik Lundberg, "Problems of Stabilization Policy in Sweden and Canada", *loc. cit.*, pp. 9-10.

[3]Erik Lundberg, *Business Cycles and Economic Policy*, p. 237.

> are low than in other branches. For that reason one cannot expect special moderation in the high wage sectors where profits are large when extra wage advances are granted in neglected areas. On the contrary, these tend to induce in the other branches of the economy larger wage claims than would otherwise have arisen...

The argument that wages for similar jobs throughout the economy should move together and that this would be consistent with long-run equilibrium conditions, thus hastening the exit of inefficient firms, has been questioned largely on the grounds of the difficulty of working out what the long-run equilibrium conditions are. In an important article that examines problems of devising criteria for the wage structure in Sweden, Dr. Faxén has concluded:[1]

> Thus, I do not think it will ever be possible to determine the positions of these long-run equilibria for wage differences between various firms, occupations or branches of industry solely by means of job evaluation methods. They could be of some help, to be sure, but they will never provide a universal solution. If this is accepted, we have to abandon the idea of a national 'wage structure' policy, based on the concept of long-run equilibrium. All we can do is to establish a bargaining procedure that is likely to give reasonable results.

In addition, the Swedish economist B. Hansen, has argued along the following lines: if uniform wage increases lead to a faster release of workers where productivity has not been rising as rapidly, unemployment may tend to increase, leading to strong pressures for the state to expand demand, but this in turn will lead to higher inflation which will increase prices and profits and cause further demands for wage increases.[2] Defenders of wage solidarity, on the other hand, have held that inflationary increases in demand need not occur and that proper labour market policy, rather than wage differentials, can be of major importance in reallocating labour. Much of the support for the extensive labour market policies in Sweden has been based on this argument.

The problem of acceptable criteria for the wage and salary structure remains largely unresolved in Swedish wage policy. At present, the principal source of tension is the relationship between the salary scales supported by the TCO and the wages for manual workers supported by the LO.

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[1]Karl-Olof Faxén, "Incomes Policy in Sweden: Problems and Developments", *British Journal of Industrial Relations*, II (November 1964), p. 345.

[2]A summary of B. Hansen's argument is in "Wage Negotiations and Wage Policies in Sweden: II", *International Labour Review*, LXXX (November 1959), p. 408.

WAGE POLICY

The attempt to develop a centralized wage policy by the LO and SAF has been the major feature of Swedish experience in the area of incomes policy. The approach, however, has varied widely over the post-war period.

(a) The Period 1946-56

From the end of World War II to 1956 the pattern of wage policy was not fixed. In the years 1945 to 1948, 1951, and 1953 to 1955, bargaining was conducted by individual unions although the LO participated and made general recommendations. The LO placed particular emphasis on reducing wage differentials between low- and high-paid workers and on introducing considerations of national economic conditions into the bargaining by national unions. But the general inflationary pressures over much of the period raised difficulties for centralized control.

At the end of the 1940's the government and central labour and management organizations attempted a period of general wage restraint. Earnings had soared by about 14 per cent in 1947 and the balance-of-payments position had deteriorated. The government in 1948 called for wage restraint, but the LO was unable to contain union demands and earnings rose by a further 8 per cent. The government countered with strong deflationary measures and these, along with the obviously serious balance-of-payments position, led to a voluntary agreement to extend existing labour contracts in both 1949 and 1950. At the same time, through price controls and subsidies, the government attempted to hold down the cost of living index. It was not a period of a complete wage freeze, however, since some bidding up of wages occurred and those paid by piece rates increased earnings along with production (see Table 7-1). In Sweden, the latter is particularly important since nearly two thirds of all workers are paid according to results.

The period of wage restraint ended with a violent wage explosion in 1951 when earnings shot up by about 20 per cent. With the devaluation of the currency in 1949 and the sharp inflationary pressures released at the outbreak of the Korean War in 1950, it had become increasingly difficult to hold the line on prices. More important, the period of wage restraint had built up serious resentment among those who felt their wages had been unfairly held back. The experience indicated that wage restraint cannot last long under general excess demand conditions and is likely to build up quickly problems about the wage structure that can lead to large wage increases when the system breaks down.

In view of the sharp wage increases in 1951 the government appealed for wage increases for 1952 that would not exceed 5 per cent, but the president of the LO rejected this appeal as unrealistic because of the labour market conditions.[1] However, the SAF proposed a central agreement between the LO and SAF and this was concluded, permitting a general wage increase of 8 per cent for men and 10 per cent for women. Some further negotiated wage increases took place and these, along with the pressures of labour market conditions, led to a total increase of earnings in the neighbourhood of 18 per cent for 1952. The central agreement between the LO and SAF was regarded as a temporary expedient, but there was still difficulty in getting acceptance of it from all unions. In the case of the paper worker's union, for example, the LO had to threaten to withhold support if its wage claims led to a strike.

In the years 1953 to 1955 no central agreement was concluded, but wage increases were lower, largely, it appears, because of changed labour market conditions. For both 1953 and 1955 the government made suggestions about the extent to which wage increases would be appropriate, but there was little evidence that wage negotiations were much affected by the appeals.

TABLE 7–1

Wages, Prices, Unemployment, and Production, 1946-56, in Sweden

Year	Adult Males					
	Contractual Wage Increase	Wage Drift	Total Earnings	Consumer Prices	Industrial Production Index	Unemployment Rate
	Annual Per Cent Change					Per Cent
1946	3.2	4.8	8.0	–	–	3.2
1947	9.7	4.4	14.1	3.3	2.4	2.8
1948	4.5	3.8	8.3	4.3	6.9	2.8
1949	0.2	2.8	3.0	2.1	4.3	2.7
1950	–	3.9	3.9	1.0	4.2	2.2
1951	14.3	6.3	20.6	15.2	5.3	1.8
1952	11.6	6.6	18.2	7.7	-2.0	2.3
1953	1.1	2.5	3.6	2.0	2.0	2.8
1954	1.5	2.9	4.4	1.0	4.0	2.6
1955	4.3	4.2	8.5	3.0	6.7	2.5
1956	4.3	3.5	8.0	3.6	3.6	1.7

Source: Data on wages and earnings from B. C. Roberts, *National Wages Policy in War and Peace* (London: George Allen & Unwin Ltd., 1958), Table 9, p. 89; data on consumer prices and industrial production from OECD, *General Statistics*, various issues; data on unemployment rate from ILO, *Year Book of Statistics*, various issues.

[1] Gösta Rehn, "Swedish Wages and Wage Policies", *The Annals of the American Academy of Political and Social Sciences*, 310 (March 1957), p. 104.

In 1956 another central agreement for wages was made between the LO and SAF, and the TCO also entered into the central agreement. At the time it was viewed as an exceptional event as in 1952 it ushered in a period of central agreements, which are still being continuously used. Before examining the experience with central agreements, a few points about the experience 1946-56 should be noted. Sporadic efforts by the government to get agreement on appropriate average wage increases had not been successful and were opposed in general by labour. The major attempt at a wage freeze in 1949-50 had some limited success, but it was followed by a wage explosion that wiped out the previous lower increase in wages. The LO had placed particular emphasis on trying to reduce wage differentials and, although some narrowing occurred, particularly in the early post-war years, the LO did not achieve its objectives here.[1] Movements in both average and relative wages had been clearly dominated by general labour market conditions. Reliance on bargaining by individual unions with employers and the absence of central agreements in most of the years meant there was very little in the Swedish experience that could justify the use of the term "national wages policy". As an OEEC report stated:[2]

> Until central negotiations in peacetime became the rule rather than the exception after 1956, the method of wage determination in Sweden differed little from other countries where industry-wide collective bargaining is prevalent, e.g. Germany and the United Kingdom; the only distinctive features were the strong powers of the central bodies on both sides, and the greater synchronization of contracts.

(b) Nature of the Basic Agreements Since 1956

Since 1956 the LO and SAF have directly negotiated basic agreements covering nearly one third of the total number of wage- and salary-earners in Sweden. These central agreements are not legally binding on the members of the two organizations and separate agreements must be concluded between employers and the national unions in the LO. But the LO and SAF Basic Agreement sets out the norms for the industry negotiations. The agreements have also contained a clause that the LO and SAF will do their best to see that principles contained therein will be followed by groups not directly represented in the agreement. Thus, this leading agreement is expected to have a major influence on wages and salaries throughout the economy.

[1] T. L. Johnston, "Wages Policy in Sweden", *Economica* XXV (August 1958), p. 225.

[2] William Fellner, *et al.*, *The Problems of Rising Prices* (Organization for European Economic Co-operation, 1961), p. 413.

No attempt, however, has been made to develop norms for profits; the objective has been to develop a national policy for wage and salary incomes only.[1]

The central agreement was first negotiated as an annual affair, then shifted to every two years, and in 1966 to a three-year period. The time-table for the negotiations has been based on the time-table that evolved for industry bargaining[2]. There is a high degree of synchronization in the timing of labour contracts, with the majority expiring during the period January to March. Thus, the period from the end of September to the end of March had become the season for negotiations over labour contracts.

Procedures in arriving at the central agreements have been based on this time-table but are not fixed. Generally, in the summer, preliminary statements and consultations about appropriate general wage developments begin. In October or November, a report is published by the National Institute of Economic Research -- a government-financed research institution which enjoys considerable independence and a high reputation for the quality of its economic studies. This report, which contains both a survey of recent economic developments and the outlook for the coming year, serves as a basis for discussions both in private meetings of labour and management and also in Parliament. Usually, in December, delegations numbering about 25 each from the LO and SAF meet to discuss the central agreement for the coming year. In January, the National Budget, prepared jointly by the Economic Division of the Ministry of Finance and the National Institute of Economic Research, is published. It is an economic survey that may sometimes contain estimates of the room for increases in money incomes for the year. The finance minister also presents his fiscal budget at this time in Parliament, and he may or may not take this opportunity to give his views on the appropriate increases of incomes. At the beginning of 1966, for example, the Minister announced a 6 per cent figure as an appropriate objective for the growth of wage incomes as part of his budget forecasts. No attempt was made, however, to translate this into guidelines for actual negotiations and to gain adherence to it. Only in this indirect way has the government plaved a role in wage policy.

The central framework agreement is then concluded, and it sets out the changes in earnings that should prevail in the industry negotiations, which are usually being carried on simultaneously with the negotiations for the central agreement. The central agreements have also contained exceptions to the general norms for industries or groups of workers who for some reason – often because of especially low incomes – merit special

[1]Karl-Olof Faxén, *op. cit.*, p. 340.

[2]A more detailed discussion of the time-table for the central agreement and industry negotiations is in T. L. Johnston, *Collective Bargaining in Sweden*, pp. 263-75.

treatment. In both the 1964 and 1966 central agreements a "wage kitty system" was used whereby the absolute amounts for wage increases in industries are determined in the central agreement and their distribution is decided in the industry negotiations. Industry negotiations have generally followed closely the norms of the central agreement, partly because of the constitutional powers of the LO and SAF discussed earlier, partly because industry representatives are on the delegations of the LO and SAF that make the agreement, and because the LO and SAF representatives participate in the industry negotiations. If an impasse in negotiations is reached, however, there is provision for the use of state's mediators.

The most difficult central agreement to conclude in recent times was the one in 1966. Both the LO and the SAF were far apart on the contractual wage increase. To break the deadlock the LO first indicated it would be prepared to ban overtime and the SAF replied with a threat to call a general lock-out by its members. The dispute was at the top between the leaders and appeared to be more a jockeying for position in a bargaining situation than a basic weakening of the industrial relations situation. The central agreement finally concluded had a number of distinctive features, but two stand out. For the first time, the central agreement was for a three-year period covering 1966, 1967, and 1968. Moreover, wage contracts each year are to be amended to include retroactive compensation for wage drift. The latter feature builds in some awkward questions for measurement of wage drift and for the flexibility of wages.

The role of the government has been indirect and informal. It was pointed out above that the government participates in the forecasting of economic conditions and, on occasion, expresses its views on appropriate wage developments for the coming year. The forecasts of the government and the National Institute are not, however, the sole forecasts used in the negotiations. Both the LO and SAF have highly competent economic research staffs that prepare their own studies. Thus, as T. L. Johnston has noted,[1] the LO in 1959 had more optimistic forecasts than those of the the National Budget and they turned out to be more accurate. This also appears to have been the case in 1964. Expressions of government views on appropriate wage developments do not appear to have had a very significant effect on the negotiations in the past. While there have been close ties between member unions of the LO and the Social Democratic Party that has formed the government either alone or as a dominant member of a coalition continuously since 1932, and while these may have had some restraining influence on LO demands at times, there is a strong resistance in these central negotiations to any form of government dictation of the terms of the agreement. In the literature on incomes policy some have argued that close ties between centralized union federations and political parties in

[1]*Ibid.*, p. 336.

power make an incomes policy easier, but some in Sweden point out that the relationship between the LO and the Social Democratic Party would make an official incomes policy a source of frequent political embarrassment to the government and of suspicion to many groups.

Although the national contracts cover the majority of workers, there is still important scope for variation in local contracts. In Sweden the contracts have focused more on wages and less on fringe benefits than in North America; fringe benefits have been left more to government legislation. The contracts are binding and disputes over their interpretation are not permitted to lead to work stoppages. In the event that the parties are unable to agree on the interpretation, the matter is referred to a labour court and its decisions are binding. Work stoppages can only arise therefore out of disputes over the renewal of contracts.

PROBLEMS WITH WAGE POLICY

The highly centralized negotiations in Sweden mean that the implications of wage increases on national economic conditions become an important part of the deliberations. An effort has been made to show that the public interest can be served on a voluntary private basis without state interference. The central negotiations have also been viewed as a vehicle through which the workers' principle of wage solidarity can be implemented. However, a number of problems have been encountered.

A surprisingly large percentage of the actual increase in wage and salary incomes has not been accounted for by the terms of the collective agreements. The difference between the actual increase in earnings and the increase which can be expected from the collective agreements is referred to as "wage drift". It is a measure of the importance of locally determined changes in earnings not controlled by the labour contracts. Table 7-1 shows that from 1946 to 1956 the wage drift varied from 2.5 per cent to 6.6 per cent occasionally being higher than the contractual wage increase. Table 7-2 shows that from 1960 to 1965 the wage drift varied between 3.4 per cent and 5.5 per cent and the average wage drift was greater than the contractual wage increase over the whole period. If the four-year period is taken as a whole, wage drift accounted for more of the actual increase in earnings than the contractual wage increase.

Wage drift may arise from a variety of sources such as the bidding up of wages by employers wishing to retain workers or to seek more workers, greater output than anticipated by workers on piece rates, movements of workers from lower-paid to higher-paid jobs. In Sweden several institutional reasons are given as to why it is generally so high. Collective agreements on the national level are not worked out in detail for local application and there is thus room for considerable flexibility at the plant level; the high proportion of workers on piece rates and the flexibility of piece-rate formulas accentuate the increase in earnings in periods of high demand.

TABLE 7–2

Contractual Wage Increase and Wage Drift, 1960-65, Adult Males in Industry

(Percentage increase from preceding year)

Year	Contractual Increase	Wage Drift	Increase in Hourly Earnings
1960	3.8	3.4	7.2
1961	3.5	4.1	7.6
1962	3.9	3.7	7.6
1963	2.5	4.1	6.6
1964	1.6	5.2	6.7
1965	3.5	5.5	8.9
1960-65	3.2	4.4	7.5

Source: Derived from Sture Eskilsson, *Löneutveckling Under Kontroll* (Stockholm: SAF, 1966), p. 16. The number of workers on piece rates was weighted by two thirds and the number on time rates by one third. The sum of the first two columns may not equal the third due to rounding.

Although the likely amount of wage drift is estimated and has been a factor in negotiations, wage drift has weakened the significance of the agreements of the LO and SAF. Wage drift has been intensively studied by many Swedish economists and the degree of excess demand for labour has been established as a major cause.[1] The market forces of supply and demand at the local level have thus played a large role in determining earnings independently of the national wage agreements.

The problem of the appropriate criteria for relative wages and salaries is not settled in Swedish discussions of wage policy but the existence of wage drift means that the effect of Swedish wage policy on the structure, as well as the average rate of change of earnings, has been limited. To those concerned about the lack of adequate criteria for determining wage and salary structure in central negotiations, wage drift has been welcomed as permitting flexibility. Thus, Dr. Faxén points out:[2]

> The existence of a sizeable wage drift is currently taken for granted in all discussions on wage policy in Sweden. In a sense,

[1]See, for example, Bent Hansen and Gösta Rehn, "On Wage Drift: A Problem of Money-Wage Dynamics", in *Twenty-five Economic Essays in Honour of Erik Lindahl* (Stockholm, 1956), pp. 87-138.

[2]Karl-Olof Faxén, *op. cit.*, pp. 341-2.

> wage drift makes it possible to conduct centralized bargaining over a sequence of years without much of a systematic policy with respect to the wage structure; it not only limits the applicability of a systematic policy, it also alleviates the need for one.

But it has weakened the LO policy of wage solidarity. While some argue that wage drift does not change the wage structure as much as might be thought at first because relative wage changes through wage drift lead to pressures for eliminating them at the next round of collective agreements, it has nevertheless undermined the original approach to wage solidarity in the ranks of the LO and forced some change in the approach. Undoubtedly, workers in some industries have been held back at times from getting wages as high as they might have, and lower-paid workers have at times got more, but the long-run effect on the wage structure has not been great, particularly on inter-industry earnings. It has been pointed out:[1] "Wages in the various industrial groups were equalized until 1952, but there has since been a widening of differentials so that, broadly speaking, inter-industrial wage relations are not very different from what they were at the end of the Second World War". This point is consistent, of course, with important shifts among industries in their ranking by wage rates paid, but a recent OECD study, which included an examination of wage structure in a number of countries from the beginning of the 1950's to the beginning of the 1960's, failed to find a significant difference in inter-industry earnings changes in Sweden compared to several other countries:[2] "In a special study of earnings and employment changes in selected 2-digit industries which was made for Denmark, Sweden, the United States and the United Kingdom, the industries which experienced above-average (or below-average) earnings increases were the same in the great majority of cases." As T. L. Johnston has pointed out, an economist for the LO acknowledged back in 1955:[3] "It is no exaggeration to state that the task of establishing just and reasonable relative wages between different groups is still in the main unresolved"; and Johnston argues: "In fact, solidarity is now a misnomer". More emphasis has been placed simply on preventing sharp short-run changes in the wage structure that appear unjustified in terms of longer-run considerations. There has been no serious attempt to implement wage solidarity through a comprehensive national job evaluation system which has stimulated more interest in the Netherlands.

[1] "Wage Negotiations and Wage Policies in Sweden: II", *International Labour Review*, LXXX (November 1959), p. 408.

[2] Organization for Economic Co-operation and Development, *Wages and Labour Mobility* (Paris 1965), p. 31.

[3] T. L. Johnston, "Wages Policy in Sweden", *loc. cit.*, p. 225, fn. 228.

Other problems have emerged for wage policy. The key role of the engineering industry in the determination of wages has been a factor of considerable importance to some Swedish economists for explaining the lack of serious balance-of-payments problems. Wage negotiations in the engineering industry, it has been argued, have typically been important in influencing other wage developments, and the engineering industry is also heavily dependent on international trade. Thus, the international competitive position of the economy has been more quickly reflected in wage negotiations through this route. More recently, however, due to heavy demand pressures, wage increases in the building industry have been particularly large, and some suggest workers in other industries are coming to regard the building industry as a more important one to which to link their wage demands. Since the building industry is less exposed to international competition, it is feared that wage developments will be less responsive to balance-of-payments conditions. Some doubt has been cast on the importance of this development, however. As in other countries where the role of wage leadership is now being more seriously questioned, recent work in Sweden has failed to show that wages in construction have a strong, systematic effect on wages in other industries.

Stronger wage pressures are also expected as a result of the very low projected increase in the labour force over the rest of the 1960's. In contrast to the high estimated rate of increase of the Canadian labour force over this period – between 2.5 and 3.0 per cent a year – the Swedish rate of increase has been estimated at about 0.7 per cent, with an increase in women entering the labour force accounting for the entire net gain. Further, due to a continued shortening of the working week, it is expected that the effective labour supply – in terms of total number of hours of work – will actually decline by 0.3 per cent per annum during 1966-70 in contrast to a rise of 0.6 per cent per annum during 1960-65.[1] Also, since there is some evidence that labour mobility tends to be higher with a more rapidly expanding labour force, stronger pressures for greater wage differentials to reallocate labour may emerge unless offset by even more intensive labour market policies.

Despite these problems for wage policy in Sweden, there are not strong pressures at present either for a major step towards decentralization of the system or, on the other hand, to greater state control. The general economic performance of the economy in terms of unemployment, economic growth and the balance of payments has been very good. The rate of increase of prices has been higher than in North America during the past decade, but not excessive in relation to countries in Europe. As with

[1]Swedish Ministry of Finance, Secretariat for Economic Planning, "The Swedish Economy 1966-1970 and The General Outlook for the Seventies", (mimeo., 1966), pp. 2-3.

other countries, however, the present direction of economic policies will depend on the avoidance of a serious deterioration in the balance-of-payments position.

The system has also been conducive to a very low level of industrial disputes and strikes. Although a true measure of output lost through labour unrest is not possible, the record in Sweden in relation to other countries appears to have been very good. Table 7-3 shows that the number of days lost by work stoppages per 100 employed persons has averaged much lower in Sweden than in France, Germany, the United Kingdom or the United States.

TABLE 7-3

Man-Days Idle by Work Stoppages in Sweden and Selected Other Countries

(Number of days lost per 100 employed persons 1956-63)

	1956	1957	1958	1959	1960	1961	1962	1963
Sweden	0.1	2.0	0.6	0.9	0.7	0.1	0.2	0.9
France............	11.0	31.8	8.8	15.0	8.3	20.1	14.7	46.3
Germany (FR)......	8.4	5.7	4.2	0.3	0.2	0.3	2.4	4.7
United Kingdom....	10.5	42.4	17.4	26.5	15.2	15.3	29.2	8.8
United States......	54.1	27.0	39.1	112.8	31.2	26.7	30.4	26.3

Source: Grafström, Some Data About Sweden and Its Labour Market (SAF, mimeo: April 20, 1966), p. 6.

There are many reasons for this record of industrial peace. In addition to the general emphasis on industrial peace by the LO and SAF, these organizations conduct extensive educational programmes for members which, it is argued, have served, among other things, to decrease the gains individuals and groups expect to win through labour disputes. Unions have been organized on an industry, rather than craft, basis which has reduced the demarcation disputes more prevalent in other countries. Some suggest that welfare legislation and continuous full employment conditions have reduced the bitterness arising from greater economic insecurity. Others simply point to the general attitudes of people in the post-war period in opposing the solution of economic problems through labour disputes.

CONCLUSIONS

Sweden has so far rejected incomes policy as an appropriate stabilization instrument of government policy. Apart from occasional expressions by the government of room for general wage increases, there has been no trend over the past decade towards direct government intervention in wage and price developments. The country has had, however, a type of private, national wage policy developed largely through the dominant labour market institutions.

The economic and noneconomic reasons for opposing an official incomes policy have been varied. (1) There has been confidence that skilful use of monetary and fiscal policies of the government, supported by some general measures to improve the adaptability of the economy, are sufficient for meeting the economic objectives of the society. Sweden's post-war economic experience suggests that so far this confidence has not been misplaced. (2) There is a high level of economic literacy in the country and there has been little general theoretical support for incomes policy in the writings of Swedish economists. (3) There is a healthy suspicion of the accuracy of government economic forecasts, although they are viewed as a help in assessing the consequences of various wage and price developments. T. L. Johnston has noted that in Sweden "economic forecasting is not generally regarded as sufficiently sophisticated for the wage rounds to be geared tightly to the budget or to the economic surveys of the Institute of Economic Research".[1] At the same time, there is little support for an automatic formula, independent of the forecasts for the next year, like the productivity guide used in countries such as the United States. (4) When a wage freeze was attempted at the end of the 1940's, largely at the prompting of the government, a wage explosion followed. This is still regarded as evidence of the difficulty of an official incomes policy. (5) The difficulties of working out the appropriate criteria for wage and salary structure, and the danger of government policy introducing rigidities here, have been emphasized. A recent government publication noted:[2]

> Government intervention in wage formation – even in cases where it is effective in the short-term – easily creates distortions in the distribution of income. In the longer term such distortions can release disruptive wage movements to restore the previous relations between wages and prices or between different groups of wage earners.

(6) Organized labour and management have opposed government interference in this area as weakening private negotiations and sacrificing freedom in collective bargaining. (7) The existence of enlightened central employer and employee organizations with strong control over members has been viewed as providing protection against abuses of economic power in particular sectors of the labour market.

While there has been a resistance to making incomes policy a matter of government policy for stabilization purposes, there has nevertheless

[1] T. L. Johnston, *Collective Bargaining in Sweden*, p. 336.

[2] Swedish Ministry of Finance, Secretariat for Economic Planning, "Inflation and Economic Development", p. 6.

been a private national wage policy. Since there has regularly been an attempt by the LO and SAF to work out the appropriate average wage increase in the light of expected economic conditions, to translate this into a sectoral breakdown among industries and groups, and to gain adherence to these norms among most of the wage- and salary-earners in Sweden, there clearly has been a type of national wage policy. The distinguishing feature has been the degree of independence of this policy from the direct involvement of government. The emphasis on wage solidarity, the high degree of centralization of labour market institutions, and the small, homogeneous population all have influenced this approach.

Some of the same difficulties encountered in countries with official forms of incomes policy have been experienced. The effect of the wage policy on the general wage changes has been reduced by wage drift that has fluctuated with the degree of excess demand for labour. Wage drift has also undermined the attempt to control the structure of wages and salaries according to the principle of wage solidarity. The wage policy has had some effect in influencing short-run movements in average wages and in reducing shorter-run fluctuations in wage differentials, but there is no clear evidence that it has significantly affected either the longer-run average movement of wages or the wage structure.

The most important effects of the Swedish approach in this area so far appear to lie in other directions: in developing procedures that have restrained the abuses which could stem from the high concentration of economic power in the labour market; in satisfying to some extent social objectives such as greater industrial peace, and the reduction of tensions accompanying economic change without serious impairment to the economic adjustment processes; perhaps most important of all, in stimulating economic debates, associated with the process of wage policy, which have served the economic educational function of increasing understanding and support of better economic policies other than wage policy. But the approach has not been free of serious problems. Difficulties in working out appropriate criteria for wages and salaries persist. The tensions in achieving the wage agreements this year have led to pressures for a major re-evaluation of the whole system of wage negotiations.

TABLE 7–4

Some Economic Indicators for Sweden

Year	Consumer Price Index	Wholesale Price Index	Implicit Price Index GNP	Industrial Production	GNP in Constant Prices	Per Capita GNP in Constant Prices	Hourly Earnings	Unemployment Rate: As Published	Unemployment Rate: Adjusted to U.S.A. Definitions
	Annual per cent change from preceding year							Annual average	
1951	15.2	28.2	23.4	5.3	-0.4	-0.8	23.5	1.8	
1952	7.7	6.0	6.3	-2.0	2.9	1.3	16.7	2.3	
1953	2.0	- 5.7	- 1.0	2.0	3.5	3.3	2.0	2.8	
1954	1.0	- 1.0	0.0	4.0	6.7	6.0	4.0	2.6	
1955	3.0	4.0	4.0	6.7	3.6	2.8	7.7	2.5	
1956	3.6	4.4	4.8	3.8	3.6	2.7	8.0	1.7	
1957	4.6	3.2	3.7	2.4	3.5	3.4	6.2	1.9	
1958	5.5	1.0	3.5	2.4	1.3	0.2	4.7	2.5	
1959	0.0	0.0	1.0	5.8	4.9	5.0	4.4	2.0	
1960	4.2	2.0	4.0	9.9	4.4	4.0	6.4	1.4	
1961	3.0	3.0	2.9	7.0	6.4	5.2	9.0	1.2	1.5
1962	3.9	2.9	5.6	0.9	3.8	3.5	7.3	1.3	1.5
1963	2.8	2.8	3.5	2.8	3.3	2.7	8.5	1.4	1.7
1964	3.6	3.7	3.1	6.3	7.1	5.6	6.3	1.1	1.6
1965	5.3	2.7	5.9	2.5	4.5	3.6	10.4	1.1	1.2

Source: See Tables 4–1 and 2–4.

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Chapter 8

The Varied Interest in Incomes Policy and the Recent French Approach

A comprehensive survey of foreign experience with incomes policy is beyond the scope of this study. The general impression to a foreign observer, however, is that there is an interest throughout Western Europe in incomes policy but that the actual measures introduced have been quite limited. There has been much talk but little action so far.

An important question in Western Europe is the effect of closer economic integration on the future possibilities for this type of policy. In the fields of fiscal, competition, commercial, and monetary policies closer co-ordination of national policies has been clearly recognized as important for the process of closer economic integration in the common market. With respect to incomes policy there has been little work on co-ordination partly because of the scepticism that still exists about this type of policy. In its medium-term economic report, released this year, the European Economic Commission indicates its support for incomes policy in member countries of the common market, but leaves open the question of how it is to be implemented in a common market framework. In current discussions on revisions to their incomes policy, the Dutch are now emphasizing that their own success will depend more on whether other West European countries will have incomes policies. There is thus an emphasis on the difficulties, particularly for the smaller, open economies, of achieving much independently on incomes policy in a more closely integrated Europe.

In each of the countries examined in this study the varied sources of interest in incomes policy have been noted. The predominant source of interest in incomes policy has been to moderate the rate of increase of prices at high employment levels. Discussions of incomes policy, however, sometimes centre on other questions, particularly that of the appropriate long-run distribution of income, and this point can be seen clearly in the recent approach to incomes policy taken in France. A brief note on French incomes policy is thus important.

RELATION TO MEDIUM-TERM PLANNING

In France recent interest in incomes policy has developed in conjunction with medium-term economic planning.[1] The setting of five-year volume targets both for total output and output by sector has been viewed as leading logically to the setting of targets for the distribution of income from the increased output. As economic planning becomes more detailed it has been argued that it is less defensible to exclude targets for the returns to social groups; the interest has been not so much in a redistribution of existing income as in the proper distribution of the increments to incomes projected in the five-year plans. The term *incomes policy* has thus taken on a broader meaning, encompassing the policies governing the equitable distribution of the expected medium-term fruits of increased growth,[2] and in this sense involves many types of policies influencing income distribution, including taxation, government expenditures and so forth.

There has been at the same time an interest in incomes policy as one of the possible devices for improved stabilization policies, which have been the subject of important recent discussions. Following the devaluations of the currency in 1957 and 1958 prices, not unexpectedly, continued to rise in France, but their rate showed little tendency to level off after the initial impact of higher import prices. Thus between 1958 and 1963 the implicit price index of GNP rose by 24.3 per cent and the consumer price index by 24.8 per cent. Since further devaluations of the currency were opposed and prices were continuing to rise, a strong stabilization programme was introduced in 1963. It took the form of deflationary aggregate policies and a freeze of prices. This experience, however, led to an interest in incomes policy as a possible way of avoiding deflationary policies, which were regarded as upsetting to the medium-term planning.

The close link between thinking on economic planning and incomes policy in France was demonstrated at an important Conference on Incomes held from October 1963 to January 1964, under the chairmanship of M. Pierre Massé, who was then Commissaire Général du Plan. Representatives from various economic groups took part. Its report[3] has provided an

[1]For a discussion of the French approach to economic planning, see L. A. Skeoch and David C. Smith, *Economic Planning: The Relevance of West European Experience for Canada* (Montreal: Private Planning Association, 1963), Chap. 3.

[2]See, for example, Jacques Lecaillon, "La Politique des Revenus", *Revue d'Économie Politique* (mai – juin 1965), pp. 517-58 and J. Delors, "Politique des revenus et stratégie du développement", *Revue d'Économie Politique* (mai – juin 1965), pp. 559-92.

[3]*Rapport sur la Politique des Revenus Établi à la Suite de la Conférence des Revenus, octobre 1963–janvier 1964* (La Documentation Française, 1964).

important basis for subsequent discussions and for incorporating some stronger elements of incomes policy into the Fifth Plan. It concluded with M. Massé's own proposals.

The main proposals were:

(1) The Commissariat du Plan should complement its usual five-year plan in physical volume terms with a plan in value or monetary terms that would include incomes planning.

(2) Annually the government should recommend the maximum increase in the main categories of income.

(3) A new body the Collège d'Études et d'Appréciation des Revenus (C.E.A.R.), composed of independent members, was recommended to review developments under (1) and (2). In addition, there was a general recommendation for more intensive research on the planning of incomes which might be largely carried out through the C.E.A.R.

Although these proposals have been important in influencing subsequent developments in France, incomes policy has not in general had great support, particularly from the trade unions. Trade union opposition has arisen for a number of reasons. First, unions have been less enthusiastic about French planning procedures than the business community. Only about 10 per cent of the members of the various industry commissions that participate in drawing up the five-year plans are from unions. Thus, the linking of incomes policy with economic planning has not led automatically to enthusiastic support from workers. Second, unions have feared that the incomes policy will focus mainly on wages and that it will involve more state control over the freedom of unions to negotiate. Third, union leadership in France has largely been quite left-wing and there is a suspicion of the new emphasis on incomes policy which is regarded as a device of a government that is basically right-wing. There is, however, a lack of unity in the union movement which is weaker and less centralized than in some other European countries. There are three major trade union confederations -- The Confédération Générale du Travail (CGT), the Confédération Générale du Travail-Force Ouvrière (CGT – FO), and the Confédération Française des Travailleurs Chrétiens (CFTC). The largest, the CGT, is communist-dominated and has not agreed with the government on its incomes policy. The CGT – FO, which is noncommunist, and the CFTC, which is Catholic, are perhaps less strongly opposed to it, but they have shown little support for it so far "partly because of their fear of losing members to the CGT and partly because they apparently believe that private enterprise would be the sole beneficiary".[1] Only the farmer's union appears to have supported the move to an incomes policy. Employers have been less strongly opposed than the

[1]Bela Balassa, "Whither French Planning?", *Quarterly Journal of Economics*, LXXIX (November 1965), p. 551.

unions but have also shown little enthusiasm for incomes policy, at least in its early stages.

RECENT MEASURES AND PROBLEMS

Despite this lack of a broadly based support for incomes policy the government has been moving ahead in this area recently. In the preparation of the Fifth Plan for 1966–70 the programming in volume terms has been supplemented by projections for the main categories of incomes and for value added and relative prices by major industrial sector. There has been some experimentation with breaking down the sectoral value-added series by major income stream, but the emphasis at this stage has been on projections of value added. The plan calls for a relative rise in profits to encourage more investment financed internally. In the annual economic budget it is hoped the government will relate annual guides for incomes to the medium-term plan. A new body, not too unlike the body (CEAR) proposed in M. Massé's report, has been established – centre d'étude des revenus et des coûts (CERC) – which will examine the development of incomes in sectors of the economy.[1] It is somewhat like the British National Board for Prices and Incomes, but appears to have more restricted terms of reference. The government will refer cases to it for study, but the CERC is not free to publish its findings and to try to influence incomes through the publicity of its studies. The government will determine any publication of its findings.

The government has taken some steps in the direction of trying to gain adherence to incomes policy. It has strong powers over prices in France, and these powers are apparently going to be used to help implement incomes policy.[2] As noted above, a price freeze was instituted in 1963 as part of the government's stabilization programme. In its recent moves to liberate the controls the government has invited producers to agree to certain rules for the future movement of prices. The approach was summarized recently in *The Economist:*[3]

> Industry, which saw its "controlled liberty" to fix prices taken away by M. Giscard d'Estaing's freeze of September, 1963, is now invited to regain its freedom by entering into a long-term contract with the government covering the duration of the new five-year plan (up to 1970). The contracts will have three main features:
>
> 1. A system of "guiding lights" covering not only price increases during the remainder of the period, but also the allocation of productivity gains between wages, dividends, investment and research. The guidelines will be tailored to each industrial sector.

[1] *Le Monde,* April 20, 1966, p. 22.

[2] A summary of the French government's post-war control over prices is contained in OECD, *Policies for Prices, Profits and Other Non-Wage Incomes* (Paris, 1964).

[3] *The Economist* March 26, 1966, p. 1271.

2. A compulsory review procedure every six or twelve months.
3. An early warning system for sectors considered to be of particular inflation potential: they will have to notify price increases in advance to the government.

The government plans to review annually the price developments and can block any price changes it views as inconsistent with the incomes policy. Another device open to the government for influencing business decisions is the use of the state's power to approve all applications for external financing by business.

The principal sanctions for gaining adherence to incomes policy are those that bear directly on producers' price and investment decisions. It is expected that these in turn will influence wages but the government's power to directly influence wage decisions is limited. The only major avenue of influence is the pay to the civil service and employees of nationalized industries. In France these employees are a significant proportion of total employees, since the nationalized sector includes electricity, railways, coal mining and the Paris transport system. The government has made some attempt to apply its guides for general wage increases to its own employees, but the unions have led an attack, including strikes, on this approach to a general wage policy.

The recent French approach to incomes policy thus has a number of interesting features. It has been more closely linked to medium-term economic planning than in other countries discussed in this study. In part, this has been due to a desire to avoid stop-go policies that could upset the balanced growth projected in the five-year plans. In part, it has been related to the view that the plans should logically be extended to cover the distribution of increments to income projected in the plan. The emphasis on obtaining a socially just distribution of the increments to income has been particularly emphasized.

With respect to the devices for implementing incomes policy, the degree of state intervention in economic markets has been much higher in France than in North America. Government powers over prices and investment provide strong weapons for backing up guides on incomes policy. The devices to affect directly wages are not particularly strong at this time.

Despite the shift since the early 1960's to a greater interest in incomes policy in France and the strong sanctions available to the government for supporting it, serious difficulties in making it work can be expected. The lack of homogeneity among social groups and the extreme difficulties of working out criteria for long-run income distribution will make the policy very difficult to achieve in practice. Some regard the approach as useful for stimulating discussion and improving information, but as making little practical difference to the longer-run evolution of incomes. The effectiveness of the over-all approach to incomes policy is also severely limited at present by the lack of support it has so far received from employers and trade unions. Some people such as Professor Balassa of Yale, have concluded that "under present-day conditions, the chances for a successful incomes policy in France are rather slim".[1] Others are more optimistic and argue that the policy must be viewed as part of a longer-term educative process that will, in time, broaden public understanding of the problems involved and facilitate solutions.

As in the other countries discussed in this study, incomes policy is in an unsettled state.

[1]Bela Balassa, *op. cit.*, pp. 552-3.

TABLE 8–1

Some Economic Indicators for France

Year	Consumer Price Index	Wholesale Price Index	Implicit Price Index GNP	Industrial Production	GNP in Constant Prices	Per Capita GNP in Constant Prices	Hourly Earnings	Unemployment Rate: As Published	Unemployment Rate: Adjusted to U.S.A. Definitions
	Annual per cent change from preceding year							Annual average	
1951	16.9	27.7	14.7	12.6	5.9	5.2	27.3		
1952	11.8	4.7	15.1	1.0	3.2	1.9	15.5		
1953	- 1.2	- 4.5	1.0	1.0	2.6	2.1	3.1		
1954	- 0.3	- 1.7	1.0	10.0	4.5	3.7	6.0		
1955	1.1	- 0.2	1.0	9.1	5.2	4.2	7.5		
1956	1.9	3.7	5.0	8.1	5.8	4.7	8.5		
1957	2.7	4.8	6.0	8.7	5.1	6.7	7.8		
1958	15.1	6.6	12.4	4.6	2.8	-0.5	11.8		
1959	6.2	6.8	6.0	1.1	2.7	1.8	6.1	1.4	2.8
1960	3.6	3.7	2.8	8.7	7.6	6.5	7.1	1.3	2.6
1961	3.3	3.0	3.7	6.0	4.5	3.4	7.9	1.1	2.3
1962	4.8	1.1	4.4	5.7	5.8	3.6	8.4	1.2	2.5
1963	4.8	3.0	5.1	4.5	4.7	2.8	8.5	1.5	2.8
1964	3.4	2.4	3.8	8.5	5.5	4.2	6.9	1.1	2.3
1965	2.5	0.5	2.5	0.8	3.4	2.3	5.8	1.3	2.8

Source: See Tables 4–1 and 2–4.

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PART III

THE SUMMING-UP

Chapter 9

Summary and Conclusions

Many countries have long been wrestling with the problems of reducing inflationary pressures at high employment levels. There are a number of approaches that are relevant for attempts to resolve this problem: greater economic knowledge of the difficult choices that have to be made in the aims of economic policies and of the relative costs of pursuing one economic objective at the expense of another; the possibilities for improving on the past mix of general economic policies; better specific public and private policies to facilitate the adaptability of the economy to changing economic conditions; various measures to try to limit directly increases in money incomes and prices. The last approach, upon which this study has focused, is not new, but under the titles of incomes policy, national wage-price policy or wage-price guideposts, it has had recently a surge of popularity in economic policy discussions and practices abroad.

Incomes policy has not been a feature of Canadian economic policy in recent years as it has been in a number of other countries. But non-conformity becomes an uncomfortable position if confidence in its advantages weakens, and more frequent public references to the alleged advantages other countries are finding in this area of policy, along with the support given to the development of incomes policies in all member countries by the Organisation for Economic Co-operation and Development, have become important sources of discomfort about the Canadian position.

Is it clear from foreign experiences that incomes policy is a useful instrument that might in some form be adapted to the Canadian environment? Differences among countries with respect to economic and political institutions and objectives, characteristics of domestic and international economic adjustment processes, and economic conditions preclude treating a foreign experience as a controlled experiment for a particular type of policy. But the difficulty is that ideal tests are not possible, and the question has emerged recently as an important one in Canadian discussions. Answers to it will be influenced by many subsidiary questions, a few of which were explored in this study. First, what is meant by incomes policy? Second, is there a strong theoretical case for an incomes policy and why has there been a changing interest in incomes policy among countries and within countries over time? Third, in practice what have been the major advantages and disadvantages of incomes policy in a number of foreign countries? Fourth, are there other approaches that might have some of the advantages of incomes policy, less serious disadvantages, and more relevance for current Canadian conditions?

MEANING

Like the term economic planning, incomes policy can be defined so loosely as to be opposed by few or so rigidly in terms of controls as to frighten most. Much public confusion thus results from the varying usage of the term. In current economic policy discussions, it has usually been recognized, however, that the distinctive feature of an incomes policy is the development by governments of specific criteria or guides for incomes and prices and the attempt to gain adherence to them through various forms of public pressures.

There are thus several components to an incomes policy: the working out on a national level of desirable targets for changes in the major forms of money incomes and the general price level; the translation of these aggregate targets into specific criteria to govern individual decisions – most frequently, those affecting changes in average money earnings and prices in the various sectors of the economy; the development of devices that are expected to help implement the criteria. With respect to the last, emphasis has been placed on methods of persuasion that would yield largely voluntary support of the guides, although it is usually recognized that some form of sanctions will be necessary if the policy is to have much effect over a period of time.

The definition is broad enough to encompass a wide range of approaches. From our review of the experiences of five countries it is clear that the United States, the United Kingdom, the Netherlands and France have experimented recently with incomes policy, although the forms it has taken have been significantly different in each case. The Netherlands is the only example where a strict form of incomes policy with important control devices has existed over much of the post-war period. The Swedish experience does not properly fall within the bounds of this definition of incomes policy, but it is useful to include in discussions of the topic both because of the interesting, centralized national wage policy developed by private groups and also because of the opposition so far to an official incomes policy.

The definition is, on the other hand, narrow enough to exclude many things that have, at times, been confused with incomes policy: national economic goals for incomes and prices unaccompanied by attempts to develop and implement specific criteria for individual wage and price decisions; policies designed to affect general price and wage changes indirectly through economic markets; support for an expanded programme of analysis and forecasting of income and price movements in the economy; special policies to curb abuses of economic power and to intervene in income and price adjustments in particular sectors, such as agriculture; public and private attempts to improve processes of collective bargaining and to moderate labour disputes; exhortations by public and private leaders about the appropriate development of wages and prices – a familiar component of public speeches in most countries for a long time. Incomes policy clearly has important implications for income distribution and may be an important component of a country's approach to longer-run income distribution issues. But many types of government policies are relevant. Better policies for tackling problems of income distribution do not therefore necessarily depend on the existence of official guides for individual wage and price decisions.

THE CASE FOR AN INCOMES POLICY

Talk about incomes policy has been surprisingly popular despite the lack of serious analysis of its advantages and disadvantages. To some people, a more central direction of wages and prices must obviously be opposed; to others, it must obviously be a feature of the modern development of western economies. The difficulty seems to be not in taking a stand, but in explaining it.

(a) The Economic Case

This study has stressed three main economic arguments that are involved in discussions of incomes policy.

First, the economic situation of the country in relation both to the currently accepted economic goals and the constraints on other policy instruments will be important. The economic situation that has recently stimulated most interest in incomes policy and that is most likely to affect Canadian thinking could be described this way: the country is experiencing a rate of increase of prices that is viewed as either too high on general grounds, or, more usually, as too high in terms of the balance-of-payments situation, and there is strong opposition to the use of major alternative policies, such as deflationary measures to reduce general price increases at the cost of some increase in unemployment, and exchange rate changes to help with the necessary balance-of-payments adjustments.

The special importance of the balance-of-payments situation can be seen repeatedly. Thus, the varying interest in incomes policy in the United Kingdom over the post-war period has been related to the country's periodic balance-of-payments crises. In the Netherlands, the strict form of incomes policy in the early post-war years was influenced by the extraordinary reconstruction problems, but relaxations of wage and price controls in 1959 and after 1963 took place when the balance-of-payments position was favourable; the decision to tighten them in 1966 occurred when there was a marked deterioration in the balance of payments. The introduction of wage-price guideposts in the United States in 1962 was related to the balance-of-payments difficulties of the time, the decision to reduce unemployment rates which would remove deflationary policies as a means of handling a more serious adverse movement in the balance of payments, and a strong aversion to using a more flexible exchange rate policy.

There have been other sources of interest in incomes policy. In France, there has recently been particular emphasis on broadening incomes policy to include guides for the appropriate longer-run distribution of the growth of income projected in the five-year plans. Interest in deriving what was felt to be, on social grounds, a better long-run wage structure stimulated much support for wage policy in the Netherlands and Sweden, particularly in the earlier post-war years. In the United Kingdom, it has been hoped that the process of implementing incomes policy might help reduce some of the rigidities in the functioning of labour market institutions and processes, and that the policy might contribute to a higher rate of growth of productivity.

The main question about incomes policy that is currently most relevant for Canada, is this: Would this policy produce a better combination of low unemployment, greater price stability, and avoidance of balance-of-payments difficulties, without offsetting costs to growth and personal freedom, than is possible on the basis of existing policy instruments? Incomes policy cannot therefore be judged in isolation. The strength of a country's commitment to a particularly low unemployment rate will be important. In the post-war period the European countries reviewed in this study have placed more emphasis on low unemployment than has Canada, and this has been partly responsible for their greater interest in incomes policy. Other factors will also be important: the adaptability of the economy to shifts in foreign and domestic economic conditions, and the ability to use other policy measures – such as significant changes in international reserves or greater flexibility of the exchange rate – to meet temporary adverse shifts in the balance-of-payments position. The more rigid the economic goals, existing policy instruments, and economic adjustment mechanisms of a country, the greater are likely to be the pressures to search for new types of policies such as incomes policy. Before proceeding to summarize a few points about the usefulness of this type of policy, it is important to note then that a review of the country's commitment to a specific set of economic goals, of the susceptibility of the economy to balance-of-payments difficulties, and of the skill with which alternative general policy instruments are being used, is an important part of any general evaluation of the need for an incomes policy.

Second, views about the way economic processes determine wages and prices will be an important influence on support of, or opposition to, incomes policy. Economic theory of inflation has traditionally stressed the role of monetary demand conditions in determining the general movement of prices, and it is well established both theoretically and empirically that any push on wages and prices will come to an end unless there is at least a permissive increase in monetary demand conditions. Thus, control of the latter will prevent large inflations, and incomes policy clearly has little relevance for restraining major changes in the general price level.

Explanations of the milder inflationary movements that have characterized most western countries in the post-war period have posed more controversial problems for economic analysis. Arguments for an incomes policy have emphasized the independent role that labour groups or business can play in forcing up wages and prices as long as the authorities create the monetary demand conditions necessary to avoid a growing unemployment of labour and capital. A study published in 1961 by the Organisation for European Economic Co-operation, that has been highly influential in the development of interest in incomes policy, stressed the role of cost-push factors.[1] Much of the support for the United States' venture into wage-price guideposts was based on some of the studies, conducted at the end of the 1950's under the auspices of the Joint Economic Committee of Congress, which also emphasized the exercise of economic power by labour and business and the apparent short-run insensitivity of wages and prices to changes in market conditions.

Variations in demand conditions, along with changes in foreign prices, still appear to have played the major role in price movements in all the countries reviewed here. Clearly, however, imperfections in the working of economic markets do influence the rate at which prices rise in response to demand variations. Indeed, in some years there may be a substantial upward push on wages and prices that is out of line with demand conditions. The difficulty has been to pinpoint the factors which incomes policy can be expected to affect and these, of course, may vary by country and over time.

Sometimes it is argued that there are key sectors in wage and price decisions where the exercise of economic power is particularly important and that institutional links tend to develop which make decisions in these sectors a guide for labour and management decisions in other sectors.

[1] William Fellner *et al.*, *The Problem of Rising Prices* (Paris: OEEC, 1961).

According to this argument, an incomes policy need not involve detailed intervention and could be limited to affecting these few decisions. The early development of the United States' wage-price guideposts was influenced by this point in particular. Considerable doubt now exists, however, in all countries that have experimented with incomes policy about the fixity and ease of identifying these links, and it seems that incomes policy has to be quite comprehensive if it is to have an effect and be accepted for long.

The factors influencing these major price and wage decisions are also a matter of controversy. Through market power higher prices or wages can be gained in some sectors, and the timing of the changes may often bear little direct relation to the current state of economic conditions. These changes can be upsetting to shorter-run full employment policies and can be symptomatic of protected positions that impair the adaptability of the economy to changing conditions. Their timing may be sensitive to public opinion, but their significance in producing a long-run cumulative rise in prices is a more unsettled issue in economic theory. A phrase "administered prices" has been a popular expression for those who have stressed the independence of price decisions from economic conditions, but the phrase has not helped to throw much light on the complex issues of the pricing process.

Another line of support for incomes policy is based on influencing expectations. It is argued in this case that if an economy has been experiencing some rate of general wage and price increases to which expectations have tended to adjust, and if it is important to reduce this rate, (for example, because of balance-of-payments difficulties) an incomes policy can usefully supplement a deflationary policy by helping to change expectations, contributing to a smoother adjustment with less disruption to employment conditions. The argument is not unimportant, but it does give incomes policy a much more insignificant role than its supporters usually assign to it. Here, declarations of appropriate wage and price changes would be of only marginal significance and the basic emphasis would have to be on the appropriate general economic policies. Incomes policy would be little more than a strong declaration of intent at the time of initiating other policies. Many would not even call this incomes policy, and it would not justify the elaborate machinery which is usually proposed to implement an incomes policy.

Another route through which an incomes policy may work is more frequently emphasized. It may secure greater agreement on the appropriate wage level and structure, and thereby moderate the push on the general level of wages and prices which emerges from sectional bargaining for improved relative wages. There are many difficult questions about the determinants of group responses in wage, as well as price, decisions, and it may be that a much better understanding and control of them will evolve. Some feel there is scope for an effect here if the approach involves broader social as well as economic considerations, but others, with considerable support from past experience, remain frankly sceptical of achieving a popular consensus on the appropriate wage level and structure, particularly in the North American environment. Incomes policy may nevertheless have the potential for improving public knowledge of the forces influencing incomes and prices and of exposing many public myths about the role of relative wages and profits – hopefully, without creating new ones.

In the past there has usually been a greater emphasis on the dangers in the exercise of economic power by labour leaders and thus on imperfections arising more in the pricing of labour than in the pricing of products. In the earlier post-war years people talked mainly about a national wage policy rather than about a national wage-price policy. The recent emphasis on including nonwage incomes and prices in discussions of incomes policy appears to reflect only in part a strategy argument that the policy will be more palatable to labour. To a considerable extent it indicates also a stronger belief in the seriousness of imperfections in economic processes that determine nonwage incomes and prices.

Third, support for incomes policy has been built on arguments about weaknesses in economic adjustment mechanisms, but there is still the important question of whether centrally determined guides for wages and prices can be expected to have an effect on the rate of increase of the general price level and, if so, whether they will aid or interfere with economic growth processes. Rigidities and imperfections in labour and product markets exert a greater upward pressure on prices than would exist in their absence. It does not necessarily follow, however, that incomes policy must be the answer, and alternative measures to foster a greater flexibility and adaptability of economic processes may be viewed as much superior.

From the experiences abroad there is evidence to support the view that incomes policy has had, at times, some moderating effect on the rate of increase of prices, but it has been a failure at other times. The results have depended on the severity of the sanctions used, the gravity of the country's economic situation (particularly with respect to its balance-of-payments position), public support of the policy's administration which has been affected in foreign countries by the relationship between the labour movement and the political party in power, and on the length of the period over which the effects are measured. In relatively normal peacetime conditions and in the absence of strong sanctions, it is doubtful whether incomes policy will have a large or lasting effect on the rate of increase of prices at high employment levels. According to some economists in the United States and the United Kingdom, an incomes policy might have as a realistic objective a reduction of the unemployment rate by perhaps as much as one half of a percentage point without raising the rate of increase of prices. While this assessment of its potential quantitative effects is disappointing to those who have viewed incomes policy as a panacea, and while it could be low, particularly in shorter-run situations of severe restraint on prices and wages, the benefit is not insignificant if there are no offsetting dangerous side effects. It is thus necessary to review some of the issues that have to be faced in developing the machinery of an incomes policy.

(b) Problems of Mechanics

Incomes policy can take different forms, but there are some common problems in instituting such a policy. What difficulties may be encountered in working out over-all targets for the average movement of earnings and prices, in deriving from them criteria or guides for individual decisions, and in developing means for implementing them?

First, the problem of the appropriate targets for the whole economy has not been a simple matter to resolve. The targets may evolve out of a general forecast of economic conditions for the following year together with the expected economic policies of the government. In the Netherlands this has been the general approach and thus the "room" for wage and price changes has been worked out in terms of annual forecasts and the problems expected in the light of proposed policies and desirable general economic goals. In Sweden, where there has been much less national economic planning, the national budget usually precedes the major wage negotiations, and, as was the case in 1966, some indication has been given of what the government views as appropriate average wage increases for the year. Difficulties are encountered, however, if this approach is to lead to specific guides. It may produce heated controversies each year about the appropriate annual projections. If the guides are to be proposed seriously each year, this approach tends to involve a deeper commitment to an annual economic planning exercise than some countries will be willing to undertake, and it poses difficulties for longer-term wage contracts. Its acceptance will also depend on public confidence in the accuracy of the short-term forecasts. In the Netherlands there has been some disillusionment with the approach on the grounds that the forecasts were often not accurate enough. In Sweden there has been greater caution in accepting the forecasts made in the national budget, and the budget has not played as serious an economic planning role in setting targets as it has in the Netherlands. In addition, there has been a shift to conducting the private, centralized wage negotiations every two or three years. Another example of this general approach is the British appeal in July 1966 for a short-term wage freeze in view of the economic difficulties that were expected in the months ahead.

A more popular approach in recent incomes policy discussions is to derive the targets from trend estimates of productivity change. Both the United States and the United Kingdom followed this approach in recent years. The United States' wage-price guideposts were based on calculations of the trend increase in productivity. It was argued that the target for the average increase in earnings should be the same as the longer-term growth of productivity and that, under these conditions, average prices should remain approximately constant. No short-term economic forecasts have been used for setting and revising the targets. But should the figure be based on historical data or on a longer-term forecast, and how should a trend be calculated? The United Kingdom, like the United States, relied in the early 1960's on a trend figure based on past experience but then shifted to a projected figure based on forecasts prepared by the National Economic Development Council. Also, disagreements may arise over the accuracy of the productivity series – the substantial revisions to the Canadian productivity series this year indicate the difficulties here – and over the method of calculating a trend. With respect to the latter, for example, a five-year moving average was used in the United States, but for several reasons it was abandoned in early 1966, to the considerable annoyance of labour organizations.

These technical difficulties should not be over-rated, but there are additional problems. The derivation of a fixed figure from trend estimates of productivity can soon become unrealistic if monetary demand conditions vary relative to the trend of productivity. Thus, in the United States, this factor played a part in the move since mid-1966 away from the fixed 3.2 per cent figure used in earlier years. Further, there is the problem of the view of the growth process implied by the approach. The argument that average returns to employees should move in line with average productivity, that average prices should then be stable, and that the average movement of nonwage incomes should also therefore move in line with average productivity, implies a view of income distribution that is a possible but not necessary characteristic of economic growth. The share of wage and nonwage incomes in total income has not fluctuated greatly in most countries over the longer run, but there is no reason to expect constancy in the shares in the future. To some this is not an important point in practice, for the guides will not be applied rigidly, but it should be remembered they may slow down even the minor adjustments in relative shares that would be beneficial to growth. In addition, there does not appear to be any reason why absolute price stability should be advantageous at all times, since it may inhibit balance-of-payments adjustments and the changes accompanying growth and fluctuations.

Assuming, however, that agreement has been reached on the targets for average wage and price movements, there is then the problem of translating them into guides for specific wage and price decisions. Even thornier issues are now encountered. To many economists it is here that any serious attempt to develop incomes policy must surely break down; there is simply insufficient knowledge about how to do this, and the market system settles the whole matter much better than any centrally imposed set of criteria. Others are much less daunted by the difficulties, and are confident that even though the criteria may have weaknesses, they will improve the working of economic markets. Most frequently, this group has supported movements of wage rates in individual sectors that are approximately the same as for the whole economy, with some exceptions to this rule in particular cases. It is argued that an equal rate of increase of wages will not significantly affect the allocation of economic resources, and references are frequently made to studies such as that by the OECD in 1965 which have claimed that wage differentials have had little effect on labour mobility.[1] Further, it is argued that since the modern form of a national wage-price policy is not to have detailed controls over wage and price decisions by sector, the guides can be left fairly general with allowance for considerable flexibility in their implementation. The matter of appropriate economic criteria for wage differentials is far from being a settled matter, however, and the disagreements become even more serious when nonwage incomes are considered. For example, few agree that the function of profit rates in re-allocating resources can be reduced to a neat formula.

The approach taken in the United States and the United Kingdom has been that wages should move in line with the average trend increase in productivity for the economy, and that industry prices should fall where productivity is above the national average and rise where it is below. Thus the ratio of nonwage income to labour costs would remain about constant both in the aggregate and by industry. Important modifications to these guides have then been recognized, including some differential movement in wage rates to compensate exceptionally low-paid workers, to shift labour, or to maintain work incentives and some differential movement in profit rates to attract more capital or to move capital out of an industry. There have been difficulties so far, however, in developing sufficiently complex criteria to incorporate, for example, relative demand and supply conditions among economic markets, while keeping the criteria from becoming too complex to be practical.

In the Netherlands and Sweden much more highly centralized labour and management organizations exist, and the labour organizations have had more definite views on the appropriate wage structures. Until recently, labour and business leaders in the Netherlands were directly involved in working out the appropriate wage increases by sector, though there has

[1] Organisation for Economic Co-operation and Development, *Wages and Labour Mobility* (Paris, 1965).

been some form of government veto if the settlements did not conform to the government's view. With respect to prices, we noted a number of principles that are supposed to relate price and wage policy in the Netherlands, but less formal criteria have been used to govern prices than wages. In Sweden, there is no attempt by the government to work out criteria for an appropriate wage structure. The matter has been left to the centralized negotiations of labour and management. Also, no criteria have been suggested for prices and nonwage incomes.

The problems of implementing a national wage-price policy must be considered next. The basic theme of supporters of this type of policy has been that the sum of private wage and price decisions do not add up to the national interest. If it is possible to work out what would be more in the national interest, how are private decisions then going to be affected?

There has been considerable enthusiasm for the role of moral suasion. Will not private groups alter their behaviour if a publicity campaign is mounted to show that past behaviour has not been in the national interest? If a change in behaviour is not in the economic interests of the groups, however, not much can be expected from a voluntary approach. But in times of severe national economic crises, such national appeals are more likely to have some effect. Thus, the quite successful appeal for restraint in the United Kingdom for two years beginning in 1948 appeared to rest on a widespread conviction that, in view of the severe post-war reconstruction problems and balance-of-payments difficulties, more restraint would be in the interests of private groups. Strong statements about the national interest on wages and prices may also have some effect on expectations if they are viewed as good indicators of what the government will attempt to achieve with its general economic policies. In some West European countries, the emphasis, at times, has been on a broader educational programme to link the criteria of an incomes policy to social as well as economic objectives. In general, however, one is driven to the conclusion that for a country such as Canada, foreign experience provides little evidence to support the contention that general exhortations will have much effect if they are unaccompanied by some means of exerting specific pressures on those who violate the guides.

A third major aspect of a national wage-price policy concerns the kinds of stronger devices which may be used to make the guides more effective. One general approach is to seek agreement from labour and management leaders on the importance of the guides and hope that through their influence on their members, major wage and price decisions will come closer to the guides. In countries with highly centralized labour market institutions this approach has more chance of success. In addition, a high degree of centralization of labour organizations, as in Sweden and the Netherlands, often implies stronger agreement within the ranks of labour on questions of the wage structure than has existed in decentralized systems such as in North America. In a country such as the Netherlands, the distinctive union structure has afforded an important route for implementing incomes policy, but serious problems have emerged in recent years. Union members especially have shown considerable discontent when it was felt that the leaders in trying to impose the national guides had diverged from the private interest of the members they represented. Thus difficulties for the leaders may arise. In addition, the existence of more centralized wage negotiations in a number of European countries than in North America has not always meant the terms of the settlements are very significant for the actual increase in wages. Since there is scope for altering the terms of payment to employees at the local level, actual changes in earnings may differ substantially from the negotiated increase in the national industry contracts. This difference, usually referred to as "wage drift", has substantially reduced the importance of national settlements. In Sweden, for example, wage drift in the economy has frequently exceeded negotiated increases in the major wage contracts. In the Netherlands, closer control has been exercized because the statutory wage system has required detailed settlements on labour costs, and employers have been prohibited by law from paying above the amounts in the contracts. As we have noted, however, the phenomenon of "black wages" has not been unimportant in this case, and there have been various ingenious devices for circumventing the system.

The kinds of devices that have been important in the United States have been based on the idea that only periodic intervention in a number of key wage and price decisions is necessary, and this more limited intervention will affect the whole system in the desired direction. Up to this point, no formal machinery for implementing incomes policy has been developed in the United States, but periodic interventions in what were regarded as pattern-setting wage and price decisions have been used. While there has been an emphasis in the United States on rallying public opinion to censure deviations from the guideposts, there has also been a threat of a variety of sanctions, including the use of anti-trust measures, the switching of purchases by the government, the manipulation of government stockpiles, and changes in the degree of protection from foreign competition. In the United Kingdom there has also been considerable emphasis on selecting key wage and price decisions and bringing public pressure to bear on those regarded as inconsistent with the national interest. Until 1966 there was a greater reluctance to use threatened sanctions than in the United States, but stronger sanctions were introduced this summer, and in the past few years there has also been a more formal machinery for a comprehensive examination of wage and price decisions than in the United States. The development of an early-warning system that requires notice of wage and price changes provides a more complete, systematic review of decisions in the whole economy. The power to impose legal penalties, introduced at the time of incomes and price freeze, mean that, at least in the short run, the British approach has shifted towards a comprehensive and much tougher form of incomes policy. Recently both countries have placed much emphasis on affecting price decisions and, through this route, stiffening employers' resistance to wage claims, in part because it has often turned out to be easier to use public pressure more successfully on price than on wage decisions. In France also, emphasis has been placed on controlling price decisions in the recent steps towards incomes policy.

Although a variety of methods has been used, the problem of developing devices for the implementation of an effective national wage-price policy that would not involve an elaborate control system has been difficult to resolve. The attempt to enforce a relatively simple set of guides is easier and more effective in the short run but becomes increasingly inappropriate over the longer run; the attempt to enforce a fairly complex set of guides is usually more defensible on economic grounds but is much more difficult to implement. Even where stricter control measures have been used along with a more comprehensive planning approach, as in the Netherlands, the pressures for more flexibility have clearly made the system difficult to administer.

(c) Political and Social Factors

For political and social reasons incomes policy may be supported even if it is not expected to have significant direct economic benefits. Important noneconomic arguments have stimulated foreign interest in incomes policy.

In recent decades, governments have carried more specific responsibilities for the economic welfare of a nation. While these afford opportunities for political advantage when economic conditions are close to the professed economic goals, they also expose governments to greater risks of loss of popularity when economic conditions deteriorate. On the principle of spreading the risks there has been an incentive to involve leaders of private economic groups in the responsibility for achieving national economic aims.

It is in the area of price stability that the declared intentions of governments have most frequently and seriously fallen short of events in post-war years. Thus some attempt to spread the responsibility for achieving this objective is not unexpected on political grounds. In turn leaders of private groups may find such involvement advantageous for maintaining leadership and winning concessions on other matters of interest to the groups they represent. But there are dangers too. A government may have sought to work out guides for wages and prices with the aid of private economic groups and may suddenly find itself embarrassed if there is a general flouting of these rules. Since the guides will generally have to indicate appropriate movements in the relationship between wages and profits and in relative wages, the government may loose popularity through becoming involved in bitter controversies about appropriate wage and profit structures. In addition, leaders of private economic groups – particularly of unions in the countries reviewed – have had to face the dangers of a weakening of their leadership if co-operation with the government has appeared to lead to unfavourable events from the standpoint of the groups they represent.

Government declarations that a form of national wage-price policy will be followed may also be a strategy for forging ahead on other economic and social programmes. Support for a government programme will be weakened if there are public suspicions of the inflationary consequences. In the United States in the early 1960's the Administration's programme for reducing the unemployment rate was opposed by many on the grounds of its effect on price stability. Recent government programmes in the United Kingdom have been criticized often on the grounds that unless more attention was paid to price stability there would be an outflow of capital from the country and serious balance-of-payments difficulties. While not always convinced by the importance of these arguments, governments may find it advantageous to take a few modest steps in the direction of incomes policy to convey the point that price stability will not be overlooked and thus to soothe the opposition to other economic programmes. In turn, those concerned about the inflation may welcome incomes policy as committing the government more seriously to price stability. An incomes policy suggests to the public that the government is really doing something about inflation, and a direct government intervention in some wage and price decisions of powerful economic groups may be reassuring and popular to a public suspicious that its interests have been exploited by these groups in the past.

An important thesis advanced by Edelman and Fleming in their review of wage-price policy in four West European countries is that there is a strong political and psychological basis to it:[1]

> It reassures an apprehensive public that the government is looking after its interests and shielding it from economic predation. Whether or not direct intervention interferes very greatly with economic market forces or prevents prices or wages from rising, all governments resort to it. They exhort businessmen and unions to exercise moderation when prices are rising and sometimes they suggest guidelines or prescribe price and wage ceilings. They do these

[1] Murray Edelman and R.W. Fleming, *The Politics of Wage-Price Decisions*, (Urbana: University of Illinois Press, 1965), pp. 318-19.

things, then, not because they necessarily bring economic stability but because there are political advantages in doing them and because the public and the public officials alike find them reassuring. The high government official who urges wage and price restraint is conveying the message to the voters that he is on their side, for they are all consumers. At the same time he is conveying the message to businessmen and union officials that the ultimate decision is really theirs, and this, too, is a welcome and popular message, likely to bring political support from those who have the most money and votes at their disposal.

There is another reason for support of incomes policy that has been stronger in some European countries and stronger in earlier post-war years than recently. This is the belief that important social advantages and few economic disadvantages would follow from eliminating much of the economic competition over wages and imposing what was felt to be a more harmonious or rational wage system. The labour movements, for example, in the Netherlands and Sweden, have been more strongly in support of a centrally determined wage policy on these grounds, especially in earlier post-war years. If there is considerable agreement within organized labour about what is an appropriate wage structure, there will be more support of forms of centralized incomes policy.

IS AN INCOMES POLICY DESIRABLE FOR CANADA?

The focus of this study has been on examining the issues on both sides of the case for an incomes policy in the light of the experiences of a few foreign countries. It was not intended to probe deeply into the many distinctive institutional features of the Canadian economy that would affect the workability and usefulness of an incomes policy. The highly complex and changing economic, social and political issues involved in discussions of incomes policies abroad also make impossible the kind of over-all, fixed, objective conclusions that are so satisfying to the scientific researcher. With these warnings in mind it may nevertheless be useful to suggest some implications of this study for current Canadian discussions of incomes policy.

From the experiences abroad it is clear that there are both benefits and costs associated with an incomes policy. In weighing them it will be important to recognize that they will be affected by the form of the policy and the skill with which it is administered. For general discussions of the value of an incomes policy, however, the following list of advantages and disadvantages, not necessarily ranked in order of importance, appear to be particularly significant.

Among the advantages that may be suggested are:

First, if a country is in a severe national economic crisis, a policy aimed at curbing directly wage and price increases may help until more fundamental economic policies are brought to bear on the situation. Under crisis conditions there is likely to be a greater response to government appeals, and the short-run nature of the policy will make less urgent a solution to the awkward questions about appropriate criteria for relative wages and prices in the longer run. For example, in both the United Kingdom and Sweden there was clearly some success from this approach during the the late 1940's. It was also the basis for the British incomes and prices freeze introduced in July 1966. The resentment that quickly builds up about the unfair impact and the danger of a subsequent wage and price explosion indicate, however, the extraordinary difficulties that will be encountered from this approach. But there have been in the past, and there may well be in the future, times when stern, direct government measures over wages and prices are helpful.

Second, under more normal economic conditions, an incomes policy may be viewed as an important educational device for increasing public knowledge of the interrelationships among wages, profits, productivity and prices, for reducing conflicts about the appropriate primary distribution of incomes, and for exposing and moderating the development of protective devices and abuses of market power. Prevalent myths about economic relationships impair economic processes, and many wage and price decisions are sensitive to public opinion. Also, through various forms of protection and support of economic groups, the state may provide the basis for higher wages and prices in some sectors, and informed discussion of the justification of of these costs to the rest of society is difficult because they are often not noticed. Through greater public exposure of deviations from the guides of an incomes policy, it is sometimes suggested – for instance, this has been an argument used in defence of the United States' wage-price guideposts – that the costs to society of protective devices and the use of market power will be more clearly seen and curbed.

Third, the guides of an incomes policy may assist in providing more accurate economic forecasts – experiences in other countries indicate they can also be misleading – and in increasing the amount of data and general economic information available for wage and price decisions.

Fourth, incomes policy may provide the basis for a more rational approach where state intervention in economic markets and a considerable degree of centralized economic planning already exists. The greater the involvement of the government in other means of influencing specifically the allocation of labour and capital, the more attractive will be a planning of direct returns to labour and capital. It is not surprising that incomes policies in other countries have often been related to interest in stronger forms of economic planning.

Fifth, proposals for mild types of incomes policies, which would not have much economic effect but which would also have few dangers, may, at times, be part of a political strategy to win support for a broader set of government policies and to allay unrealistic fears of a serious inflation.

It is obviously impossible to give any precise estimate of the effect an incomes policy could have in Canada in moderating the rate of increase of prices at high-employment levels. Earlier it was noted that a mysteriously popular view at this time among economists in the United States and the United Kingdom is that the policy might permit over time a reduction of about one-half percentage point in the unemployment rate for given rates of general price increases. If such an estimate were correct, a smaller effect would probably have to be expected in the case of Canada in view of such special features as the great importance of foreign, particularly United States, price movements on the Canadian price level. But clearly there are conditions that could make the effect even smaller or significantly larger. The criteria of an incomes policy, for example, may raise the aspirations of workers in wage agreements by providing little more than a minimum from which union leaders will feel their effectiveness in bargaining will be measured. It is perhaps worth repeating that the effect of an incomes policy appears to be greatly influenced by the severity of the sanctions accompanying it, the seriousness of the country's economic problems which will affect public support of the policy, the significance of cost-push factors at the time, public acceptance of the aims and methods of administration of the policy, and the length of the period over which the effect is measured. Also, the survival of an incomes policy in which the criteria are derived from trend estimates of productivity will depend on keeping the economy on a stable path of expansion, since under strong inflationary pressures the policy tends to be swamped and under depressed conditions interest in it is likely to decrease.

Some modest effect from an incomes policy, designed to supplement other policy instruments, would make it worthwhile if its costs do not offset its benefits. The experiences of other countries indicate that none of the following dangers can be completely disregarded.

First, there is the danger that the government in order to gain public support for the policy will have to launch a major publicity campaign about the merits of such a policy, and this may tend to divert public attention and weaken support for other more important economic policies. Some argue, for example, that a more fundamental set of policies to deal with the recurrent British balance-of-payments problem would have been adopted sooner if the hope of large effects from an incomes policy, based largely on moral suasion, had not been continually encouraged in the past. It has been argued in the case of the Netherlands that stronger deflationary measures would have been easier to introduce following the outbreak of serious inflationary pressures in 1963 if there had not been a belief that incomes policy would make these measures unnecessary. Related to this general disadvantage is the point that the political resources for economic leadership are limited and that, in the ordering of priorities, there is the danger of an incomes policy consuming too high a proportion of these resources in relation to the possible benefits of such a policy.

Second, a period of restraint that has some effect in the short run has frequently been followed by a wage and price explosion. This was the case in the Netherlands after 1963, in Sweden in the early 1950's, and in the United Kingdom following the 1948-50 period of restraint. Thus, the pressures are often only stored up to be released at a later time.

Third, there may be discriminatory effects since some forms of income and prices are easier to restrain directly than others. In order to set an example, the government may tend to apply the guides most vigorously in the public sector and produce a serious discrepancy between wage movements in the private and public sectors. This is widely acknowledged to be one of the most serious drawbacks of the British attempt at an incomes policy in 1961. There has been a concern about the U.S. wage-price guideposts because some industrial sectors, such as construction, have not been as easy to include in the implementation of the policy. Despite the rigorous, comprehensive form of Dutch incomes policy in the past, some forms of income escaped control and evidence of a few receiving high income increases contributed to the unrest that seriously weakened the policy after mid-1963.

Fourth, because an incomes policy, if it is to be seriously applied, must have some guides for the wage and price structure, and because economic knowledge of the criteria for an appropriate structure is deficient, there is a danger of introducing new rigidities that will impair economic growth.

Fifth, in seeking to make a wage-price policy work, governments and private groups will tend to enter into various forms of agreements, and political pressures will tend to become a more important factor in wage and price decisions. Dangers from such a development have been a concern to many. For example, in their reservations to the majority recommendation for national wage policies in the OEEC Report, *The Problem of Rising Prices*, Professors Fellner and Lutz argued:[1]

> ...governments committed to a national wages policy would, in our opinion, have to become involved in rather extensive regulations relating to individual wages and prices. In such circumstances,

[1] William Fellner *et al.*, *op. cit.*, p. 63.

political considerations and the usual group pressures would exert a very significant influence on the wage and price structure and also on the general wage and price level. We are opposed to moving in this direction.

Sixth, the original intention of a national wage-price policy may be the use of only moral suasion to implement it, but empirical studies show that an incomes policy has had little effect for long unless sanctions are introduced with it. Thus, if there is a serious commitment to this type of policy, lack of success with it may drive the government much further along the road to detailed intervention in the economy in order to make it work, and to avoid serious political embarrassment. This has recently been the pattern, for example, in the United Kingdom. Even in the case of the United States the President became more involved in the use of threatened sanctions than was expected at the time the wage-price guideposts were formulated.

Seventh, a serious attempt to develop an incomes policy will affect collective bargaining arrangements. Some loss of freedom in collective bargaining will be a cost vigorously opposed by many, and is currently a source of concern among unions in such countries as the United Kingdom and France.

In weighing the advantages and disadvantages it is also important to consider distinctive institutional features of the Canadian economy that would cause special problems for instituting an incomes policy. A few are immediately obvious. Canada's federal structure severely limits the central government's powers on labour matters and on the regulation of prices. The economic power of the provincial governments, along with the differences in regional economic interests, would thus involve complications for a national incomes policy that are not found in the European countries examined here, and that would be more serious at this time than in the U.S. federal system. In addition, the decentralization of labour and management institutions would lead to greater difficulties in achieving a national consensus on the criteria of an incomes policy and would restrict the role that leaders of economic interest groups could play in committing members to the machinery of an incomes policy. Finally, there are the implications of the openness of the Canadian economy and its close economic ties with the United States. The openness of an economy has not necessarily been a deterrent to an incomes policy, as we have seen, for example, in the case of the Netherlands. But, in the Canadian case, there are the close ties between management and labour policies in Canada and the United States, the high labour mobility across the border, and the strong direct influence of wages and prices in the United States. These links greatly limit the scope for an independent incomes policy.

Undoubtedly, there would thus be very serious difficulties and dangers to the development and implementation of official criteria for incomes and prices in Canada at this time.

The use of strong temporary control measures over wages and prices may well be justified in some types of severe economic crisis conditions.[1] But even their short-run application will require a broadly based support and will pose special difficulties in the Canadian environment – particularly, of course, if there are problems of achieving the necessary co-operation on them between the provincial and federal governments. A recurrent theme in the experiences of many western countries is that forceful measures to curb incomes and prices have not been viewed as sustainable for long without popular support for them and, in view of their costs, have only been used with reluctance when the pressures for adjustments in the economy and the adaptability of it to meet these pressures have been seriously out of joint. The international economic situation and the success in maintaining an appropriate mix of other economic policies to stabilize monetary demand conditions and to promote the longer-run adaptability of the economy to changing domestic and international conditions are clearly the key factors in influencing the future need for, and usefulness of, strong direct curbs on incomes and prices. Economists' trite pleas for getting the basic aggregative policies straight to avoid the high costs of harsher measures retain their importance despite their lack of public glamour.

It is under less serious economic conditions, in which milder and more feasible longer-run forms of incomes policy may be considered, that more difficult issues in taking a position arise. The conclusion here is not that the problems which have stimulated an interest in incomes policy are all insignificant, but rather that different approaches to their solution are likely to be more fruitful in Canada.

Few would deny the importance of measures to stimulate a better analysis and public understanding of the interrelationships among incomes, prices and productivity, to expose more clearly problems from the concentrations of economic power and the costs to society of protective devices, to provide more information on wage and price developments and on emerging problem areas as a help in the co-ordination of public and private policies, to explore modifications to present systems of wage and price determination that would reduce their inflationary impact. But it is doubtful if an approach that begins with a set of official criteria for incomes and prices is the best route. There may well be weak forms of incomes policy that could at least do little harm and that will find favour, but the complexities of the issues

[1] See, for example, James Tobin, *National Economic Policy* (New Haven: Yale University Press, 1966), Chap. 10, "Monetary Restriction and Direct Controls", pp. 123-7.

and the special features of the Canadian economy point to the desirability of a broader, more flexible approach.

Many steps are consistent with the latter approach. It has been noted here that in a number of countries there are important reviews under way of the current appropriateness of institutional features of collective wage bargaining.[1] Modernization in this area depends greatly on the extensiveness and quality of the educational work by labour and management organizations in developing a better understanding of the economic and noneconomic issues. Yet, in relation to many other countries, the Canadian work has not been impressive. Devices to raise the level of debate, without making a fetish of agreement on real questions where conflicts of views contribute to solutions, are to a considerable extent the responsibility of private organizations. But, as in West European countries and in the United States, there is much to be said for improved public devices for the exchange of views among government, business and labour leaders, and for publishing more and better data that should provide the factual basis for both private and public policy decisions.[2]

Measures to promote a clearer understanding of desirable national economic objectives on prices and incomes are important. Governments may find it useful at times to suggest more specific targets for average wage and price changes, but, as Swedish experience, for example, has shown, they need not be accompanied by an official incomes policy for individual wage and price decisions. There are areas, however, in which more detailed government wage and price policies are clearly necessary. The development of better wage policies for employees in the public sector is currently a significant issue in all the countries discussed in this study. Also, since governments frequently enter into major disputes that have widespead effects in the economy and since, through the great publicity they receive, the terms may have at least short-run pattern-setting effects, efforts to improve economic bases for the government's position on them and to gain public support for the position are of obvious importance, as the events of 1966 in Canada have shown. Further, through various forms of protection governments at times create barriers to change that increase prices and rigidities in particular sectors. Increased attention to more positive approaches to facilitate economic adjustment processes and to the benefits from exposure to international competition is necessary not only to reduce the effect of

[1] It is of interest that an important study of incomes policy for the International Labour Office emphasizes many of its problems and concludes with a chapter on alternative approaches to moderating the inflationary impact of present methods of wage determination. See, H.A. Turner and H. Zoeteweij, *Prices, Wages, and Incomes Policies in Industrialised Market Economies* (Geneva: International Labour Office, 1966), pp. 157-70.

[2] *Ibid.*, pp. 166-8.

market power on prices but also to facilitate the adaptability of the economy to changing domestic and international conditions at given rates of general price increases.

Diverse proposals for better policies can be made, but the great need is for a continual, critical evaluation of them and for finding the catalysts that will produce more effect than exhortations. A step that is particularly favoured here is to stimulate through a high quality independent research body a deeper analysis and better general understanding of the issues. In this area good government research is obviously important, but, due to its confidential nature on controversial matters and to the impact of public opinion on actual policy decisions, there are strong arguments for paying more attention to remedying the present lack of support in Canada for more independent economic research and to promoting intelligent national debates of the problems. It is useful to have greater knowledge of the economic criteria or guides that should play a role in public and private decisions, but, without the inflexibilities of official criteria which the government may feel compelled to defend even though they may not be suitable in some specific cases. A better public awareness of the determinants of the distribution of incomes among wages, profits and other incomes and of their relation to general economic developments can help remove some of the misconceptions in popular discussions of wage and price decisions and facilitate public policies affecting the redistribution of income. The body would have considerable freedom to focus on particular problem areas in wage and price developments and on the broad set of private and public policies that affect them. If desirable, it could, through publications and periodic conferences, present its reviews of wage and price developments without the need for formal endorsement of them by labour and management, which seems to be too much to expect in the present Canadian decentralized system of labour market institutions. They can serve to promote, however, more regular and better reviews of wage and price developments by labour, management and government leaders.

This step would be quite different from that of an official incomes policy, but it also has its weaknesses. Too much may be expected of it. It is no substitute for improved public and private economic policies, as it would simply be a means of stimulating better economic research into the controversial problems of income and price developments and of promoting more informed public discussions of new and old ideas for private and public policies. An aura of infallibility, an expectation of immediate significant results, or a public relations effort to please everyone would doom the body from the start. In view of the imperfect state of economic analysis and forecasting in this area, it is to be hoped that the work of the body would largely be a source of irritation to provoke labour, management, and governments to re-think constantly their wage and price policies and to develop better analyses and reviews of their own, which may often turn out to be superior. Indeed, this should be the route through which it has an effect. If the body is too closely tied to economic interest groups or to governments, the freedom and depth of its work could be hampered. If its staff is not of high quality and is dominated by a narrow, intolerant outlook, its work could be useless. Although it may be misused, the approach would appear to promise returns that would justify an investment in it.

Better approaches may evolve, but instead of a comprehensive, official set of criteria or guides for individual wages and prices – which is the essence of an incomes policy – this alternative seems to be currently more suited to the Canadian economy.

Date Due