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WAGE RESTRAINT IN PEACETIME

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The celebrated "Guideposts for Noninflationary Wage and Price Behavior," issued only seven months ago, have occasioned more comment and criticism than any previous pronouncements by the Council of Economic Advisers since that body was established in 1946.

Promulgation of the Guideposts was preceeded and succeeded by numerous statements from high government officials - including the President, Secretary Goldberg and Chairman Heller - to the effect that important wage and price decisions were no longer a purely private matter but now partook of the public interest. The government would henceforth concern itself with the content of collective bargaining agreements and not merely with procedures for peaceful negotiation. After five years of slackness in the economy, the Administration was determined to restore full employment (although the concept of full employment had been loosened somewhat). It was feared that as full employment was more closely approached, price inflation would set in, by virtue of collective bargaining and administered pricing, even though economic resources were still in ample supply. Inflation would make it more difficult to increase the favorable balance of commodity trade, which approximated $5,000,000,000 in 1961. But unless the balance of trade could be improved, the country could not meet its military and economic responsibilities around the world without encountering an intolerable gold loss.

Economists had been wrestling for some years with the question of whether full employment and price stability could both be achieved with existing price and wage-determining institutions. In the 1950's there was a widespread conviction we could not have the best of both worlds, and that creeping inflation was preferable to creeping stagnation if a choice had to be made. This earlier debate was conducted primarily in a domestic context, however. Emergence of the foreign exchange problem gave another twist to the screw and inspired renewed efforts to find ways and means of reconciling our principal economic objectives.

Before turning to the Guideposts themselves, we may observe that the United States is not the only country currently endeavoring to restrain wage increases, in order to prevent inflation, without implementing full-blown wage and price controls. Since 1955 the Conservative government in Great Britain has experimented with various techniques. Most recently the Chancellor of the Exchequer, Mr. Selwyn Lloyd, instituted a "wage pause" in the Civil Service, the nationalised industries, and other activities subject to direct control of the government. It was hoped that this policy would set a good example for the private sector. It is not at all clear that this hope was realised, but it is amply clear that the "wage pause" contributed to the sagging popularity of the Tories and to Mr. Lloyd's replacement as a Cabinet member in July of this year.

Similarly, Chancellor Adenauer and the President of the Reichsbank have been sounding warnings against wage increases in excess of four percent, which is stated to be the average annual increase in man-hour productivity in West Germany. These warnings have been enthusiastically seconded by BDA, the central confederation of German employers. The individual employers have ignored them almost completely, however, and have been granting wage increases which would seem astronomical even in the California construction industry.

In France, as in Britain, an austerity wage policy has been pursued in the public services and nationalised industries. Great unrest has resulted, particularly among transportation workers. When Prime Minister Debre addressed a letter to the employers' confederation urging restraint in wage bargaining, the union groups reacted angrily against this one-sided intervention.

Here in the United States, the Council of Economic Advisers has made repeated observations on wage policy during the past decade. In January 1952, President Truman's outgoing Council urged that wage increases be held to the level of productivity gains, about two or three percent annually. President Eisenhower's Council more than once endorsed the same proposition in rather general terms. In the 1959 steel dispute, Administration pressure probably held down the size of the wage package, but also encouraged the employers' intransigent bargaining posture and the long strike over local working practices.

Thus the Guideposts are not new in principle. What is new is the more detailed exposition of these principles by the Council and the ardor with which the Administration has embraced them.

The Council's central proposition is that "if all prices remain stable, all hourly labor costs may increase as fast as economy-wide productivity without, for that reason alone, changing the relative share of labor and nonlabor incomes in total output." This is the Delphic pronouncement which was widely interpreted as establishing a "three percent productivity limit." Actually no percentage figure is stated, but a table is supplied showing average rates of growth of output per man-hour in various parts of the economy during various time periods. Three percent is the average annual increase in the total private economy between 1947 and 1960.

The Council then modestly observes that productivity is a <u>guide</u> rather than a <u>rule</u> for appraising price and wage behavior. There are problems in measuring productivity change; the existing distribution of income between labor and capital is not necessarily immutable; and "the pattern of wages and prices among industries is and should be responsive to forces other than changes in productivity."

After an inconclusive discussion of productivity measurement and the share of labor income, the Council proceeds to the third point. "What are the Guideposts which may be used in judging whether a particular price or wage decision may be inflationary?", it asks.

Passing over the discussion of prices, we come to the guides for non-inflationary wage behavior. "The general guide...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...wage rate increases would exceed the general guide rate in an industry which would otherwise be unable to attract sufficient labor; or in which wage rates are exceptionally low compared with the range of wages earned elsewhere by similar labor, because the bargaining position of workers has been weak in particular local labor markets. Wage rate increases would fall short of the general guide rate in an industry which could not provide jobs for its entire labor force even in times of generally full employment; or in which wage rates are exceptionally high compared with the range of wages earned elsewhere by similar labor, because the bargaining power of workers has been exceptionally strong."

At first blush the Guideposts seem simple enough but on further analysis, numerous problems of interpretation and application arise.

Are the Guideposts only a means of assisting the general public in appraising the wisdom of private wage and price decisions, or are they mandatory and subject to enforcement through the exercise of executive power? The Council's Report insists that the Guideposts are intended as a contribution to "public discussion and clarification of the issues." But the President and Secretary Goldberg have stated on more than one occasion that the government cannot stand idly by when the public interest needs protecting.

How are the Guideposts to be interpreted? Three possibilities suggest themselves. The first is that increases should not exceed 3.0 or 3.5 percent. Although the Council strove to obviate such an interpretation, the Administration has contributed to it by publicly praising significant wage settlements "within the limits set by productivity," and remaining silent on those exceeding 3.0 or 3.5 percent.

The second possible interpretation is the one which the Council urges: that average wage increases should not exceed average productivity gains, but that specific adjustments may deviate upward or downward in accordance with the Council's suggested criteria. The criteria themselves have some startling implications, such as the notion that wage increases under free collective bargaining can and should be inversely proportional to the workers' bargaining power. The Report betrays a curious innocence of the pressures and energies at work in real collective bargaining situations. But there is an even more fundamental problem: how can a desired ex post statistical result be converted into thousands of ex ante wage decisions? Has the Council really given us policy guides or merely tools of economic analysis? Moreover, do not the criteria easily lend themselves to opportunistic re-labelling of wage demands and adjustments? The United Automobile Workers, ingenious as ever, led the way by asserting that increases in excess of average productivity gains should be negotiated in the aerospace industry in order to "catch up" previous deficiencies. Also, has the Administration now established an inflationary "bargaining floor" of three percent, as many employers complain?

A third possible interpretation of the Guideposts is that they provide a serviceable tool which the Administration may use as the basis for exerting pressure in a few key situations such as steel. This is probably the most practical and realistic view, but here also there are some sticky questions to be answered. Aside from the basic steel industry, where are these key situations? As Solicitor General Archibald Cox recently confessed, "steel is almost unique." He said that "the trick may be to pick out those few key situations which have the same potential as steel for setting off a chain reaction." Automobiles, aluminum, petroleum and aircraft were mentioned as possibilities, but of these only the first really has the power to set off a chain reaction in other industries.

All four of Mr. Cox's candidates, like basic steel, are industries with a few big corporations which negotiate company-wide agreements with industrial unions. As many observers have noted, the Administration has not found any practical method of putting its finger on the construction industry with its highly decentralized bargaining structure. Is it equitable to concentrate on a few industries and unions which are exposed politically by virtue of size and concentration? Moreover, is it practical, or will the so-called "responsible" unions find the price too great? In this connection we may note that the Teamsters Union is now attempting to raid the Communications Workers, who consulted with the government prior to the recent wage settlements in the telephone industry. One of Mr. Hoffa's principal arguments is that CWA officials sold out the interests of the membership.

Regardless of how the Guideposts are interpreted, there are some additional problems to be noted. When the government endeavors to influence the results of a decentralized bargaining system while preserving the right to strike, we really have a dual basis of wage determination. The weak unions will expect the government to assist them in securing "the productivity formula", while the strong unions will exert their bargaining power. As we learned from the experience of the Wage Stabilization Board during the Korean War, the net result is likely to be stimulation rather than restraint of wage increases.

Subjecting the wage-setting process to a formula would sterilize the central function of trade unions at a time when the labor movement is already in deep distress. Can organized labor accept voluntary sterilization? The case might be different if something were offered in return, as the War Labor Board offered union security in return for wage control during World War II. But nothing is provided to help the unions solve their institutional problems. Under these conditions it is certainly doubtful that the Administration could implement the Guidelines in a serious way without sacrificing labor support.

Finally, we must ask whether active emphasis on wage restraint is appropriate when economic recovery has fallen so far short of full employment. So long as the rate of unemployment hovers between five and seven percent of the labor force, inflation is not a serious threat. (During the past two years prices have advanced more rapidly in Western Europe than in the United States.) Wage restraint is clearly an indispensable element in a real full employment policy; but in the economic circumstances of 1961-62, the degree of emphasis has been quite disproportionate.

It is always possible, of course, that a policy which appears to have serious defects on paper will work well in practice. After less than one year of experience, it is too early to appraise the practical effects of the wage guideposts. The Administration was successful in staving off a damaging increase in steel prices. The steel wage settlement was praised for being non-inflationary. Likewise the wage settlement for non-operating railroad employees (slightly exceeding ten cents per hour) won a presidential blessing; fut if the Guideposts had been taken seriously the increase would have been smaller, considering the rapidly declining employment trend in the industry. In any event it is doubtful that the increase would have been any larger in the absence of the Guideposts. In the shipping and airline industries, wage settlements far out of line with the Guideposts were developed with the assistance of federal mediators, emergency boards and special representatives. Large increases in the construction industry have been negotiated in contracts running from three to five years in duration. As 1962 has worn on, informed observers have increasingly come to believe that the Guideposts are impeding peaceful agreement and probably exerting an inflationary impact on balance. In a significant speech delivered at San Francisco, the Director of the Federal Mediation and Conciliation Service went out of his way to play down the "productivity formula", urging that there should be less emphasis on the average and more emphasis on the exceptions, qualifications and deviations. I am inclined to predict that government leaders will by saying less about wage guideposts in the immediate future.

I have no desire to deprecate the problem to which the Guideposts are directed. Standards of economic performance have become more exacting; creeping inflation is no longer as acceptable as it seemed a few years ago. There is little reason to doubt that the price level would begin to climb once more if we should come close to full employment, that a cost push originating in administered-price industries would contribute to the trend. Most of the economically advanced countries are struggling to find ways and means of encouraging noninflationary wage settlements without sacrificing the institutions of free collective bargaining. The fact that they have not yet been successful does not mean that the search should be abandoned.

The next step for us in the United States, I believe, is to understand more fully the requirements of successful wage restraint in peacetime and to appraise our situation realistically in the light of these requirements.

1. The first requirement is public acceptance of an overriding national need justifying restraints on private behavior. There was

public acceptance of the need during World War II, of course. Some European countries have experimented successfully with wage restraint during the postwar period; in these countries foreign trade is such an important part of the economy that the exchange problem is clear to all concerned. On the other hand, American labor and management have certainly not been persuaded that these traditionally private areas of decision have now entered the public domain.

2. Second, decision makers and opinion leaders must have at least a general understanding of the economic relationships involving wages, prices and productivity. In the United States labor and management each employ their own distorted caricature of economics, as contrasted with a country like Sweden where one finds a basic consensus on these matters. The relatively low level of economic understanding in the United States has several explanations, in my opinion: foreign trade has been only a minor component of total business activity; economic constraints in general have not been as taxing as in Europe; professional economists have too often shied away from public affairs, preferring to sharpen their analytical tools rather than use them.

3. Next, a successful national wage policy must have positive as well as negative elements so that all the pressure will not appear to be directed against the workers. In this connection it is interesting that some European countries combined wage restraint with a policy of "wage solidarity", an explicit commitment to improve the relative position of those at the bottom of the income pyramid. One of the difficult elements in the Administration's approach is that all the praise is reserved for the low settlements. The federal minimum wage

has been increased, it is true, but legal enactments do not contribute directly toward balancing out the performance of the collective bargaining mechanism.

4. Wage restraint must be sought in an appropriate context of economic policies designed to implement a full-employment commitment. Until very recently, the Administration seems to have been unduly preoccupied with fears of inflation and insufficiently concerned with restoring full employment. At times we have been given the impression that wage restraint is vitally needed in its own right even with a five or six percent unemployment ratio. Surely this is not correct. Concededly the Administration has a difficult row to hoe in persuading most Americans to accept the economic policies necessary to maintain full employment. Resistance to planning and controls, the tradition of corporate autonomy and the strength of business unionism are powerful barriers. These barriers will not disappear overnight and a single speech at Yale on the subject of economic myths will not suffice to dispel them.

5. History shows that effective wage restraint cannot be imposed on the parties from the outside. On the contrary, it must be developed through consultation between labor, industry and the government. For this purpose there must be a potent, competent consultative mechanism capable of producing an authoritative consensus. In the President's Labor-Management Committee we have an interesting experiment in top-level consultation, but the effectiveness of the Committee in controversial areas is not yet demonstrated. The central problem seems to be that of interest-group leadership. Who speaks for American employers? If N.A.M. and Chanber of Commerce officials are selected, they will adhere

to rigid organizational positions. If prominent industrialists are chosen, their individual views will not necessarily be binding on industry as a whole. In selecting labor representatives, the Administration necessarily turns to the heads of the AFL-CIO and of major unions; but here again it has not yet been shown that these representatives will deviate publicly from their institutional doctrines. In this respect the recent White House Conference on National Economic Issues, sponsored by the Labor-Management Committee, was particularly disappointing.

6. Finally, any influential national wage policy must be impregnated into the collective bargaining apparatus. Otherwise it will merely serve as a target or beacon for the weak unions without restraining the strong. There are several possible ways in which a wage policy might be incorporated into the collective bargaining system. (a) There might be a highly centralized bargaining structure, with leadership and coordination supplied by powerful labor and employer federations. This is the situation in Norway and the Netherlands, which are regarded as the most successful practitioners of conscious wage restraint in peacetime. (b) There might be a tripartite government board with mandatory power, such as the National War Labor Board of World War II. (c) The collective bargaining scene might be dominated by a few unions with centralized bargaining policies. If sufficiently secure from factionalism, rival unionism, and internal unrest, these unions might be amenable to government pressure. (d) Conceivably, the public sector of the economy might be so large that the wage policies of government, acting as an employer, would set the pattern for the private sector as well.

To list these possibilities is enough to show how remote they are at the present moment. The American bargaining structure is among the most decentralized in the world, and the federations of industry and labor are very weak. Certainly the nation is not now prepared to accept the equivalent of compulsory arbitration and direct wage-price controls in peacetime. Union members are divided among scores of organizations; and many of these - such as the construction unions - practice decentralized bargaining. And certainly the public sector is not a pattern setter, nor likely to be one in the forseeable future.

Thus a realistic appraisal of the situation gives no grounds for easy optimism over the prospects of wage restraint in peacetime. Yet the underlying problem is still with us if we continue to believe that a five percent unemployment rate is too high, a three percent growth rate is too low, and a two or three percent rate of creeping inflation is too much. All this means that we will have to develop a more sophisticated consensus on economic facts and relationships. We will need greater acceptance of overriding national goals and a proper "policy mix" in which wage and price restraint have their necessary place in a full employment strategy. We will find it necessary to develop some new institutions and adapt existing institutions. These things will take considerable time unless we should enter a period of crisis.

Probably the Administration expected too much too soon. Probably the Guideposts should really have been viewed as "a contribution to a discussion", which is the way the Council described them, rather than as a national wage policy. But in any case, the discussion has now been opened. Economists can and should play a leading role in pushing it forward.

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