A POLICY FOR WAGES?

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I

THE publication of Mr B. C. Roberts's book on wages policy[1] has revived academic interest in this subject, though there has never been any real possibility of a wages policy on the lines of those adopted in some other European countries, notably Sweden and the Netherlands, being accepted here. In these countries, the main responsibility for fixing wage rates has been given to a central body in the hope that this procedure would help to stabilize both wages and prices, thereby bringing the inflationary spiral to an end. As a secondary aim, it was hoped that centralized wage fixing would bring about a more equitable and rational wages structure than would free collective bargaining. In this country, though we have been faced with the same kind of economic problem, the trade unions have preferred to retain their traditional independence and freedom in collective bargaining.[2]

II

The argument that a centralized wages policy will check inflation rests upon two assumptions: first, that rising money wages are a cause of inflation, and secondly, that centralized wage fixing will in fact lead to a stabilizing of wage rates and labour costs. The Cohen Report showed that personal incomes in this country, in which wages and salaries are the biggest item, have risen more rapidly than output since the war. Between 1946 and 1956, production rose on average by three per cent a year and the wage and salary bill by eight per cent a year.[3] This, however, is not proof that wage increases have been the principal cause of rising prices, or that the wage increases have been the result of irresponsible demands by trade unions. The pattern of events has

1 *National Wages Policy in War and Peace* (George Allen and Unwin. London, 1958).

2 Although the trade union movement has supported the idea of a planned economy in general, it has failed to accept the logical consequence of this, namely that wages too should be determined centrally. It is difficult to say whether this is really a deep-rooted objection to pushing economic planning to its logical conclusion, or whether it arises from a fear that a Conservative Government, whilst abandoning economic planning in general, would welcome the opportunity to retain controls over wages and use its powers to the disadvantage of the trade union movement and workers as a whole.

3 Council on Prices, Productivity and Incomes, *First Report* (H.M.S.O. London, 1958), p. 50.

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not been greatly different in those countries that have adopted a wages policy.

Mr Roberts rightly attributes inflation to other causes than wage increases, though these may be a contributory factor. Where wages form a large proportion of the total cost of finished products, an increase in wage rates will almost certainly lead to a rise in prices.[4] If wages were forced up by irresponsible demands from trade unions, the process would come to an end with the initial price increases. The wage-price spiral is only kept going because money is created to increase demand so that the whole output will still be purchased at the higher prices. With a strict credit policy, part of the output would remain unsold, unemployment would increase, and this would tend to moderate the demands of the trade unions for higher wages.

Since the war, the level of demand has been excessive. Immediately after the war there was a pent-up consumer demand, investment in industry was needed, the export trade had to be boosted to unprecedented levels, and at the same time the Government chose to maintain a high level of expenditure both on defence and the social services. The economy was over-strained, and wages and prices rose. But in fact, the increases in negotiated wage rates lagged substantially behind the increases in actual earnings. Earnings rose sharply as a result of competition between employers for scarce labour.[5] Labour costs rose, forcing up prices, but with an easy-going monetary policy, demand kept rising too and the spiral continued.

There is no single explanation of the adoption of such an easy-going monetary policy in the face of inflation. The desire to keep interest rates low and to reduce the burden of the National Debt is one factor. More important, however, has been the fear of governments to take steps that might increase the level of unemployment even slightly.

Since it has been the excessive demand resulting from lax monetary policies that has caused inflation, central wage-fixing scarcely touches the problem. In those countries operating a National Wage Policy, the same 'wage drift' has occurred,

4 This is assuming that there is no simultaneous increase in productivity, so that an increase in wages means there is an increase in labour costs. In practice, no substantial increase in wages is possible in industry generally at the expense of profits.

5 Earnings were increased by overtime payments, and by employers trying to attract labour by offering more than the rates negotiated with trade unions.

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earnings rising more rapidly than wage rates. The centralization of wage-fixing does not alter the trade union pressure for higher wages, though it may eliminate the 'leap-frogging' that has sometimes been met in this country, where the granting of a claim by one union is immediately followed by a demand from another to maintain differentials. Generally the wage-fixing authority either includes representatives of both sides of industry or is required to consult representative organizations. Only a totalitarian régime can entirely ignore the strong pressures for higher wages existing in situations such as have prevailed in most west European countries since the war.

Germany, however, has been an exception to the general pattern. Wage rates in Western Germany increased almost as rapidly between 1950 and 1956 as in Britain, but there was a very much smaller rise in prices. Earnings increased only slightly more than wage rates. The German trade unions have been in a relatively weak position, and there has been nothing like the same competition between employers for scarce labour that there has in other countries. The influx of refugees from Eastern Germany has prevented this, and enabled expansionist policies to be carried out in Western Germany without the inflationary results that have occurred elsewhere.

III

This is not to say that a policy for wages is unnecessary. If inflation is to be avoided, the Government must ensure that the total wage bill does not increase more rapidly than output, unless there is a shift in the distribution of the national income in favour of labour.[6] This objective, however, will be more satisfactorily achieved by controlling the general environment in which wage bargaining takes place than by direct intervention in the fixing of wages.[7]

It is clear that on average wages should not rise by more than the average increase in productivity unless prices too are to rise. The idea has sometimes been put forward that wage increases should not be permitted except where productivity has increased.

6 Wages and salaries now take such a large share of the national income that this is possible only to a very limited extent, and may be far from desirable.

7 The Government must take a more direct part in wage fixing so far as the public service and nationalized industries are concerned. There is a limit to the extension of these sectors if the trade unions are to retain their traditional rôle.

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Once this is accepted, however, there is a danger that wage increases will in fact be proportional to the increase in productivity in the firm or industry concerned. This is a dangerous policy, and has been criticized both in the Cohen Report and by Mr Roberts. If proportionate wage increases are conceded where productivity is increasing fastest, workers in other industries will not be satisfied with less. The result is that wage increases everywhere will tend to equal the *maximum* increase in productivity, and if this happens, inflation is inevitable.

The first duty of the Government is to ensure that the aggregate demand is no greater than is required to purchase the goods and services available. Above all, it must not increase demand by creating additional money when wages and prices rise. There is a risk that these monetary measures will involve some increase in the level of unemployment. This is recognized both in the Cohen Report and by Mr Roberts. It is misrepresenting the Cohen Council to suggest, however, that they were advocating any return to the mass unemployment of the 'thirties, and Mr Roberts believes that there would be no need for the level of unemployment to be raised permanently much above the very low levels that we have experienced since the war.[8]

Secondly, the Government should avoid policies that are inconsistent. Thus the Labour Government tried by means of physical controls and its appeal for wage restraint to check inflation, whilst adding to the inflationary pressures by its own spending and cheap money policy. Similarly, the Conservative Government, until late in 1957, attempted to control inflation by monetary policy but failed 'effectively [to] discourage the nationalized industries and the private sector from raising wages far faster than productivity was rising'.[9]

The trade unions, in a free society, must remain free to seek higher wages for their members, but in doing so they must take account of the general economic policies being pursued by the Government and recognize that when monetary policy is designed to maintain full but not over-full employment, excessive demands will tend to create additional unemployment. Mr Roberts would even leave them free to negotiate long-term agreements on the American pattern incorporating an annual wage increase in

8 *loc. cit.*, p. 165.
9 *ibid.*, p. 166.

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anticipation of rising productivity.[10] This suggestion raises an important question which must be considered carefully. Is it really desirable that wages should rise at all in money terms? Nobody would dispute the desirability of real wages increasing in step with productivity, but this could just as well be brought about by constant money wages and falling prices.

IV

The advantage of this alternative would be that the benefits of increased productivity would be shared with all sections of the community, including pensioners and others living on small fixed incomes. In practice, however, two difficulties arise, and it is probably much easier to limit wage increases and keep prices stable than to prevent any general wage increase and to bring prices down.

In the first place, it is a mistake to suppose that changes in productivity are necessarily independent of wage policy. If wages rise, the employers must bring about the anticipated increase in productivity if they are to maintain their profits without raising prices.[11] On the other hand, if there is no automatic increase in wages, profits will be maintained at current prices without any technical change, and many firms may be content to carry on as they were without bothering to increase productivity.

The second problem is a more serious one. Attention has so far been concentrated on the aggregate wage bill. This is important when considering inflation, but inflation is not the only economic problem. The fundamental economic problem is to make the best use of our scarce resources, to use them to produce the things people want most. The wage levels in different occupations serve to allocate workers to the jobs where they are needed, and to ensure that scarce labour is used to the best advantage.

During a period of inflation, whether there is a National Wages Policy or whether there is free collective bargaining as in Britain,

10 This would only anticipate the expected rise in average productivity, of course, not the increase in productivity in that industry if it were one where rapid technical changes were taking place.

11 If all wages tended to rise in proportion to the average increase in productivity, some firms, where productivity rose less than this, would be unable to maintain their profits without raising prices. Where productivity rose more than the average, there would be the same wage increase and prices would fall. Thus the average price level would not change, although some prices rose and others fell. Although some firms would have to raise prices, firms could not lightly assume that they could do so without losing sales, and would therefore make every effort to raise productivity in order to keep up their profits.

wages can only fulfil this function imperfectly. There is such a strong demand for goods and services, and therefore for the labour needed to produce them, that *all* industries appear to be short of labour. If the inflationary pressure were removed, some industries would still be expanding but others would be in decline. Men would be attracted from one to the other by means of the wage differentials that would tend to emerge.

Some people may not like this approach to wages. They may feel it treats labour as a factor of production and the wage as just another price. It is not wrong, however, to treat labour as a factor of production, for it *is* one, and wages *are* a price. The only mistake is when labour is treated as nothing more than a factor of production. Men have to be allocated to the jobs where they are needed, and in practice there are only two ways of doing this: either wage differentials attract them to some jobs and deter them from others, or they are directed by some government agency to where they are wanted. The former is surely more compatible with human freedom and dignity than direction of labour.

A shift in relative wages can be brought about by raising some wages, or reducing others, or a combination of the two. It may be much easier in practice, however, to bring about the change by raising some wages than by lowering others. The negotiation of actual wage cuts might produce resistance. Perhaps such resistance would be illogical. Real wages are no lower when money wages are cut and prices fall in the same proportion than when money wages and prices both remain unchanged. Nevertheless, there will always be a suspicion of actual cuts, and this cannot be ignored. For this reason, it may be best if we are content to try and hold prices steady, and to limit the total increase in the wage bill to the increase in output. Some wages will increase by more than the average increase in productivity in order to attract labour to expanding industries: some will perhaps not increase at all in those industries that are in decline, but actual cuts in money and real wages will perhaps be quite rare.[12]

V

Although the approach to wages policy considered here would not involve any formal restrictions on the freedom of trade

12 It has been assumed that expanding industries need more labour and *vice versa*. Where technical changes mean that a greater output can be achieved with a reduced labour force, expanding industries may in fact require less labour.

unions, in practice a considerable degree of responsibility would be demanded of them. In part, they would be compelled to exercise such responsibility in the interests of their members, for otherwise they might suffer from widespread unemployment. A truly successful policy for industrial relations, however, demands that the unions should be convinced that they are getting a fair deal. If the overall increase in wages is to be kept within the limits set by increasing productivity, the unions must not be left with a suspicion that firms are able to make big profits in those industries where productivity is rising fastest. Indeed, it has been seen above that unless these firms lower prices, the stability of the general price level cannot be maintained.

It is particularly important, therefore, that the danger of monopolistic exploitation should be ended. The procedures of the 1956 Restrictive Trade Practices Act are as yet untried. This act deals with the main types of agreements between firms to limit competition. Even if it proves an effective means of controlling these deliberate restrictions of competition, it does not touch the problem of the single firm monopoly. The Monopolies Commission will continue to deal with such monopolies, but it is doubtful whether it can be really effective. Monopolies may be compelled to refrain from practices that might prevent the development of independent competition, but there are at present no powers to enable the Government to do anything to control the prices or profits of monopolies.

In the case of one practice, the fixing of resale prices, the position of individual manufacturers has been strengthened by the new legislation. Although collective arrangements for the enforcement of resale prices have been outlawed, manufacturers have been given improved facilities for enforcing their prices through the courts.[13] The Cohen Council did not consider that it was within its terms of reference to discuss the desirability of this change, but it went so far as to suggest that the matter should be 'carefully reconsidered'.[14]

13 Some manufacturers have been making use of these provisions. In the case of groceries, however, there have been signs of dissatisfaction among important elements in the retail trade of the fact that little action has been taken by manufacturers in spite of extensive price cutting. There was even a suggestion that retailers might boycott manufacturers who did not take action to enforce resale prices fixed by them. This suggestion apparently overlooked the fact that such a boycott would be illegal, in precisely the same way as it is now illegal for a group of manufacturers collectively to boycott a trader who cuts prices on goods made by any one of them.

14 *loc. cit.*, p. 48.

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