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WAGES POLICY UNDER FULL
EMPLOYMENT

WAGES POLICY UNDER FULL EMPLOYMENT

BY

ERIK LUNDBERG, RUDOLF MEIDNER
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FOREWORD

THE aim of this book is to make available to the English reading public some Swedish contributions to the discussion of a major problem. Now that full employment has become a generally accepted aim of economic policy, the question of wage policy needs examination, if only because of the difficulties inherent in the adoption of a full employment policy. These difficulties are obvious enough, but unfortunately many authors have passed them by, so that relatively little has been written on the subject in English. If this book, which is intended for a far wider circle than merely that of the professional economists, stimulates further discussion it will have served its purpose.

The authors are all economists. Professor Lundberg is chief of the Konjunkturinstitut (Business Cycle Research Institute) in Stockholm, where the other three contributors have been, or are working. Mr. Meidner and Mr. Rehn are employed by the Swedish T.U.C. (Landsorganisationen), and specialize in labour economics. Mr. Wickman is a specialist in welfare economics. The articles originally appeared in the Social Democratic monthly *Tiden* and in the Swedish

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economic journal *Ekonomisk Tidskrift*, whose editors have kindly given permission for republication. The authors have revised their articles for this book. Chapters II and III were translated in Sweden: that part of the other chapters which has not been re-written by the authors in English I have translated.

RALPH TURVEY.

ERRATA

Page 59. Footnote: for "1941" read "1951"

Page 70. Sixth line from bottom: for "contribution" read "contraction"

I

GENERAL SURVEY OF SOME ISSUES OF WAGE POLICY

By ERIK LUNDBERG

1. *The norms of wage policy.* The post-war economic difficulties experienced in Europe and the U.S.A. have led to intense discussion about wage policy in a society with permanent full employment. The originators of the modern theory of employment gave the problem a rather unsatisfactory solution. Keynes, Beveridge and Alvin Hansen all pointed to the inherent conflict between full employment and stable prices, but only concluded that the trade unions would need to display a high degree of "social responsibility" if inflationary wage movements were to be prevented.

There is wide support for the view that the general level of wage rates should rise in accordance with productivity. But in periods of prosperity and low unemployment actual wage increases tend to be substantially bigger, as has been the case in the post-war years. This is the basic issue in its simplest form.

Three main problems seem to be involved in

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the present discussion: (1) the norms of a desirable wage policy; (2) an analysis, statistical, institutional and theoretical, of how actual wage rate changes are determined during different phases of the trade cycle; (3) how far it is possible by means of economic policy to create such conditions that the norms agreed upon can be realized.

The first two problems will be briefly analysed in this chapter. Readers who are not interested in theoretical and technical problems should pass directly to the next essay, "The dilemma of wages policy".

Two main principles have been put forward in the discussion of the relative movements of wage and price levels: (1) Wages should be kept constant and the price level vary inversely with changes in productivity. (2) The price level should be constant and wage increases directly related to increases in productivity. The first principle means that gains in productivity should be translated via lower prices, while the second involves their transmission via higher wages.

There is no reason in this connection to discuss the reasons for, and the merits of, these different aims. It should be sufficient to mention that they have been intensively discussed in Sweden since the issue was raised by Wicksell and Davidson at the end of the 19th century. It may perhaps

be mentioned here that during the 'thirties, and above all during World War II, the old Davidson rule, that the price level should vary inversely to productivity, was officially accepted as a guiding principle in economic policy. Prices were to be allowed to rise when increased real costs and a scarcity of goods occurred as a result of reduced imports and of the requirements of defence. Keeping prices of the factors of production constant (including wages) would also have meant a price-fall after the war, when productivity was recovering.

It should be stressed that the Wicksellian norm of a constant price level of finished goods and Davidson's rule of a price level varying in inverse proportion to productivity were not only, or even mainly, aimed at keeping the value of money constant, though the desirability of this was not questioned. The rules as put forward by the Swedish economists and as interpreted in the declarations of policy during the war implied a notion of stability of the whole economy. There can be no balance in the economy (including in this concept equality of the supply of, and demand for, labour) unless the general price level behaves so as to prevent the creation of profit inflation or deflation. It is well known that after the good fortune of the 'thirties the aims of post-war Swedish policy were not fulfilled. Prices did not

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fall and wages have since then increased rapidly. But could not the rise of an inflationary boom in 1946 be interpreted as the result of failure successfully to apply Davidson's rule? Prices did not fall when productivity increased, and as a result there was a rapid increase of profits and in profit expectations which both made possible and stimulated the subsequent rapid growth of wages. The original disequilibrium gave rise to the kind of cumulative process that Wicksell pictured, and since then we have had the problem of excess demand, full employment and a rate of increase of wages in excess of the rate of growth of productivity.

On the whole the Davidson alternative has been rejected, in the current discussions, chiefly for practical reasons. A continuous reduction of piece-rates is implied, if we are to keep wages constant when productivity increases, and this would obviously create unnecessary friction. Above all it is highly improbable that, with industry organized as it is at present, prices would really be lowered fast enough to offset increases in productivity. The necessary price reductions could be achieved only in a buyers' market, and this would have to be so marked that full employment would be endangered. Also any adjustment of wage differentials which may be deemed necessary or desirable is much more easily

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achieved during a general increase of wages, than by cutting some wages and raising others, thus keeping the average level constant. Moreover, one of the most important functions of the trade union movement would be eliminated, if wage earners got the increases in real income automatically through price reductions without any efforts from the trade unions.

We thus seem to have to accept as our general principle that the wage level should rise in accordance with gains in productivity. Several interpretations of this formula are possible, however. Rates of increase in productivity vary widely between different industries and even between different firms in the same industry. Should the wage level be adjusted to the *average* increase in productivity, or should wage rates be geared *absolutely* to increases in productivity within each branch of industry? Normal and practicable wage relationships would obviously be impossible, if wage rates were fully adjusted to changes in productivity. But granted this, there are several possible compromises between the two extreme alternatives.

The economic consequences of the two alternative principles might tentatively be analysed as follows. Firstly, suppose that all wages move upwards uniformly. Industries with a greater than average rise of productivity would then

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earn higher profits, while industries where productivity gains were less than average, or non-existent, would suffer losses or reduced profits. The former industries would be able to expand, either increasing sales by price reductions or financing new investments out of the increased revenue. Similarly the latter industries would have to contract, raising their prices or reducing their investment expenditure. Thus the more productive or efficient firms would be stimulated in relation to the less productive, and the uniform increase in wage rates would fulfil the static "welfare" condition of equal pay for equal work.

On the other hand, consider the case where wages increase in accordance with the productivity gains in each particular industry. Wage policy would in this case be decentralized, and the trade unions would concentrate their wage claims in industries most able to pay higher wages and perhaps most unable to prevent their employees from getting their claims met. Moreover, expanding industries are not always prompt in lowering the prices of their products. Consequently unequal wage increases are a quicker way for the consumers to receive the benefits of higher productivity than the more uniform increase achieved with a general wages policy, which has to take account of the difficulty of marginal firms in financing higher wage pay-

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ments. This should in theory mean that the share of the national product accruing to labour will be greater, the more fully are wage rates in each industry adjusted to productivity gains in that industry.

If the mobility of labour is assumed to be considerable, then uneven wage increases may more quickly bring about the change in output called for by the divergent increases in productivity, than would happen under a system of uniform wage increases. When the adjustment has taken place, the redistribution of the labour force might gradually reduce the wage differentials which were needed to produce it. In the long run the same price-wage relations might rule (through price reductions in industries where productivity increases are relatively high and price increases in other industries) as in the case of uniform wage changes. Thus only during a period of transition would there be short-run changes in relative wages in order to secure the desirable changes of output. This line of argument, however, ignores the fact that change is continuous and that a new period of transition due to new changes in productivity would start before the old had tapered off. The welfare condition of equal pay for equal work would never be fulfilled, but on the other hand, granted high labour mobility, the economy would be more

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flexible and responsive to changes so that the long-term rate of increase in productivity would be greater than with a policy of uniform wage changes.

The above analysis is of course extremely simplified and schematic; all sorts of modifications and middle ways are possible. The wage differentials required need not become intolerably high. The trouble is that they may arise for less acceptable reasons than divergent increases of productivity. Here, however, I am concerned only to raise the question of what function the inter-industry wage structure should perform. The radical modern view is that prices and wages should be deprived of their key position in determining the course of events. Many people think that the structure of relative wages and prices has little effect on what they regard as an automatically rising level of productivity. But could it not be argued that once continuous full employment is achieved, the wage structure becomes even more important in determining the distribution of the labour force and thereby the composition and growth of total output, than it was in periods of unemployment? With full employment there is a greater need for wage incentives such that labour will be attracted to where it is needed, repelled from where it is redundant, and economized where it is

scarce. Being less stick, there must be more carrot!

Putting the argument another way, the problem is to create conditions such that movement of labour will result when economically motivated, while the unnecessarily high labour turnover which is often a consequence of inflation is avoided. If, in view of this, one is prepared to accept significant margins between the wages of skilled and unskilled labour, why not also accept extra wage increases in firms or industries which ought to expand? If there is a relatively free pricing process and no large divergences between social and private costs, there seems to be no reason why there should not also be relatively free wage determination but for the danger of a wage-price spiral which will be discussed later. If, because of this risk, wage differences must not be changed much, mobility should be stimulated by various State measures.

2. *Some Observations on the Actual Determinants of Wage Movements.* In the past, wage changes in different phases of the trade cycle have not corresponded to any of the norms discussed above. For the long run (30-50 years) one can, by the choice of suitable years, show a strikingly high degree of correlation between the rate of wage increase and gains in productivity. There is, however, very little conformity in their short-

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run movements, as may be demonstrated by the following figures which relate to the United States:¹

| Period | Per cent. Increase in Industrial Production per Man Hour | Per cent. Increase in Nominal Hourly Earnings |
|---------|--|---|
| 1919-23 | 31 | 9 |
| 1923-26 | 17 | 5 |
| 1926-29 | 12 | 3 |
| 1929-33 | 5 | -22 |
| 1933-37 | 10 | 41 |
| 1937-40 | 14 | 6 |
| 1940-45 | 7 | 55 |
| 1945-48 | -5 | 28 |

The correlation between these two series is about as bad as it could be, although for the whole period both wages and industrial productivity approximately doubled!

This result is by no means surprising, for there is no automatic mechanism to hold the short-run movements together. It is true that a particularly big increase in productivity may, by increasing profits, raise the demand for labour, but this will not raise wage-rates much if unemployment is high. Sometimes an increase in productivity due to rationalization can even go

¹ Taken from Kerr, "The short-run behaviour of physical productivity and average hourly earnings" (*The Review of Economics and Statistics*, 1949, No. 4).

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together with a (temporary) fall in employment. (A rise in productivity will of course not be followed by increased profits if it is accompanied by a general decline in demand.)

In contrast to the policy that seems desirable, wage increases usually coincide with falls in productivity or with a low rate of increase, for example at the end of a boom, when the price level is rising. According to American statistics, productivity per man-hour in industry fell during both 1946 and 1947, while hourly earnings rose by 6 per cent. and 13 per cent. respectively. Similarly in 1936-37, when productivity sank by 1 per cent. and wages rose 12 per cent. Thus the price rise and the relatively high employment of the boom seem to have been the driving force behind the increases in nominal wage rates, there being no correlation with productivity changes. Yet the evening out of wage and productivity movements which has happened over long periods can perhaps be explained as something more than a statistical accident. If for a number of years of prosperity wages lag behind the rise in prices, there will then follow a period of falling prices with rigid wages, evening out the real difference. With a good choice of years a fair degree of agreement between rise of productivity and real wages can be shown. The correlation between rates of change in wages and productivity

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is much higher if one compares years with approximately the same price-level.

The following table relates to Sweden :

| AVERAGE YEARLY INCREASE OF : | | | | |
|------------------------------|-------------------------|--|---|--|
| Cost of Living | Industrial Productivity | Nominal hourly earnings in Industry (male workers) | Real hourly earnings in Industry (male workers) | Average Unemployment (Trade Unionists) |
| 1923-30 -1.0% | 2.6% | 2.0% | 3.1% | 11.3% |
| 1930-33 -2.4% | 2.6% | -2.4% | 0.0% | 18.6% |
| 1933-37 1.5% | 3.3% | 1.9% | 0.4% | 16.0% |
| 1937-39 3.0% | 2.5% | 4.4% | 1.4% | 10.3% |
| 1929-39 0.1% | 3.0% | 1.3% | 1.2% | 14.7% |
| 1939-45 5.9% | -0.2% | 6.1% | -0.2% | 7.8% |
| 1945-48 2.6% | 4.8% | 10.0% | 7.2% | 3.3% |

The table supports the negative conclusion that during the periods shown there was no connection between changes in wages and industrial productivity. Variations in money wages have been large (from -2.4 per cent. to 10.0 per cent. per year) while productivity rose fairly steadily. Changes in real hourly earnings were less uneven, but had no particular relation to productivity movements either. Their relatively good agreement in the 'twenties and 'forties was broken in the 'thirties when productivity on average rose twice as rapidly as real

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wages. The explanation seems to be that in the 'thirties there were considerable movements of labour from low-wage (agriculture) to high-wage industries causing a considerable rise in average real wages which is not reflected in the index number. Generally speaking, the wage policy of the 'twenties seems to have been more free and dynamic so that wage increases occurred mainly in the expanding industries. The rise in real earnings in the 'thirties, on the other hand, was the result of a greater solidarity in wage policy and of transfers of labour in response to the wage differentials which had arisen in the previous decade.

The correlation between money wage increases and productivity gains is also weak if one studies movements from year to year. Before the Great Depression, years with a relatively large increase in productivity were usually followed by a relatively large increase in real wages, but this was mainly a consequence of lower prices. The relatively large increases in money wages happened after a reduction in unemployment, and had no connection with productivity changes. In the later years of the 'thirties increases in money wage rates were largely offset by a rising cost of living.

We cannot of course get very far in explaining actual wage changes by merely studying general changes in productivity, profits, employment, etc.

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More thorough studies are required where individual trades and industries are investigated, and much attention must be given to institutional factors. The determinants of trade-union policies must also be examined. But such detailed studies alone are not enough; they merely give the material on which generalizations can be founded so that we can obtain at least some basis for judging what are the main causal factors behind wage movements.

We might learn something by comparative studies. The sort of thing we want to know is what effect various factors such as recent price movements, profit levels, employment trends and so on have on the wage-level. By comparing two situations which are similar in some respects we might discover something about the effects of the factors which are different in the two situations. We might reach general judgments of the following kind: according to pre-war experience if unemployment is about 10 per cent. and then falls by 2 per cent., wages are likely to rise more than productivity even if there is no price rise; at a lower level of profits this might not happen. It is possible that even if we can derive such generalizations from our inter-war experience—because of the small number of “cases” they will certainly be very tentative—they will not have much relevance to present conditions.

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The tragic fact is, of course, that we have very little empirical foundation for our generalizations about the complicated interdependence of wages, productivity, profits, level of employment, etc. Consequently there is plenty of room for divergent opinions, and since recommendations as to policy must be founded not only on accepted aims of policy, but also on some conception of how our economy works, very disparate recommendations as to wage policy can be put forward by different people. The following discussion lends support to this conclusion !

II

THE DILEMMA OF WAGES POLICY UNDER FULL EMPLOYMENT

By RUDOLF MEIDNER

WHAT is true of economic policy generally is equally true of wages policy: the present difficulties in pursuing a wages policy along traditional lines are mostly regarded as transitory, and the situation that has produced a new attitude in trade union policy is looked upon as exceptional. This conception implies the assumption that we may expect a return in the reasonably near future to pre-war society, characterized both by freedom from State interference with prices and production and by the existence of a considerable labour reserve.

The main features of today's economic situation are too evident to need description here. It has been clearly shown in many investigations (*inter alia* the Swedish Marshall Aid Committee's four-year plan) that the task of re-establishing external and internal balance will take years, and that present scarcities will remain during this period of adaptation. In addition, full employment is in itself—independent of changes in the current

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economic situation—an essential objective of economic policy. No Government is or will be able in future to ignore the demand for full employment.

Since the full employment of the post-war period came almost as a surprise not only to the man in the street but also to the majority of the economic experts, we were not prepared to face the difficulties that this new type of society brought in its wake. The position of trade union wages policy in a society utilizing its productive capacity to the utmost has proved to be one of the central problems we have to face. Some people have regarded the wages policy pursued as principally responsible for the inflationary trends of the last few years. But although the trade union movement has succeeded in rejecting this conception, it is clear that its policy has got into a precarious and more and more evident dilemma: the situation on the labour market strengthens the tactical position of the trade union movement against the employers, while at the same time society requires trade union co-operation in a stabilization policy, co-operation which takes the form of abstaining from possible increases in wages.

The existence of this problem has not been overlooked by economists, although what they put forward gives us precious little to act on.

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British and American writers especially have pointed out the new role played by wages policy in a society where there is full employment. Beveridge, for example, has devoted some pages in his *Full Employment in a Free Society* to analysing this question. He says that agitation for increased wages at a time when industrial and labour capacity is utilized to its full extent, may cause inflationary tendencies and thus jeopardize the full employment policy. His suggestion for preventing or counteracting such a development is that the wage-behaviour of the different trade unions ought to be co-ordinated by the Executive in order to form a centralized wages policy in which the different claims could be judged from the standpoint of the economic situation as a whole. His ideas concerning the desirable wages policy of trade-unionism may be clearly seen from his frequent use of the terms "responsibility" and "reason". This appeal to the trade union movement to display reason and responsibility has so far been one of the few contributions by economists towards the solution of the trade union dilemma in a full-employment society.

Before we examine in more detail Beveridge's recommendations for solving the difficulties of full employment in the domain of wages policy, we shall point out more concretely where and how full employment tends to screw up wages.

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Several years' experience of over-employment in various countries make it possible to draw certain general conclusions. To begin with it is evident that good profits during a boom period constitute a favourable basis for progressive improvements in wages. The competition between firms for scarce labour and their willingness to outbid one another are checked only by the effectiveness of Government price-control. The characteristic inflationary situation with pronounced shortages first in one key branch of production, then in another, puts certain groups of employers and employees in a favourable position to demand income improvements, i.e. both price and wage rises. Society may well be forced to accept such claims for general economic reasons. But these claims tend to start similar claims, often based on equally just arguments, from other groups, and the bottlenecks themselves tend to alter or grow, giving rise to new agitations for wage increases which can be demanded with as much right as previous claims. This income spiral is, however, not limited to increased wages for different groups of industrial workers; it reaches its most complete and dangerous stage when it produces "maladjustments" between industrial wages, civil service salaries and farmers' incomes. This almost automatic process in which the action of one group sets going that of the

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others, has become a dreaded phenomenon in the post-war economy of many countries.

There is no doubt that this development has, so far, resulted in an income-levelling between different groups: a levelling between agricultural and industrial workers, between men and women, between wage-earners in urban and rural areas and between skilled and unskilled workers. This levelling is partly due to the conscious efforts of the unions. But in the main it has been made possible by the full employment which has strengthened the position of the lower income groups, where labour shortage has been most keenly felt.

The fact that in a full-employment period income-levelling generally takes place by means of unequal rises in wages and not by the advance of one group while the wages of other groups remain stable, constitutes in itself a factor which screws wages up. But before these differences in wages—which are mostly the result of historical factors, of the strength of the organizations, or of other circumstances none of which constitute any economic or political justification for the prevailing inequality—have been partly abolished, another trend in the opposite direction is coming into being. This new differentiating tendency, the strength of which cannot be estimated or even guessed at, is closely allied to the attempt on

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the part of the State to use various regulatory measures, in particular price-control. It has repeatedly been made clear that a price policy along the lines hitherto followed runs the risk of contributing to a distortion of production. In a democratic society with full employment but with imperfect methods of control, relative price-levels may alter because of the varying efficiency of different controls, and as controls are now largely confined to necessities, the price structure for less important goods is freer. These conditions relating to prices have their parallel where wages are concerned. Since the wage structure in a country such as Sweden is quite free from State control it is probable that the differentiation in the price-structure will have similar effects on the wage structure, i.e. it will make relatively higher wages possible within those sections of industry which are uncontrolled or not easily controlled.

Beveridge's fears have subsequently been realized. The general situation on the labour market under full employment—the characteristic labour shortage in key industries, the tendency towards a levelling of wage differences and distortion of production—has created claims for increased wages. The trade union movement thus has to face the task of deciding which of the possible lines it is to follow: whether to stand by the traditional methods and take the consequences

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of a continuous fall in the value of money or to build up a wages policy along new lines.

The first alternative is generally discarded without further argument. Yet one cannot simply assume that a wage and price spiral always hits the wage-earners. It is also possible that employers and employed together will be able to augment their share of income at the expense of other groups. The share of wage-earners in the national income has, for example in the U.S.A. and England, been unchanged since the outbreak of the war. In Sweden this share has undoubtedly increased during the same period. Consequently, should a deterioration in the value of money occur, the wage-earners are not so much threatened with the risk of their quotient of the national income being cut down. Rather they would be affected by the stagnation or fall in production and real income that is the inevitable result of a more pronounced inflationary process. It is this latter effect of inflation, which makes it clear that the traditional wage policy ought to be abandoned. In addition, one must remember the possibility that a careless wage policy could make control of prices so difficult that employers' profits might actually increase more than wages. If the trade union movement decides not to use its tactically favourable position to obtain increases in wages in excess of the rise in productivity, it

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will have to draw up a completely new wages policy. The economists, headed by Beveridge, and a number of spokesmen from the trade union ranks have pointed out the desirability of a centralized wage policy, that does not only consider the unions' and the movement's interests but also those of the community as a whole.

These ideas have more and more guided trade union policy in the European democracies. Efforts are being made—by utilizing the limited constitutional possibilities of the trade union federations and by a voluntary co-ordination of wage policy and general economic policy—to keep intact the freedom of the unions and at the same time to prevent the economy from being disturbed by inflationary wage movements. The experiences gained in this field have not been sufficiently extensive (wages policy during the war must be judged separately) to admit of any clear interpretation. Furthermore, the prerequisites for this generally accepted new wage policy have been submitted to critical investigation only to a very small extent. The article published some time ago by H. W. Singer¹ therefore deserves special attention.

Singer has a clear conception of the fundamental problem of traditional wage policy in permanent full employment: the total effect of wage-

¹ *The Economic Journal*, December 1947.

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increasing actions by national or local unions in a permanently favourable position cannot be expected to keep the average increase in wages in pace with the average increase in production in the long run. On the contrary, a progressive increase in prices will result. But he doubts Beveridge's simple conclusion that a centralization of wage negotiations is a good solution. Such centralization is neither a possible nor a sensible instrument for attaining that balance between production and wage-structure which in Singer's opinion would be most advantageous to wage-earners in the long run. The employers' opposition to centralized wage claims would be weak, since the increases in wages would cover all enterprises equally and the fear of lower costs of production for competitors would disappear. From the workers' point of view, Singer proceeds, the demand for wage-restraint in a period of prosperity, and freedom to claim rises only in time of depression, cannot be altogether attractive. Such a wage policy would have the effect that profits made by non-marginal enterprises would remain intact. Inasmuch as a centralized wage policy gave special increases to certain groups for economic and political reasons it would become unpopular with all the other groups.

Nor is the claim for a wage policy "based on economic facts" approved by Singer. His chief

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objection is that the trade union movement is not likely to accept without further discussion the facts provided by firms. Low profitability would give rise to demands for increased rationalization. The firms' accounts of their economic position would also in many cases clearly show that from a purely financial viewpoint they could pay considerably higher wages. It would then be much more difficult to oppose claims for increased wages than when the employees did not know anything about these conditions. Finally, Singer stresses the character of wages fixed by agreement as being minimum wages which the employer can increase in each individual case.

One of Singer's observations is of great importance: if the trade union movement accepts a centralized wages policy it gives up in certain situations one of its most important former tasks. In its early years the central object of the movement was to give mutual help in case of illness, unemployment, etc. This task has now virtually been taken over by the State and the community, while the function of giving the members more security in their work has been solved by full employment. The other purpose of the trade union movement throughout its long history has been that of increasing wages. This function is now being more and more set aside. The Webbs' classical definition of the trade union as "a con-

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tinuous association of wage-earners for the purpose of maintaining and improving the conditions of their working lives” has been expanded by a present-day historian as follows: “. . . and for the participation of wage- and salary-earners, as an organised group of producers, in the life of the nation.”¹

The risk involved in this necessary reconstruction process is that the movement’s objective is too abruptly switched over so that the great mass of members find it difficult to view the new objective as their own and the unions are exposed to serious troubles during this period of transition. These troubles will arise because responsibility towards the interest of the working classes and those of society as a whole, in contrast to the tangible but short-sighted interests of one’s own group, presuppose a training of the masses which even the advanced trade union movement in England or Sweden is not likely to be able to bring about in so short a time. Economic realities act on individual opinions to a higher degree than economic theory. The presence of important unofficial wage increases outside the agreements undermines confidence in the organizations and their leaders. It is hardly just to say that the trade union movement is not yet prepared to be “a responsible element in Society”

¹ N. Barou : *British Trade Unions*, London 1947.

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as *The Economist* puts it. It is fairer to say that the general economic situation for the time being is not such that one can reasonably force upon the trade union movement a responsibility it cannot bear.

All these difficulties of a centralized wages policy may lead to an escape into two extreme alternatives: either a continuation of the traditional, decentralized wage policy, or the movement's sacrifice of itself by giving up freedom in the labour market.

The first line of action might eventually lead to the abandonment of full employment. For a certain length of time the effects of successive wage and price increases might be apparently neutralized by means of price-control and subsidies. This system is, however, doomed as soon as—if not before—the high cost level renders competition in export markets impossible.

The opposite alternative is alluring from the doctrinal point of view of economic planning which their political opponents often like to attribute to the Social Democrats, though it has but few adherents within the Swedish trade union movement. The statement made by the Executive Committee of the Swedish T.U.C. in 1945 rejects the suggestion of any encroachment upon the freedom of trade-unionism. "State regulation of wages . . . would mean that the trade union

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organizations would lose their character of independent partisan organizations. They would be altered into negotiating bodies without the right to decide for themselves upon their wages policy and to take the responsibility for it. As such a system gained ground, the members' desire for and interest in the organization would flag. The consciousness that the organization no longer had the final decision in making agreements, must needs weaken the feeling of common interests and moral strength, which has been and still is the shibboleth of trade-unionism. It is obvious that this would be fatal to its power—perhaps in a changed political situation—of asserting its members' financial interests and pursuing their ultimate aims." The belief that one could deprive the trade union movement of its character as a free organization and at the same time maintain it as an economic and political power-centre is thus shown to be an illusion.

Since trade-unionism obviously rejects the extreme alternatives, it remains to build up a platform for trade union policy which will make it possible to prevent a relapse into a society of the insecure pre-war type, without paving the way for a State-regulated society with no trade union freedom. Arguments about "responsibility" or a "reasonable" wages policy are nonsensical if wage agreements no longer determine the level of

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wages. The main condition is therefore the elimination of the excess monetary demand which is the real cause of over-payment, affecting both prices and wages. There is no organization whose very existence is threatened to the same degree by this excess demand as is the trade union movement which must maintain its dominant position in the wage-formation process if it wants to survive.

When the consolidation of trade-unionism, increased centralization and economic stabilization (the abolition of acute inflationary tendencies) have been carried through, the obstacles to a co-ordination of economic policy in general and of trade union policy will in the main be cleared away. In such a situation a wages policy that furthers production need cause no fear of inflationary tendencies. The important problem will be to fix wage differentials with regard to the importance of different types of production and the situation in the labour market. Whether the trade union movement will be able to use wage policy as an instrument for increased production and efficiency, will depend on the capability of the Government in working out measures leading to that goal and on the willingness of the different groups of society to accept such measures.

III

THE PROBLEM OF STABILITY: AN ANALYSIS AND SOME POLICY PROPOSALS

By GÖSTA REHN

IN recent years relatively less attention has been paid to the problem of how to obtain full employment and relatively more to the problem of combining it with stability. If sectional wage bargaining is not to drive up the price- and wage-level continuously, a higher degree of centralization of wages policy than has hitherto existed is probably necessary, as has often been stated by economists arguing for a "responsible" or "rational" wages policy. To say this, however, is not enough or even the main thing. If liberty in the labour market is to be maintained in a full-employment society (the right to strike, the free fixing of individual wages within the framework of collective agreements, free choice of work, etc.) and in spite of this wages are to be made to develop parallel with productivity, two other general conditions must be fulfilled:

1. *Average profits must not be high.* But average profits tend to be very high in a state of full employment, unless measures are taken to re-

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duce the general level of profits without reducing employment. This is difficult, but necessary. If profits are high it will not be possible for a free trade union movement to refrain from increasing wages even when its leaders are convinced that any increase of wages above the rate of increase of productivity would lead to rising prices, still higher profits and—sooner or later—disastrous inflation, eventually resulting in the destruction of full employment.

2. *Large wage differentials, which cannot be accepted as fair premiums for different degrees of skill, accident risks and the like, must not exist.* The injustices which were maintained during long periods of “free” sectional bargaining, with thick buffers of unemployment around every profession or industrial branch making them “non-competing groups” with very different pay for equally arduous work, cannot be accepted for any lengthy period of time once full employment is achieved. One of the most outstanding features of the present period of full employment is that employers or industries with low wages have been compelled to increase relative wages in order to get any labour at all. We have now got virtually one single labour market, because of the labour shortage, and this makes undue wage differences impossible.

These two conditions can also be expressed in

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a somewhat different way: (1) The possibility of a stable development of wages must not be destroyed by other elements of economic policy which—via profits—push up the general wage-level in spite of “responsible” wages policy. (2) The wage system must be given internal consistency, the achievement of this being the task of the drafters of the wages policy, and the primary *raison d'être* of centralization. (We use the word “centralization” to mean merely a higher degree of central influence on wages policy than has hitherto been exercised in Britain or Sweden, and not an absolute centralization which places the power of concluding wage agreements entirely in the hands of the T.U.C. governing body.)

We may call these the external and the internal conditions respectively. “External” and “internal” relate to the point of view of some central trade union authority which has a more or less authoritative influence over wages policy.

The External Condition for Wage Stability. The cause of the tendency towards excessive wage increases does not lie solely in the strong bargaining position of the trade unions, which is the result of the elimination of unemployment. Full employment, and the certainty that it will be permanently maintained, must also tend to result

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in high profits and thereby give rise to fierce competition for the labour with the help of which the profits are to be gained. This would lead to rises in wages which increase purchasing power, thus leading to further rises in prices, increasing profits still more, etc.

Such a sequence is inevitable if full employment is to be attained by making effective demand greater than the supply of labour. If full employment (according to the Beveridge definition: more jobs than men) is to be attained in this way *everywhere*, the demand for goods and labour will be *too great* in many fields, so that inflation makes its appearance. Thus any tendency towards overfull employment, necessitating special measures of State control to prevent overstrain of the productive resources in large sectors of the economy, must be avoided. Therefore we must see to it that profits in general are so small that any exaggerated wage competition between firms is checked. But smaller profits imply that, in some fields, private initiative tends to make employment insufficient, so that special State efforts are called for to prevent the unemployment which threatens to appear.

Thus we see two alternative types of full employment policy: (1) Where full employment is achieved through an inflationary effective demand checked by controls (price control, invest-

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ment control, wage control or the exercise of "reason" and "responsibility" by the trade unions, etc.); (2) Where the same degree of employment is achieved through a lower general level of effective demand supplemented by special (local, marginal) measures to create extra employment in any place or industry where private enterprise does not keep the demand for labour at the same level as the supply. There should also be strong stimuli to move from places or branches with low, to those with high, demand for labour.

To speak figuratively of type (2): Purchasing power should be pumped away so that the demand surface sinks. The islands of unemployment which then appear must not be flooded over again by re-raising the "demand surface", but instead must be removed.

Psychologically, and from the administrative point of view, there is an absolutely decisive difference between an economy where the State (as has happened during the post-war years in Sweden, Britain and other countries) must impose many negative controls, and an economy where the intervention of the State is aimed at creating employment in specially threatened fields.

It is neither necessary, nor probable, that residual (frictional) unemployment, which is

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inevitable in any society and under any policy, would be larger in the latter case, even in the short run. Indeed, in the first case inflationary disturbances might make unemployment bigger in spite of the higher demand for labour. Thus the alternative to full employment under repressed inflation, with all its muddle and distortions and bureaucracy, is not to abandon full employment but to follow other methods of maintaining it.

For us the freedom of the individual from compulsory direction of labour is something of prime importance, accepted by all. The examples of Nazi Germany and of the Soviet Union have shown, however, that not even arbitrary wage fixing by the State, could solve the problem of the balance between wages and production in those countries. It was also found necessary to prohibit black-market wages, and this was possible only when the worker was robbed of his right to leave his job without seeking permission. Naturally our free agreements between trade union organizations and employers, even if they are centralized, cannot solve the problem either, if the strain on the labour market is permitted to go beyond a certain point. It will be very difficult to maintain a proper balance, for there may be only an infinitesimal difference between appropriately

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full employment and a strained position on the labour market, where increased labour turnover further accentuates the shortage of labour and reduces productivity, and money earnings increase because of intense competition between firms for labour. If the trade unions attempt to assume the responsibility for maintaining economic stability by abstaining from wage increases in such inflationary situations, they will not succeed for any longer period (and they would very soon appear to their members to be meaningless organizations). Only if there is no over-tension of the labour market can the trade unions conceivably adjust their wage demands to current economic conditions. Our argument may be formulated thus: to say that we will attain full employment by making effective demand in general larger than supply is to say that full employment will be the result of good profits for private enterprise, so good that entrepreneurs always find it profitable to hire as much labour as exists. This policy can be pursued for a certain period of time, but it is neither desirable from a socialist point of view nor practically possible, hence it would be wrong to ask the trade unions to accept such a policy for more than a short period of time.

But this policy is exactly what is being tried in Sweden, Britain and other countries, whose

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governments aim at a wage freeze or restrictive wages policy in order that production may catch up with total demand. These governments, very naturally impressed by the difficulties of enforcing a lot of detailed regulations, are trying to attain a better balance between total production and total demand and so command a halt to all income increases. For a time this method can be successful, and its use may even be necessary if the need arises to brake an acute inflation through a disinflationary offensive using all means available. But the fact that an untrained car-driver avoids running against the wall to the right by a sudden turn of the wheel does not mean that he can feel happy for the rest of the way, especially if he has sworn never to run into the ditch to the left. Sudden shifts of economic policy are justifiable in special cases, as after the War, but we need a better method of avoiding accidents.

If the break-the-inflation policy really succeeded, saving would become so large that investment controls could be abolished. The balance between production and effective demand should not be brought about through a diminution of investment, but through an increase of saving. If the large masses of the people, the wage-earners, generated this saving all would be well, but this is rather improbable. Usually the more reliable source of saving is (undis-

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tributed) profits. And in fact this is what we are told, explicitly or implicitly, by our governments: labour must allow profits to be so high that entrepreneurs find it both profitable and possible to supply the capital necessary for a high rate of investment. This high rate is necessary not only for the post-war period when investment is urgently needed to increase production and the general standard of living. It will be necessary in the future to provide employment in a society where technological unemployment continually threatens.

In other words, to ask labour to keep wages down amounts to saying that workers must allow profits to be high in order that the Government be able to abolish controls: when profits have increased enough and the most urgent reconstruction investment has been completed, we shall arrive at a less inflationary balance between saving and investment and then trade unions may try to increase the purchasing power of their members. But even when we have come so far, they will be asked not to diminish these high profits, if this policy is to continue. They will be asked to restrict themselves to demanding wage increases only in so far as these are made possible by *further* increases of production, because profits must be kept so high that private enterprise provides full employment through a

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high demand for labour and high investment. But this means that the trade unions will be asked to do something unreasonable. They have accepted the unnatural policy of allowing high profits in the extraordinary conditions during and after the War. But this fact should not lead to the conclusion that they will be able to do that permanently, or that they should. If they try in spite of everything, they will not succeed.

The Internal Condition. Reasonably low profits are not a sufficient condition for preventing too rapid a rise of wages. If the State has promised to maintain employment at all costs, a group of workers can ignore the fact that their organized wage demands might stamp out a large part of their branch of industry. They can hold that the State must give them employment, if private enterprise does not because of negative profits. In a full-employment society it becomes unnecessary for every trade union to have regard to the financial strength of its employers. Every union can draft a wages policy without concern for the profitability of the work done. The fact that unions in the past did not usually demand wages that would make too many enterprises unprofitable was of course not due to any moral scruples about the right of capitalists to get a fair profit. It was due to the realization that too high wage demands mean unemployment, organized either

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by employers' federations (lock-outs) or brought about through the discontinuation of unprofitable firms. By definition a full-employment society is a society where the State always saves those threatened by this sort of unemployment, either through the creation of new jobs or through a monetary policy that allows prices to rise enough to restore profits. Thus no union is any longer compelled to take into consideration the effects of its wages policy on the employment of its members. (Of course there are qualifications to make to this statement; to lose one's job is often a bad thing even if there are new jobs waiting.)

In fact, during and after the war the labour market has to a considerable extent functioned in accordance with this sketch of full-employment conditions. The wage differences which prevailed earlier, related to the different wage-paying capacities of different industries and different firms, have disappeared to a remarkable extent. As already stated above, the separate labour markets have become more one big single market, thus making it impossible for low-wage-paying firms to keep their workers. (As far as the author knows, this holds true of most Western European countries.) To put it in a somewhat over-simplified manner: in an economic system with unemployment at pre-war levels, wages had to adapt themselves to the different capacities to

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pay of different industries; under full employment industries have to adapt themselves to one wage level.

Of course it is not wholly true that we have got such a single wage level. In all countries, not least in Sweden, there are many outstanding injustices in the wages structure. Indeed the "stabilization policy", the wage freeze of 1948, has given results which partly run counter to the levelling tendency natural in full employment. To prolong all collective agreements, as was done in Sweden in 1948, means that some groups of workers will in practice be able to increase their hourly earnings because of the form of their agreements and/or a good profit level. (The latter often being the result of difficulties of effective price control in the industry concerned.) In other cases such wage increases are less possible. Thus a need for inter-industrial wage adjustments accumulates and provokes even larger wage claims than would a less rigid policy.

To a certain extent the system of wage negotiation functions in such a way that the low-wage groups demand wage increases to reach the level of those who have better wages, and then the latter demand increases on the grounds that so many others have been granted increases. When there is full employment, sufficient weight can be put behind both sorts of claims. In this way

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the wages policy of the unions may be a spontaneous factor in inflation, even though the state of the labour market in general is not one of serious shortage. The demand for equalization of wages, which is inevitable, cannot be satisfied by lowering the incomes of the high-wage groups, it can only be a matter of the size of the increases being different for different groups. A period of rising prices therefore appears inevitable once full employment has become permanent. It is necessary to ensure that during this period an acceptable and tenable relation between different groups of wage earners is obtained, which means that a new wage structure must be established.

This line of thought may perhaps be exemplified by developments during recent years. If, from the end of 1945, the aim had been to raise the general level of wages by 30 per cent. within three years (which happened in fact) and to accept the concomitant price rises and other complications, these years could have been utilized to effect fair adjustments in wages much better than was actually done. It would also have been possible to carry out more purposefully those adjustments in wages which were necessary to solve the labour problem of the basic industries. Now many unreasonable wage differences exist, and some of them have been growing bigger because of differing possibilities

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of getting wage increases within the framework of collective agreements which have been prolonged, thus provoking very reasonable but inflationary wage claims later on.

A centrally planned wage policy, aiming at the establishment of fair relative wages has not existed to any extent, but in fact it is on this point that the trade union movement can reasonably be asked to take responsibility. This means that the central trade union body has to ask the individual national unions on the upper part of the wage scale not to misuse the bargaining position gained through full employment. It must be this body which explains to the unions that the State guarantee of full employment is not unconditional, and that it does not imply that the State will always counteract the effects of wage increases on employment. The central body must support reasonable wage claims and check the less reasonable ones, the primary criterion to act on being the relative wages of the respective groups instead of the different profits in the different industries; there must be solidarity in wage policy.¹ When a spontaneous

¹ The original meaning of this phrase as used in the Swedish discussion referred to a more or less centralized policy aiming at a diminution of existing wage differentials. This principle has later—when a great many of the income differentials between different groups of wage earners have in fact been abolished—been modified and now implies that wage differentials should depend on the kind of work; e.g. heavy and dirty work should be paid relatively more than easy

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wage increase is to be expected for a certain group, it is true that no central trade union organization can prevent the union concerned from taking advantage of the situation, even if the relative wage level of its members is already high. This, however, only means that the "external condition" for wage stability is not fulfilled. But if it is, then a more centralized wage policy¹ becomes possible and the unions together can try to formulate an autonomous wage policy.

It is often stated that adjustments of relative wages should be used as a more active instrument of labour market policy. Wages should be made high in industries needing more workers, and lower in industries with a diminishing demand for labour. This is, however, very impracticable. It would be necessary to make wage differentials very large for the resultant flow of labour (with no unemployed reserves to

and pleasant work. This also means that wage rates should not be determined exclusively by the profitability of the particular industry or by the bargaining strength of the parties. If the productivity of a certain industry permits only a lower wage rate than that paid on the average by other industries, then the lower wage rate should not be accepted. Consequently the industry will have to contract, assuming that it can neither rationalize enough to offset the higher payrolls, nor is deemed worthy to be subsidized. If an industry is to be subsidized this should not be financed by the employees through lower wage rates but by society as a whole.

¹ In the sense of a *higher degree of* influence exerted by the central organization over the policy of the different unions, not centralization in any absolute sense.

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draw on) to be of any appreciable size. As there is no possibility of decreasing any money wages, such a policy would involve continual wage increases, first in one industry, then in another, as the demand for labour changed. The impossibility of such a policy goes without saying. Nevertheless it has often been argued that to steer the flow of labour must be one of the tasks of wage policy.

On the other hand, the need of better instruments for the allocation of labour between industries is increasing. The possibilities of augmenting the labour force in an expanding industry are decreasing for other reasons as well as the abolition of the unemployment reserve. In most countries there is a progressive rise in the average age of the working population, which makes mobility less. The most one can expect from wage policy is that wage differentials do not hamper the readjustments between industries. This is a secondary motive for abolishing those wage differences which are not justifiable by differences in skill and labour conditions, etc. As a contributory driving force for a flow of labour in the right direction we may of course count upon certain small wage differentials, sometimes the automatic result of the higher profits usual in expanding industries, but we must be clear that this incentive to change functions

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far too slowly to be compatible with full employment (especially with an ageing population).

It, therefore, seems necessary to elaborate more effective methods of getting rapid and smooth responses to changing demands for labour. Great stress must be laid on labour market policy in the form of planned location of industry, well-organized labour exchanges and so on. But even this does not seem to be enough. In the author's opinion the ordinary wage system should be supplemented by *remuneration for changes*. In Sweden during the War and post-war years a system of "day premiums" has been utilized especially in cases where workers have been "borrowed" from one firm by another firm in another part of the country, these day premiums being said to constitute a reward for the extra costs of living away from home and family. This system, however, was disliked by the permanent workers of these firms, especially in cases where the extra labour force tended to become permanent, for they held the view that they should get these premiums as well.

Probably any remuneration for change could best be in the form of initial "training premiums" for new workers coming to expanding industries, plus travelling expenses, etc. paid by the labour exchanges. It must be made more acceptable to the existing staff that people coming from

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other industries get substantial compensation for the economic and personal sacrifices connected with the change of job. Of course this reward should not be given as a remuneration for *any* change. The labour exchanges should give it, without any means test, only to workers moving from certain industries or professions in certain districts to other specified industries, professions and districts.

As has been already stated the trade union movement must be expected to make use of full employment to increase the share of wages in the aggregate of profits and wages, and not to accept a high level of profits. It must be the task of the State to see to it that prices do not subsequently rise so that profits are again increased, leading to fresh wage demands, and so on. It may be thought that *price-control* should be used to keep profit margins sufficiently low to satisfy the trade unions. And it is obvious that some price control must be retained in the form of control of monopolistic price fixing, if full employment is to be permanent; it would of course be unreasonable to demand a general wage policy, if profits in certain fields could be forced up monopolistically.

But it is essential to make it clear that, in the long run, the use of price control on a more general scale as a means of maintaining a balance

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between wages and profits is ineffective and can have many harmful effects.

The stricter is price control in the fields in which it can be effective, the more it induces industry to profit from the high level of effective demand which is necessary for full employment, by switching over to other fields which are difficult to control. Some writers totally overlook this complication, saying that governments must have price control on necessities while it is unnecessary to control luxury goods. As a war-time measure this might make sense, but in the long run it does not. During a war the allocation of materials checks much of the distortion of industry that would otherwise result, and in any case such distortion takes a certain time, a fact that has misled many into believing that there is little danger involved in this and other types of partial controls.

Thus the conclusion is that the possibility of selling at high prices must be abolished in those types of production where prices cannot be properly controlled by administrative methods. This implies that inflation must be combated by monetary means, by restriction in purchasing power, instead of by price controls which reduce productivity. The alternative would be the regulation of every single detail of production by the community.

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Restriction of investment, which also limits purchasing power, suffers from the same faults as the control of prices: it is most effective in limiting large-scale building and construction, but it can cover neither the many small investments, which make possible the distortion of production, nor investments made to avoid taxation.

Conclusion. We find that, as a pre-condition for stability, *profit margins must be severely squeezed between the high wages which the trade unions can secure when there is full employment and a purchasing power restricted by taxation.* In the long run distortion of production, overfull employment, and wage increases which foster inflation can only be avoided if this condition is fulfilled. As has been indicated previously, this reduction in the possibilities of making profits must go so far that at specific points direct State measures for creating new jobs will have to be taken in order to secure full employment, for it cannot be expected that exactly that balance between the supply of goods and purchasing power which is necessary to avoid inflation will result automatically in an appropriate degree of employment in every locality.

The way in which new jobs are created is a secondary question. In principle what is required is to use part of the Budget surplus, for

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encouraging the movement of workers from industries and areas where there is an excess supply of labour. Some subsidization of marginal firms may also be necessary.

The difficulty in creating the necessary balance is that it cannot be attained by means of an appreciable increase in *direct* taxation. There is a good deal which is correct in the talk of the disincentive effect of high direct taxes and of the distortion in production due to efforts to escape these taxes. Thus in its place there must be indirect taxation (that is gross taxes on production instead of net taxes on profits and other income). The labour movement has an old antipathy to indirect taxes because they are said to be detrimental to the lower strata of wage-earners, but in fact they can be made an instrument for redistribution of incomes. Indirect taxation must then be made so high that some of it can be handed back to those who need it most, in the form of increased children's allowances, old-age pensions, etc. But apart from this, the old arguments are not valid against the proposal to increase indirect taxation in order to make possible wage increases for the lower strata of income earners at the expense of profits without risking inflation. Such an increase in indirect taxation is certainly in the interest of the workers. It is also possible to levy part of

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the indirect taxes on capital goods and on the production of capital goods, thereby limiting profits still more directly.

The type of crisis which may be expected in a community with an effective full employment policy is a conflict between inflationary tendencies and overfull employment on the one hand and local employment difficulties on the other. To master such situations the State must absorb a sufficiently large part of the national income in order to be able to create work for those who cannot continue in their old occupations without producing any risk of inflation. Thus, if the State is to be able to guarantee both economic stability and full employment, without all too many detailed regulatory measures, it must be able to determine and direct the use of an increased share of the total national income.

Economic stability cannot, as experience has shown, be maintained solely by varying taxes, but nevertheless some variations in taxation must certainly be aimed at, at least as regards the direct taxation of limited liability companies and indirect taxes on investment goods.

The general scheme for maintaining a stable balance—after the foundation has been laid with the help of a consistently low rate of interest and the other usual means of encouraging high employment—ought therefore to be the following:

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State revenue should be normally maintained at a higher level than is necessary to cover *regular* State expenditure. In times of inflationary tendencies part can then be sterilized as a budget surplus to moderate the inflation. The same part can be used for measures to create employment when there are both local employment difficulties and a general risk of inflation. If tendencies to depression make their appearance, e.g. through international influences, the budget can be underbalanced more radically than otherwise on the basis of this long-term financial policy. Intervention to affect the composition of production and developments on the labour market ought in general to be in the form of support to desirable expansion, but not, as at the present time, to the suppression of undesirable expansion by means of administrative controls.

A special problem is how to effect the change of policy from the present *ad hoc* stabilization measures to a more realistic long-term policy. It is a matter of using any opportunity to go in the right direction when economic changes make it politically and psychologically possible to change policy. A dangerous possibility is that if wages again begin to increase faster than productivity, governments—stricken by fear of an inflationary spiral—will not let prices increase (by raising indirect taxes as I propose) but instead

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try to check further wage increases by promising to stabilize prices by price control. Thus they would try to make profits lower *without* securing another source of capital accumulation, and this policy would in the end result in failure. There must be keen timing: price rises should follow excessive wage rises immediately, so that they are not an argument for new wage increases, but are seen to be a consequence of the wage increases. If the price rises come a year or half a year after the wage increase they may become motives for new wage demands.

If governments wish to avoid detailed physical controls of a negative character, and this they are now wisely doing in many countries, they must choose between two policies: (1) To allow capitalists to direct both production and labour with the help of the price mechanism; (2) To take this instrument in their own hands to so great an extent that they can thereby guarantee both full employment, monetary stability, and the necessary flexibility in the functioning of the economic system. Unfortunately they often have tried instead to buy the consent of workers to high profits, the source of desperately needed investments, by keeping the cost of living low with the help of subsidies. It has been one of the aims of this paper to show the poor chances of success of such a policy over an extended period. The

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membership of trade unions cannot be expected to accept private capitalists as the owners of all the new capital. Thus, if we wish to avoid inflationary wage increases, the increase of the national wealth must be to a rather large extent, the result of collective saving done by the masses on the basis of high wages and high taxes.

Full employment implies a redistribution of economic power in favour of the working classes, in particular trade union members. They must profit from this increased power but at the same time labour must assume the responsibility for both stability and progress by allowing the State to tax away that part of the wage increments which were previously the basis of saving and investment by private owners of industry.

IV

A CRITIQUE OF REHN'S APPROACH

By ERIK LUNDBERG

MR. REHN's article seems to me to give a much more realistic treatment of the problem under discussion than do the writings of many economists, who only stress in a rather vague way the need for a restrained wage policy on the part of the trade unions. Even so, however, his argument is at times rather simplified, and some essential points, both theoretical and practical, have been consciously left out. As a result I feel that several reservations must be made and some parts of his analysis be questioned.

Any discussion of the best wage policy must, I think, distinguish between two main cases: (1) A wages policy for the present situation with its various tensions and disproportions; (2) a wage policy for the long run when the transition period is over and these tensions and disproportions have been overcome. On the whole Rehn seems to have concentrated on (1), since he devotes considerable space to the problems of how to secure a proper relationship between total wages and total profits, and how to establish a sensible wage structure.

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If we assume that the present situation is correctly described by saying that profits are too high,¹ that the structure of relative wages is wrong and that full employment will be maintained whatever happens to the wage level, then it is true that in the absence of restraint there would be "too big" an increase in wages, in the sense that it would be inflationary. We can best illustrate this by a stylized example.

Suppose that the total wage increase threatens to be 500 million crowns too big (in relation to the rise in productivity). Allowing for marginal tax and saving, this might increase consumption by 400 million crowns. With constant prices profits will be 500 million less (than they otherwise would have been) and this will probably reduce business tax payments and business saving by the same amount, leaving dividend payments unaltered. Thus total consumption expenditure will increase by 400 millions and total saving be correspondingly lower. If capital formation and State expenditure are unaffected, this means that

¹ Rehn does not mean by this that profits (after tax and minus depreciation calculated on the basis of replacement costs) are higher than normal (pre-war) in relation to turnover, but that in his opinion they are unnecessarily high to call forth the volume of production and the risk-taking which are necessary for full employment. Two conditions must be fulfilled if, as Rehn assumes, too high profits in this sense are to lead to excessive wage increases: (a) The trade unions must think profits are too big and so be induced to make wage claims. (b) The employers must think so too, in the sense that they consider production to be so profitable that they will grant the wage claims.

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there is an inflationary gap of 400 million crowns.

Rehn's remedy would not be the prevention of the excessive wage increase, but the imposition of increased indirect taxation (or reduction of subsidies) in order to abolish the inflationary gap. The increase would probably have to be greater than 400 millions because some people would try to maintain their real standard of consumption, in spite of the price increase, by increasing their expenditure. This tendency might, however, be partly or wholly offset by a reduction in the investment expenditure of those firms which were particularly hard hit by the rise in labour costs. Ignoring these complications, the result would be an unchanged real volume of consumption and investment; wages would be up by 500 million and profits (before tax) down by the same amount. Thus the wage increase would not affect national income at Factor Cost. The redistribution, by raising total expenditure by 400 million, would, however, mean a corresponding increase in national income at market price, balance at this higher level being attained by an increased public saving offsetting the reduction in business saving.

It is possible that equilibrium would not be reached all at once, but in stages. Now the aims of the policy are to get to a position where

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relative wages are acceptable and where average business profits are "sufficiently" low. An awkward possibility is that the latter aim might be fulfilled before the first, so that wage claims on the part of relatively underpaid groups are still forthcoming and yet profits are not such as to permit any further increases in wages. Earlier wage increases, for which firms would not receive compensation because of the parallel increases in indirect taxes, have brought about a state of affairs where they are forced to refuse any further wage increases in excess of the rise in productivity. If nevertheless such wage increases are driven through by the trade unions the result will either be a fall in employment (which, by assumption must be counteracted by State action such as subsidization and public investment¹) or a price increase which raises sales proceeds. In the latter case the price increases will threaten to call forth further wage claims and there will therefore be a temptation to avoid this by a compensating reduction in indirect taxation, which, if carried out, would produce inflationary pressure and thus an increased demand for labour. Apart from this, however, it is clear that an economic policy which aimed at compressing profit margins by allowing wage increases would be only a transient

¹ Such State measures designed to keep up employment obviously do not necessitate a restoration of profits to the level ruling before the wage increases.

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phase. If and when it had succeeded the big problem would remain: how can we ensure that the long-run trend of wages does not exceed the amount made available by increasing productivity? Rehn would presumably answer that after the transition phase when profits would be low and an acceptable wage structure exist, the pressure for wage increases would be smaller than at present, while at the same time the power of resistance of business to wage claims would be greater. There is as yet, however, no empirical verification of this.

Ignoring now the various complications of the transition period (of which more below), what are the theoretical implications of Rehn's view? Let us assume that the initial state of affairs is such that there is no Inflationary Gap, so that the "excessive" profits are not due to any excess of the demand for goods over the supply. As Bent Hansen has shown,¹ there can be an excess demand for labour in spite of this if the relation of the marginal cost curve to the price level is such that firms wish and try to increase production by increasing employment above the level set by the available labour supply. The cure for this (whether there be free competition or monopolistic elements) is to reduce the price-wage ratio, and this can most simply be done by in-

¹ See his *A Study in the Theory of Inflation*, London, 1941.

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creasing wages. Any effect which this has on the demand for goods can be offset through the imposition of heavier taxes.

If Rehn's case is only for a redistribution of income as being desirable in itself, then the purely economic aspects of the argument are not very favourable. The psychological and political effect of low profits in restraining wage claims must be weighed against the negative effects on employment and saving. Rehn maintains that profits are too high if firms grant wage claims without very much resistance, but such readiness is not *necessarily* the result of high profits, for when there is full employment employers will be afraid of losing workers by resisting their demands. Furthermore, a high level of direct taxation tends to diminish the willingness to resist cost increases.

Let us now suppose that there is initially equilibrium in the labour market as well as between the demand and supply of goods. A rise in wages beyond the increase in productivity will then produce reductions in employment at the margin as a direct effect. Also that part of investment expenditure which is financed from business saving will fall. The final result cannot be determined in advance; it is possible that induced increases in productivity may compensate the depressive effects, but the importance of

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this possibility is highly conjectural. The case for a structural reduction in the price-wage ratio can, however, be made in terms of the desirable allocation of resources as follows. A high ratio with correspondingly high profits allows marginal production and investment to take place under private enterprise which come lower in the scale of priorities than unfilled needs in the public sector. An increase of wages relative to prices would eliminate those forms of production and investment least valuable to the consumer (uniform indirect taxation would not impede the functioning of the price mechanism), leaving room for expansion in other more desirable spheres.

So far I have discussed some purely theoretical aspects of Rehn's proposed policy. Useful and practical conclusions can only be reached if some important realistic complications are allowed for. Rehn has ignored most of them quite consciously, for the sake of brevity and clarity in the discussion of broad principles, but it is now time to carry the argument further.

Perhaps the most important practical complication is that different branches of industry experience different degrees of prosperity and have different intensities of labour shortage or surplus. In a boom, for example, the export industries and some types of investment activity show extra good profits which may induce too

great a wage increase along the whole line. The inflationary effect of this cannot be met by increasing indirect taxation on consumption goods, for the consumption goods industries may not have abnormally (unacceptably) high profits. Thus sooner or later there will come a time when too great a wage increase leads to price increases which accrue to the firms. The problem then arises whether they can be compensated for, without disturbing the balance of the total demand and supply of goods, by reducing indirect taxes. The difficulty of this type of economic policy is that it tries to balance between inflation and deflation in a position where relatively small disturbances can produce unforeseen developments.

Let us, for the sake of an imaginary illustrative example, assume that export markets improve and that the rise in export demand leads to an investment boom in some industries. Assume further that it is considered good policy to take advantage of the favourable export markets and to allow at least part of the induced increase in investment. There will be some risk of investment increasing over the limit decided on. But in addition there will be the possibility of a wage increase which is greater than the situation permits. Suppose that the expected increase in exports is 500 million crowns and the permitted

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investment increase (according to an investment budget) is also 500 million (1000 in the absence of any investment controls). If real national product is expected to grow by 1000 million crowns then there is clearly no room for any increase in consumption. But a rise in consumption demand of 1000 million threatens due to a 10 per cent. general wage increase. Indirect taxes which will raise the price level by 5 to 10 per cent. are therefore seen to be necessary. This would stop the tendency for the volume of consumption to rise and reduce the profits of the consumption goods industries, thereby evening out the improved prospects in export and investment industries. Thus this economic policy means that too great prosperity in one sector has to be compensated for by a slump in other sectors. In a *reductio ad absurdum*, Rehn's method of treating different firms within a single industry can be extended to whole sectors: industries which begin to contract after the wage increase and the imposition of heavier taxation are "treated" with judiciously balanced subsidies!

It may be, however, that it is not desired or not possible to allow the favourable export conditions to have more than a very limited effect on the structure of production. If so, the tendency to an increased profit level in the export trades must be dealt with directly. Consistency in the

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system would require export duties and taxation of investment, but, if there is a sizeable exchange reserve, a currency appreciation might be the best way of preventing the undesired profit increases and rise in the demand for labour.

How will things be in the opposite case of a slump initiated by a fall in exports? If, in spite of the depressive tendencies at work, a greater wage increase than that made possible by increased productivity threatened, then this would not need to be offset by higher indirect taxation, for the decline in export and investment production ought to be compensated for by stimulating consumption. Indeed if wages increase insufficiently to take up the slack, indirect taxes should actually be reduced. If the foreign exchange reserve is small, devaluation and the removal of any existing export duties and taxes on investment would be the correct policy. If, however, the latter two measures are very effective and keep exports and investment at a high level, then the excessive wage increase will need to be compensated by higher consumption taxes.

The carrying out of an economic policy of this kind would impose very big demands on the authorities, who would have to foresee coming tendencies to change and adopt suitable measures quickly and consistently, without political friction.

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They would have to be very well informed indeed about the economic situation. But quite aside from immediately practical and political difficulties attached to the execution of Rehn's proposed policy, it would be exposed to a number of hazards which I now proceed to list in a somewhat summary fashion.

(1) There is some risk that after the introduction of higher indirect taxes, firms might nevertheless be able to compensate themselves for too great a wage increase by raising prices (before tax). (The tax increase might have been insufficient, or unforeseen changes might have occurred, improving profit prospects.) The price increases will be made where demand is inelastic, while elsewhere indirect price increases may take place by the abandonment of lines of production which are no longer profitable. The combination of price increases and reduced employment within the private sector on the one hand and compensatory state action on the other hand are unpleasant alternatives. Inflationary disturbances can be expected to occur every now and then, particularly because of changes in foreign trade, so that if full employment is maintained there will not be many opportunities ever to reduce the indirect taxation.

(2) Another risk of price increase lies in the possibility that wage-earners will try to ensure

that they actually get the increase in real wages which was the aim of the increase in money wages. If the increase of prices due to the higher taxation calls forth further wage claims, Rehn's policy would be of no use. Can we really expect that trade unionists will distinguish between price increases which carry with them higher profits and price increases which raise Government revenue? This could constitute a serious problem in the long run when the distributional problem had been solved and a desirable wage structure achieved. If the tendency to too great an annual wage increase (i.e. one in excess of the annual increase in productivity) exists, then the possibility exists of a cumulative price-wage increase actually accelerated by the increases in indirect taxation.

(3) It is obviously always possible to damp down an expansion by a sufficiently strong wage increase and a sufficiently large dose of indirect taxation. They take effect, as is the aim of the policy, by reducing profits and not by cutting real purchasing power. Marginal firms and marginal production are hit by wage increases for which compensation cannot be obtained by price increases. According to the theory the intra-marginal firms will earn sufficient profits but no "efficiency premium". As was maintained above, the system must be extended to

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cover firms which produce capital and export goods as well, for it would not be enough to keep down profits in consumption goods production only. Taxation must be imposed on all branches of production not only in order to be fair, but also to prevent a misallocation of resources by the over-expansion of untaxed production. In other words, solidarity in wages policy must be accompanied by solidarity in profits (and tax) policy.

This being so, where will be the incentives to re-orientation of production when the structure of demand alters and technical progress is uneven? Will there be enough risk taking? Will firms desire to carry out investment projects if they can only finance them by borrowing, for example, from the new State banks which will be formed to look after the saving forced from private income-recipients in the form of indirect taxation? It is not enough to answer by simply saying that big enough subsidies will solve these problems. The greater the proportion of costs of production covered by subsidies, the wider is the degree of detailed State interference with private industry and the less does the price system fulfil its function of allocating resources.

(4) Foreign trade relationships always cause difficulties with autonomous economic policies. A system with excessive wage increases which are

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neutralized by increasing indirect taxation can easily get out of step with international price trends, allowance for which would disturb the internal balance. Thus it seems to me that Rehn's policy would require a flexible exchange rate. But can we assume that wage-earners would acquiesce to a price increase caused by a devaluation rendered necessary by changes in external conditions as readily as to one caused by higher indirect taxes following a general rise in the wage level? Would not rather the increased profits of exporters or increased import prices be considered justification for a wage increase? If the exchange rate is fixed in spite of the fact that the internal wage and price level is rising too rapidly in relation to international standards, then there will have to be export subsidies and import duties (and licensing). If, with fixed exchange rates, the domestic price and wage levels have to follow international trends, an autonomous wage policy must be restricted within very narrow limits in order to avoid balance of payments troubles.

(5) We know far too little about the nature and strength of the forces which tend to raise the wage level to be able to know whether the fiscal policy recommended by Rehn creates circumstances favourable to the wage policy he believes in. For example there is no empirical support

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for the thesis that high profits are always a potent factor for rapid wage increases when these profits largely go in taxation and in financing investment. Even with low profits, a high level of employment and of investment or an unsuitable wages structure might cause excessive wage increases. Nobody knows these things, we can only carefully feel our way forward and see how things go. As yet our power to forecast future trends is small, so that any attempt to say just how much should be raised in taxes if a threatened change occurs would be subject to great uncertainty. Another difficulty is that without a very high degree of political agreement a really flexible taxation policy would be impossible.

(6) The most serious risk with these proposals is in my opinion the concentration of power they involve, the aim being to transfer a large part of private saving to the State. The State would also have to use some of its large surplus for subsidizing marginal firms, and as I have pointed out above this would involve a tremendous amount of detailed control.

Mr. Rehn's contribution seems to me stimulating and important. His ideas deserve much consideration both from a theoretical and a practical standpoint. As I have indicated, I think there are great risks involved in relying too much on Mr. Rehn's solution. Indirect

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taxation can without doubt be used to a certain extent in certain situations to create a more balanced position. But, as with all means of economic policy, indirect taxation should be used modestly and with care, and it should in most situations be co-ordinated with and supplemented by *monetary policy*.

While fiscal policy must play a big part, perhaps the main part, the possibilities of complementary measures are in danger of being forgotten. Squeezing profits by the proposed policy will make private industry more dependent on the availability of credit. It is very possible that some degrees less of full employment, secured by a restrictive credit policy and without price increases, might be more effective in stabilizing wages than increasing prices by indirect taxes. Investment is checked and the unemployed would be supported by the State, as compared with Rehn's policy where it is primarily consumption that is to be restricted and State support goes to firms. It is paradoxical that the relatively small rise in rents which would be produced by a small contraction of credit with an accompanying rise in the rate of interest by 1 to 2 per cent. should be regarded as utterly abhorrent, while the much greater increase in the price level due to increased indirect taxation *à la* Rehn should be supposed acceptable. An increased concen-

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tration of capital formation in the hands of the State places high demands on political competence and administrative capacity and requires central decisions on such difficult questions as the long-run distribution of capital resources between industries. Monetary and credit policies, by contrast, work in a decentralized manner through their effects on the decisions of individual firms. Fiscal policy which relies on variations in tax rates as its weapon for maintaining full employment requires the preparation of "national budgets" and forecasts. Although these give the appearance of national planning, our experience is that the power of adaptation of government policy to the dynamic changes of reality is very inadequate and the political element in economic considerations great. Monetary policy, on the other hand, might more easily be kept free of day to day political control and does not pretend to give any precise results and forecasts to be put in an over-ambitious plan. Monetary measures must be taken tentatively, but they can more rapidly and flexibly produce changes in the economy via their effect on the liquidity of thousands of firms.

V

A REPLY TO PROFESSOR LUNDBERG

By GÖSTA REHN

THE most important thing to say as a reply to Professor Lundberg is that the difference between us is more one of putting different questions than of giving different answers to the same question. The sort of problems which I tried to answer were as follows:

Granted that we want full employment, what is necessary to obtain and maintain it without inflation? How can we arrange matters so that the trade union movement will be able to avoid ruining the policy by inflationary wage increases?

In his list of six hazards Lundberg shows that the problem is extremely difficult, being a matter of balancing on a tightrope between inflation and deflation. But this is no objection, it is only a description of the task. I agree that there are risks and unsolved problems. I had not considered myself to have shown that absolutely 100 per cent. full employment (something nobody has dreamt of) is compatible with a pace of wage increases limited to that allowed by productivity trends. I simply meant that my policy proposals

permitted a closer approach of employment to the 100 per cent. limit than that permitted by the methods followed by governments in, for example, Sweden and England after the war, the keystone of which has been a restrictive wages policy in spite of profits of a magnitude that makes this wages policy impossible in the longer run.

Instead of proposing alternative lines of approach to the problem I have specified, Lundberg really asks quite another question: *if* we are to prevent a wage-induced inflation, *can* we have full employment? (This means that he should have defined exactly what he means by full employment, whilst I can avoid definition because my aim is only to show that a policy along the lines I propose would make it possible to get nearer 100 per cent. employment than with other policies.) He seems to recommend some degrees less of full employment (less than what?) secured by a restrictive credit policy and without price increases. But my problem was to seek the best of several different alternatives to follow in order to get as close as possible to the unattainable 100 per cent. employment level without destroying the possibility of wage stability. (By wage stability we both mean that wage increases do not exceed the gains in productivity.)

My answer was that there must be a more deflationary (or less inflationary) fiscal policy

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than we have had up to now, but, instead, a—seemingly—more inflationary wages policy. Thus there should be a larger volume of collective saving and consequently low business profits. Specific State measures will then be necessary to prevent reductions in employment wherever they threaten to appear. To achieve this, rather than to persuade trade unions to be restrictive in their wage claims should be the task of economic policy. The task of persuading trade unions should lie more with employers, and they will voluntarily assume that task if profits are kept sufficiently low.

Lundberg objects both that this may not work and that it involves what is to him a distastefully large degree of State interference. These are judgments which cannot be discussed on wholly objective grounds. As regards the second point, however, it is important that with the approach I have proposed there would need to be far less purely restrictive control over investment and prices than exists at the present day. Instead, State measures would be of a more positive kind such as securing a greater mobility of labour from employment with a low productivity to employment with a high productivity, and the removal of local patches of unemployment.

Lundberg says several times that we do not really know what are the forces which give rise

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to big wage increases (see his point 5) and that therefore excessive wage increases may occur even if profits are kept low. But it is just because of this that I consider a proper structure of relative wages to be just as important as low profits. These two points give no absolute guarantee of wage stability, but I do think that they are necessary *conditions*.

In his point 2, Lundberg questions whether "trade unionists will distinguish between price increases which carry with them higher profits, and price increases which raise Government revenue". But this is exactly what happened in Sweden in 1948, when tax increases and cuts in food subsidies ate up the major part of the recent and untenable wage increase. Most trade union members, and not merely their leaders, concluded that the wage increase had been largely meaningless, so they might as well have a wage freeze. If, however, the price increase had gone into profits and caused increased competition for labour with consequent wage increases above the minimum fixed in collective agreements, the story would have been very different.

Lundberg refers to what he calls my belief in flexible and rapidly variable indirect taxes as an important instrument of policy. Apparently I have not been sufficiently clear on this point. Actually I consider variation of taxes to be

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almost as clumsy an instrument as interest policy. After the transition period required for us to learn what is really required to maintain full employment without inflation, I believe that what is needed is a level of taxation, which (apart from an upward trend, due to other factors) would be fairly constant, but high enough for the State to be able to stimulate and create employment wherever and whenever necessary without resort to inflationary devices. My point is thus that Governments should not use tax reductions as a weapon against incipient tendencies to depression until these have gone rather far; instead, employment policy should consist in creating work and stimulating mobility, though with a radicalism that is as yet untried.

I do not expect, as Lundberg seems to think, a *long* series of excessive wage increases followed by equally large tax increases. I do not think that a very great increase of saving brought about by a budget surplus is needed to achieve sufficiently small profit margins for it to be possible to attain the desired stability in the labour market by agreement between the different organizations. Of course, only by trial and error can we find out how far and how quickly we can pursue this policy. Lundberg is afraid that there must be a permanent surplus in the State budget of such dimensions that nearly all

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saving is done by the State. In fact, however, we have as yet a long way to go before the excess of tax revenues over current expenditure covers even the whole of State capital outlay. Let us get to that point first before we get excited.

Lundberg's first footnote on what I mean by "too high" profits is somewhat misleading. I simply meant that profits are too high if they produce appreciable wage increases (irrespective of collective agreements) through competition for labour. Another matter concerning profits is whether my policy would eliminate the differential profits of the most efficient firms, as he fears. If all profits are reduced, however, this will not eliminate the differentials, but only turn the profits of marginal firms into losses. This, together with very active measures to increase mobility in desirable directions (and here, in my opinion, is the corner stone of any full-employment policy) will surely help, and not hinder, the transfer of resources from less to more efficient firms and from declining to expanding industries.

Lundberg names as an important complicating factor unevenness in the degree of prosperity between different industries. As far as I can see, this is my argument, and not his. Just because of this unevenness full employment cannot be maintained exclusively by general, over-all

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measures (credit and monetary policy as recommended by Lundberg), for deflationary and inflationary tendencies can exist simultaneously in different parts of the economy. Credit contraction would not only have the desirable effect of imposing a check to excessive activity; it would also produce undesirable and unnecessary restriction in other sectors unless credit control is very selective. If local and sectional measures are not taken, either full employment must be abandoned, or we get continuous inflation or excess purchasing power in many sectors, held in check by a vast apparatus of controls and restrictions. Thus the relevant point is not whether "my" policy is difficult, but whether it is *more* difficult and has more undesirable features than the alternatives. It is no use being utopian: there is no perfect solution.

In his point (4) Lundberg mentions the foreign trade complication. It is undoubtedly true that violent disturbances in trade can knock any economy to bits. But the possibilities of counteracting such disturbances are greater, if the State can permanently determine the use of a large proportion of national income, thus being able to facilitate necessary redistributions of resources. Here again general monetary and credit measures will not be of much help. Thus, if there is a fall in exports, is there to be a credit expansion to

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assist expansion of employment in other parts of the economy, or a credit contraction to bring down the domestic price and wage level in order to restore competitive power? Much more needs to be said on this point, but that would carry us too far away from the subject of wage policy.

VI

THE TRADE UNIONS, INFLATION AND FULL EMPLOYMENT

By KRISTER WICKMAN

ONE reason why it is so difficult to recommend any specific wage policy with confidence is that we know very little about the significance of wage movements in the inflationary process and about the factors which at present determine wages. Certainly the role of trade unions in inflation, has been exaggerated in some of the recent discussions, as Professor Morton has very strongly maintained in his recent article in the *American Economic Review* (March 1950). Just as there were great men before Agamemnon so have there been inflations, and big ones at that, long before there was any trade union movement. Furthermore, the worst inflations after the war have occurred in countries where wage formation has been least free (Russia and Hungary) or where trade-unionism is insignificant (China). The essential causes of the inflation since 1945 have been the pent-up demand left over from the war and vastly increased liquidity. Few of the price increases in the United States

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have resulted from the effect of wage increases on costs, they were caused by increased demand, and the inflationary effect of higher payrolls depends largely on their demand effect. An investigation covering the years 1945-47 shows that half of the increase in demand came from wage increases, while half came from other groups and from increased employment. The primary increase in consumer demand raised prices which led to increased wages, larger incomes and so still further increased demand. Thus the wage-price spiral is not the sole cause of inflation and, more important, it is not an exclusive product of wage policies. Wage policies are according to this view the instrument, rather than the cause, of the wage-price spiral, and equally large wage rises would probably have taken place even if the labour market had not been organized; indeed one may even say that the total effect of the existence of trade unions was anti-inflationary, since fear of future wage rigidity has made firms more inclined to resist price and wage increases. In England and Scandinavia, of course, the policy of wage restraint has had an even greater importance in this respect.

It is essential to remember that the question of full employment and inflation is a difficult problem quite apart from the wage policy of the trade unions. This was clearly shown by the

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New Deal in the United States, for the 20 per cent. rise in employment from 1933 to 1937 was accompanied by a 15 per cent. rise in the cost of living even though there were still as many as nine million unemployed at the end of that period. One might also refer to older figures relating to a largely non-unionized society. American statistics covering the period 1890-1933 seem to imply that non-union wages increase by more than the "productivity three per cent." when unemployment is below the 5 per cent. level. Really heavy wage increases occurred only during pronounced price inflation (World War I). An authority like Professor Slichter has concluded that inflation starts as soon as employment rises above 90 per cent.—this without explicit reference to any union activity.

If one interprets full employment to mean the absence of even, say, 3 per cent. frictional unemployment—that is if one wants overfull employment—then there is no possibility of avoiding inflation. Frictional unemployment can only be avoided if the demand for labour is so great that every firm is short of labour, for then an unemployed worker can get a new job without delay. But if the worker is to get the "right" job, the job where he will be most "useful", it will take him some time, and it is the carrying out of such movement which causes frictional unemployment.

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Any reduction in the three per cent. should be done by improving the system of labour exchanges and increasing mobility rather than by increasing demand. The latter measure would, in the words of an English economist, be to cut off an arm to spite a finger. On the other hand, however, it should be recognized that there might be non-economic arguments in the other direction. Workers may well prefer the security and independence which result from their being able to get a job wherever and whenever they want in spite of the obvious economic disadvantages.

The usual solution proposed to the dilemma of wages policy is no more than a vague appeal to the spirit of social responsibility of the trade unions, asking them to restrain from forcing through wage increases in excess of the rise in productivity. This will not do. The movement could not continue and membership and solidarity could not be maintained if the unions abandoned their primary function: that of improving the conditions and pay of their members by all possible means. The wage restraint of the war and after was always regarded as something provisional and obnoxious in general. It is for this reason that both Meidner and Rehn wish to lay the responsibility for preventing excessive wage increases on the State. More generally Meidner says that any excess of total demand

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should be prevented by fiscal and other instruments, since otherwise the trade unions cannot continue to dominate in wage formation and yet an inflation be avoided.

To a Social Democrat the natural reaction is to ask whether there is not a risk that if demand is kept low enough to remove the wage difficulty, full employment may be removed as well. We thus come back to the question of what we mean by full employment and to our ignorance about the relations between the level of employment and wage changes. Most Social Democrats seem to assume that a sufficiently low level of employment to secure flexible and non-inflationary wage formation would mean a higher level of unemployment than is acceptable.

Even if this is correct, however, it is still worth discussing what possibilities there are of diminishing the correlation between increases in employment and inflation. A "consumption socialism", which solves every unemployment problem by increasing demand is not much use. If unemployment in a particular case is not due to deficient demand it would be wasteful to remove it by increasing purchasing power. It would be much better to adjust price-wage relationships to enable adaptation to the more or less free market demand. But if one considers that, at least for the present, a differentiated policy of this sort is

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impossible for institutional reasons, then we are once again back at the fundamental problem of the trade union movement's psychology.

The advantage of Rehn's proposals is seemingly that this consequence is avoided. Without discussing the facets of the problem dealt with by Lundberg, I shall endeavour to show that this would not in fact be the case in the long run. If the policy of using indirect taxation to maintain balance between total demand and supply is known to the unions, may they not allow for this in their wage claims or at least ask for compensation afterwards? In any event any particular union can always obtain an increase in real wages for its own members, since the additional taxation cannot be levied only on purchases by those workers who have received wage increases. On the other hand other workers who have now to pay higher indirect taxes but have not secured wage increases will press for a compensatory rise in their wage rates.

Another problem is that of how the reduction in profits will affect investment. If there are repeated wage and tax increases, the price received by the producer remaining unaltered, more and more firms will be forced out of business. If full employment is to be maintained then either there must be an extension of the area of State enterprise, or subsidies will have to

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be granted. The first alternative means concealed nationalization, the second requires an immense administrative machine. In either case, directly or indirectly, more and more workers would become in effect employees of the State and find themselves in the favoured position of negotiating with an employer who had guaranteed them full employment. Instead of the traditional cumulative price rise there would be a cumulative increase of taxes on consumption which would bring with it more problems than those we were out to avoid.

In indicating this possible result of Rehn's policy I have made several unrealistic assumptions. The essential hypothesis related to trade union behaviour, for I have assumed that they would use their power to its full extent. Rehn, however, has given two reasons why one might expect wage movements not to be so large as to create instability. Firstly, relative wages will be properly adjusted so that the wage structure is no longer such as to provoke demands for wage increases which exceed the rise in productivity. Secondly, profits will not be so high that firms drive up wages by competing for labour. Both of these points surely relate to the psychological question. Thus, to take the first, a union with the power to drive through a wage increase will never refrain from doing so if it feels that its

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members' earnings are unfairly low in relation to other trades. Again, low profits not only keep down the demand for labour, they also make restraint in wage claims acceptable to the workers.

We may add two more conditions which must be fulfilled if a voluntary stabilization policy is to be at all possible. Since wage claims depend not only on the profit position but also on price movements, the cost of living must be kept approximately constant. If there are cyclical changes in the cost of living and if wages are inflexible downwards, wages will rise in the boom but not fall in the slump and the resulting step-like upward movement of the price level will create complications for foreign trade. Secondly, wage changes must not be regarded as a means of achieving a more even income distribution, a function which they have not been able to fulfil up to the present. This implies that other means must be used to redistribute income. Perhaps in the long run the greatest task of economic policy is to redistribute income in a manner which has no disastrous economic effects and which has general support or at least is accepted as tolerable. If success were achieved in this, not only would economic policy be much easier thereafter, but also the degree of social harmony would be much greater than it is at present.

The discussion of wage policy thus inevitably

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leads to the consideration of much wider problems of social reform. It is not enough to reach agreement on how the parties in the labour market ought to behave; we must go much further and create conditions such that they can and will behave in a manner which seems desirable both for themselves and for society as a whole.

