The Role of Incomes Policy in Industrial Countries Since World War II

ANNE ROMANIS BRAUN *

WIDESPREAD RECENT EXPERIENCE of rapidly rising prices and costs has created renewed interest in incomes policy as an effective anti-inflationary weapon. This article provides a survey of some major issues of incomes policy rather than an evaluation of individual countries' policies. It seeks to highlight and explain the changing emphasis of such policies in the three periods when they were widely adopted—just after World War II, during the early 1960s, and during the last few years. Attention is drawn to the changing context for incomes policy resulting from the adaptation of wage-bargaining institutions to expectations of continued high levels of employment and from the growing "openness" of the industrial economies. Sources of information on particular countries are indicated. The concluding section considers the case for incomes policy at the present time.

I. What Is Incomes Policy?

The term "incomes policy" is commonly employed to cover specific measures aimed at restraining the rate at which money incomes tend to rise, by curbing the exploitation of market power by business and labor, professional, or other groups. Incomes policy is thus an adjunct to fiscal and monetary policy. Its purpose is to moderate the rate at which prices and costs tend to rise when the level of aggregate demand and employ-

* Anne Romanis Braun, Assistant to the Director, Research Department, is a graduate of Cambridge University. She formerly worked as an economist at the Oxford University Institute of Economics and Statistics, in the U.K. Ministry of Production and Board of Trade, the Organization for European Economic Cooperation, and the United Nations. She has published a number of articles in the field of incomes policy and of international trade.

A preliminary version of this paper was presented at a seminar, organized by the Regional Office for Latin America and the Caribbean, International Bank for Reconstruction and Development, on "Lessons for Latin America of Industrial Countries' Experience with Incomes Policies," April 25, 1974.

1 Citations by author and date refer to the Bibliography, pp. 30-36.

©International Monetary Fund. Not for Redistribution
ment is not so high as to force up prices and wages by creating scarcities or to provoke a balance of payments crisis.

The need for incomes policy arises when it appears that a tolerable degree of price stability cannot be achieved by reducing the level of demand, or can be achieved only at an unacceptably high cost in terms of unemployment, loss of real output, and interference with growth. Hence, incomes policy is often presented as a means of improving the trade-off between unemployment and price stability.

Incomes policy is often defined as deliberate intervention by the government in the process of price formation for labor and products aimed at preventing pretax money incomes from rising faster than the growth of national income in real terms. However, it is desirable also to include deliberate effects to this end made by the private sector organizations, on a nation-wide basis, without direct government intervention. Under systems of coordinated national wage bargaining, the central labor and employers' organizations are faced with the need to work out an incomes policy, since they are generally obliged to relate their decisions to the overall economic situation and outlook. This fact may be quite as effective in ensuring a reasonable rate of increase in money incomes as a policy directly involving the government.²

Incomes policy as here defined is essentially an anti-inflationary device; it should not be interpreted to cover the whole range of policy with respect to incomes. Policies concerned with income distribution per se, such as measures to reduce the inequality of incomes, to eliminate very low wages, or to reduce poverty by social welfare legislation, are not comprehended by the term. In practice, however, such measures are often adopted along with an incomes policy, because the labor organizations regard measures to improve the position of lower-paid workers as a prerequisite for their cooperation in an incomes policy. "Indeed, one of the general comments on the experience of incomes policy in Western Europe is that it has been impossible to evade the distributinal aspect of even the simplest kind of incomes policy."³

The term is sometimes used in the other sense; in particular, its French equivalent (politique des revenus) has meant policy with respect to the distribution of income in the course of development. In France during the 1950s and early 1960s, the formulation of such a policy involved discussions between the representatives of the different interest groups in the process of preparing the medium-term Economic Plans.⁴

³ Blackaby (1971), p. 41, referring to the introduction to the ECE Survey.
⁴ Massé (1964); International Monetary Fund (1964), p. 120; Hayward (1966).
The specific objectives and methods of incomes policy differ greatly with the institutional and political characteristics of the countries where it is implemented. The wide variety of measures adopted may be grouped into the following categories:

1. Short-term intervention to prevent wages or prices rising by "freezes" or temporary controls. Such measures are often applied in the hope that if increases can be avoided temporarily, conditions later may be more conducive to restraint so that increases may be moderated or prevented. Or the measures may be aimed at checking the development of inflationary price expectations.

2. Efforts to inform public opinion by publishing expert reports, setting up advisory bodies, etc., to promote a consensus on what is an appropriate rate of increase in wages and salaries and on the need for moderation of pay claims if inflation is to be avoided. The aim is to bring the force of public opinion to bear as a curb on wage and price increases. This objective involves the more or less explicit formulation of a "guideline" for wage and salary increases, and of concomitant ideas concerning pricing behavior, profit margins, and the share of nonwage incomes in national income.

3. Mandatory, or voluntary, implementation of guidelines for wages and salaries, with or without measures of price control or profit restraint.

4. Measures aimed at restraining cost pressures in specific sectors (e.g., construction, basic industries, public services, rental housing), including provisions for investigation of price or wage decisions, for prior notification of price increases, and approval of wage settlements.

5. Operation of a coordinated system of wage and salary determination (often also covering farm incomes), with or without direct government involvement, as in Scandinavian countries, the Netherlands, and Austria; or through compulsory arbitration procedures for wages and salaries in Australia and New Zealand.  

6. Long-term measures under the heading "institutional engineering," such as improving facilities for mediation and arbitration of disputes, imposing sanctions against unofficial strikes, or providing for imposition of cooling-off periods; measures to reduce the scope of disputes concerning employer, employee, and union prerogatives; classification of legal status and duration of wage contracts, simplification of wage structures, systems of payment, etc.; reorganization of the union structure to avoid disputes about membership coverage, to simplify wage

---

5 A high degree of coordination in wage fixing applied throughout the postwar period in the countries mentioned, and more recently in Belgium and Ireland—Blanchard (1971); Browne (1965). Elements of greater coordination have also appeared in Italy—Saunders (1972).
bargaining, and to lessen tendencies for interreaction of wage claims, causing a wage/wage spiral; labor market policies to improve mobility or to provide retraining facilities in order to lessen the tendency for wages to rise while there is still considerable unemployment in some regions or among some categories of workers.

II. Industrial Countries' Use of Incomes Policy Since 1945

Since World War II there have been three periods of strong interest in incomes policy—the immediate postwar years, the early 1960s, and the last few years. The objectives, general approach, and specific measures adopted in these three periods differed widely as a result of the very different circumstances in which the policies were implemented.

THE IMMEDIATE POSTWAR PERIOD

In the period just after World War II, incomes policies were applied in a number of European countries in a context of scarcities of goods and critical shortages of foreign exchange. Policies then involved a considerable element of compulsion. Centralized control over wage and salary decisions was enforced in several countries (the Netherlands, Norway, Finland, and Sweden) and coordinated wages policies were adopted in Austria and the United Kingdom, in a setting of widespread controls and restrictions, such as direction of labor into essential employment, rationing, allocation of materials, price and rent controls, dividends restraint, and excess profits taxation.

Wages policy was implemented through central organizations of the labor unions and employers' associations, or by joint bodies used to formulate and coordinate policy during the Great Depression. Wage restraint was accepted by wage earners as necessary, in the short run to secure an equitable distribution of the strictly limited resources available for consumption, and in the longer run to support the development of productive resources and employment opportunities by promoting the expansion of export industries and import capacity. Their support was conditioned by the existence of a stringent and highly “visible” balance of payments constraint, in the shortage of “hard” currency to pay for essential imports. Furthermore, the bargaining power of wage earners

6 Policies during this period are described in Roberts (1958); Sturmthal (1957); Marris (1961); Edelman and Fleming (1965); David C. Smith (1966); ECE (1967), Ch. 4. See also Skånland (1964) on Norway; Johnston (1962) on Sweden; Markman (1964) on the Federal Republic of Germany; Pedersen (1964) and Hoffmeyer (1964) on Denmark; Zoeteweij (1955), Pedersen (1957), and Windmuller (1969) on the Netherlands.
was circumscribed by the existence of considerable unemployment and of underemployment in agriculture and distribution, and by fear of a recurrence of the heavy unemployment experienced before the War. In all the countries mentioned, the implementation of policies was aided by the development of a considerable consensus on economic policy objectives during and immediately after the War; and the cooperation of the unions in incomes policy was facilitated by their close ties with the socialist or coalition governments then in power.

Countries in which the political situation was not conducive to the adoption of comprehensive policies along these lines experienced severe inflation. In both France and Italy, an extensive system of price controls, set up during the War, continued to be enforced in the immediate postwar period. The authorities subsequently developed a weapon for influencing the behavior of large enterprises through their control over sources of external financing. In both countries, the power of producers or distributors to raise prices was a more important cause of inflation than cost pressures originating in union wage claims in the private sector, because the unions' power to negotiate wage increases was limited and the employers combined to resist the development of collective bargaining.

The need to strengthen the country's balance of payments position was absent in the United States, Canada, and Belgium; and explicit incomes policies were not adopted in these countries. In the United States, some moderation of wage pressures was achieved by tightening labor legislation (especially by the provision for injunctions against strikes and legally imposed cooling-off periods under the Taft-Hartley Act).

The upsurge of world prices in 1950 caused by the Korean war undid efforts to ensure wage and price restraint. After the war, cost pressures lessened as primary product prices fell back sharply and industrial capacity in Western Europe and Japan was restored. Restraints on the free working of the market economy were gradually removed, and interest in incomes policy subsided, except in countries still facing severe balance of payments difficulties. The Netherlands and Austrian systems proved their usefulness in balance of payments crises in the late 1950s. In the United Kingdom and Sweden the problem of incomes

8 Giugni (1965).
10 Roberts (1958), pp. 118-34; ECE (1967), Ch. 4; Pen (1964); Barbash (1972), pp. 61-80; Bhatia and Bouter (1961); Windmuller (1969).
11 ECE (1967), Ch. 4; Spitäller (1973); Robinson (1973), pp. 14-22.
12 Knowles (1962); ECE (1967), Ch. 4; David C. Smith (1968 a).
policy continued to attract considerable attention because of the tendency for labor costs to rise more rapidly than in other countries with a lower degree of utilization of labor. In Sweden the system of centralized wage bargaining, which has been characterized as "private incomes policy," was developed over this period. In France where the basic price control legislation of 1945 remained in force, with modifications, throughout the 1950s and early 1960s, the Government was able to reimpose controls at any time: the 1950s were marked by alternating periods of liberalization and stiffening of price controls, including successive freezes in 1952, 1954, 1956, and 1957, followed by a progressive easing that lasted until 1964.

THE EARLY 1960s

When output and employment began to rise after the 1958 downturn, there was a widespread revival of interest in incomes policy. Attention was concentrated on voluntary measures aimed at moderating the rate of increase of prices, and more especially of wages, by influencing the climate of opinion and the attitudes of partners in wage bargaining. Policies were directed (1) at securing the cooperation of employers and trade unions in limiting inflationary pressures by appropriate wage and price decisions; (2) at educating those concerned with such decisions on the "public interest" aspect of avoiding inflationary repercussions, and mobilizing the forces of public opinion against undue increases in wages, salaries, and profits; and (3) at establishing, or strengthening, specific checks and balances to reduce cost pressures in particular areas of the economy.

The early 1960s were the heyday of the productivity guideline (guidepost, guiding light, or gearing). "The proposition that prices will be stable so long as aggregate factor incomes increase no faster than the

13 Johnston (1962); Moully (1967); Anderman (1967); Lindbeck (1972); Barbash (1972), pp. 5-41; Brehmer and Bradford (1974).
15 The 1967 ECE Study, Incomes in Postwar Europe, stated, "For the present purpose, incomes policy is taken to mean the effort to acquire a degree of direct collective control over the level and structure of the remuneration of labour and capital and over the distribution of the national income to households and enterprises. . . . The phrase 'collective' rather than 'government' control is used because it is taken as a reasonable assumption for western European societies that the decisions will remain, essentially, in the private sector and that governments, even if they hold certain compulsory powers, must influence primary incomes mainly by guidance and persuasion of managements, workers and their representative organizations; in practice, in particular for wages and salaries, it is the policies adopted by these collective organizations which must be the instruments of incomes policy" (Ch. 1, p. 2).
INCOMES POLICY IN INDUSTRIAL COUNTRIES

The total volume of output has passed out of economics into public relations.” It was “further simplified into the proposition that, to avoid a general price increase, average pay per employed worker should not increase faster than average productivity per employed worker. . . .” 16

“Norms” based on this principle were widely adopted with two basically different aims. In the Netherlands, Norway, Sweden, and the United Kingdom, the basic aim was to prevent pay rising faster than productivity in order to avoid loss of competitive power vis-à-vis countries in which industrial prices were under only slight upward pressure, such as the United States, the Federal Republic of Germany, Japan, and Italy. In the Netherlands, this aim was not altogether appropriate, because Dutch wages were by now well below those in surrounding countries and strong upward pressures were beginning to be experienced for that reason, weakening the entire system of coordinated wage fixing.17 In some of the other group of countries, notably in the Federal Republic of Germany and the United States, the aim was to reconcile fuller utilization of manpower resources with the high priority accorded to price stability by the electorate;18 that is, the object was to forestall price increases as full employment was more nearly realized.19 In either case, wage restraint could plausibly be presented to the wage earners as necessary for maintaining full employment in a world in which there were strong pressures for price stability.

During the late 1950s and early 1960s, when prices of internationally traded goods were not increasing, price stability was a not unrealistic goal for any one country. Primary product prices were tending to decline, while export prices for manufactures were virtually stable. There were two main reasons for this. One was that a number of countries were still in the position of having considerable underutilization of the labor force (allowing for excess manpower in low-productivity agricultural and service sectors) and were expanding industrial employment under the stimulus of expanding exports, in some cases aided by highly favorable exchange rates at the going level of wages (e.g., the Federal Republic of Germany, Italy, Japan, the Netherlands,

16 Ibid., Ch. 1, p. 5. See also Council on Prices, Productivity and Incomes (1961), pp. 25-29.

17 Kervyn de Lettenhove (1965).

18 The highly influential framework of guidelines in the Economic Report of the President for 1962 clearly relates to a situation of less than full employment, as it refers to industries in which there is usually an excess of manpower.

19 Policies during this period are described in the ECE Study of 1967, Ch. 4. See also Pen (1963) and (1964) on the Netherlands; Johnston (1963) and Faxen (1964) on Sweden; Phelps Brown (1966), Fels (1972), Ch. II, and Dorfman (1973) on the United Kingdom; Kienzl (1966) on Austria; and Dunlop (1966), Sheahan (1967), and Ackley (1972 a) on the United States.

©International Monetary Fund. Not for Redistribution
Norway, and Finland). The second reason was that the United States under the Eisenhower administration was giving to price stability a high priority, and unemployment there was increasing. Despite expansionary measures, unemployment remained high until the later 1960s.\textsuperscript{20}

The maintenance of price stability in industrial countries was, of course, facilitated by the gradual improvement in the terms of trade over most of the 1950s and 1960s owing to declining prices for primary products. Declining prices for basic commodities make it possible for the aggregate level of prices not to increase even though wages and salaries are rising somewhat faster than productivity and profit margins are maintained. Alternatively, price stability can be achieved, and real wages can rise in line with productivity, even though some shift to profits is taking place. Of particular importance, for countries that are heavily dependent on imported food and raw materials, is the fact that declining primary product prices may make it possible to stabilize the cost of living, even though unit labor costs and prices of many industrial goods and services are rising. Thus, the effect of large wage increases in inducing further increases to compensate for the resulting rise in the cost of living can be avoided. Consequently, even the stabilization of primary product prices would make it more difficult to avoid price inflation, while rapidly rising commodity prices would tend to provoke an accelerating rate of inflation.

The goal of incomes policy during this period was essentially to modify the working of the existing system, with the least possible interference with the market mechanism, by strengthening underlying forces of competition, which, it was presumed, could be revived or brought into play. In most countries, interest centered on moderating wage increases rather than on limiting price increases directly because prices in general were relatively stable. Recent experience made it not implausible to suggest that if unit labor costs were prevented from rising, prices could be stabilized by aggregate demand policies. Indeed, in some countries declines in profit margins were actually seen as posing a risk that private investment would decline, and hence that the expansion of employment opportunities would be reduced. In addition, it seemed more feasible to restrain increases in pay rather than increases in prices because of the smaller number of decisions involved. Formal collective bargaining was the predominant factor in wage and salary determination; hence, the rate of increase was effectively decided by a manageable number of

\textsuperscript{20} Lindbeck (pp. 307-308) and Johnson (p. 319) in the panel discussion, “World Inflation,” in Stabilization Policies in Interdependent Economies, ed. by Claassen and Salin (1972—cited elsewhere in these footnotes as “World Inflation.”)
bargaining units, with changes occurring relatively infrequently—rarely more than once a year. Therefore, "no great administrative apparatus is required. Even the imposition of statutory control would not prove too overwhelming an administrative task." On the other hand, it was generally held that "the number of significant price fixers is too large for control through a few organizations or a small administrative machine."  

Within a few years this view had been reversed in the light of changing circumstances, and by 1971 we find the Organization for Economic Cooperation and Development (OECD) declaring that "basically, it is apparent that incomes are, in many countries, less amenable to institutionalised systems [of control] than prices."  

RECENT YEARS

Stronger measures of incomes policy were adopted by several countries that were faced with severe balance of payments problems in the late 1960s. The British Government established a mandatory incomes policy in 1965 in an effort to avoid devaluation, taking legal powers to prohibit or postpone increases in pay and prices. Finland instituted a comprehensive national incomes policy after devaluing in 1967. In 1969 Canada set up an independent Prices and Incomes Commission, which attempted to organize a comprehensive package of income restraint; although the unions opposed the wage guidelines proposal, large businesses undertook to limit price increases in 1970. The Netherlands, Denmark, and some other countries made use of price/wage freezes, power to prolong wage agreements, and other measures in an attempt to curb a marked acceleration of the rate of price increase. The experience of the United Kingdom and the reports of the Prices and Incomes Board had a considerable influence on the price/wage policy adopted in the United States in 1971.

21 ECE (1967), Ch. 1, p. 12.
22 OECD (1971 b), p. 36. For an interesting account of the problems of implementing incomes policy at the plant level in the United Kingdom, see Clegg (1972).
23 Fels (1972), Ch. 3; David C. Smith (1968 a); ECE (1967), Ch. 4, pp. 17–20; OECD (1970), pp. 86–88; Ulman and Flanagan (1971), pp. 17–23; Blackaby (1971); Balfour (1972 a); Hunter (1973); Mitchell (1972); Roberts and Rothwell (1972); Jones (1973).
27 For details of the U.S. stabilization program over the period August 15, 1971 to April 30, 1974, see the various Economic Stabilization Program Quarterly
By 1971, direct measures of price restraint were in force in nearly all the industrial countries, a wage freeze had been implemented in the United States, and wage increases were postponed or limited by direct government intervention in Finland, Ireland, the Netherlands, and Norway. Such intervention in price and wage decisions lessened when demand pressure eased in 1972 but again became widespread in 1973. (See Chart 1.)

The increased emphasis on controlling prices in recent incomes policies reflected several important changes in the context in which the policies were implemented.

First, and most important, in the inflationary world situation (not altogether unlike the situation at the time of the Korean war) it could no longer be assumed that the general level of prices within an economy could be stabilized if average unit labor cost was prevented from rising. It became impossible to specify a guideline for wages and salaries without allowing for the effect of rising prices abroad. Second, under full employment conditions, changes in pay had ceased to be so strongly determined by formal collective bargaining on a national basis, and wage bargaining no longer appeared to be more amenable to restraint than pricing decisions. Third, the events of 1968 in France affected the climate for wage decisions, strengthening the aggressiveness of labor and making employers' organizations and governments elsewhere in Europe unwilling to risk provoking a similar confrontation by policies that curbed wages rather than prices. Fourth, evidence was emerging that expectations about future price increases, particularly on essential living items, were a major determinant of union wage claims. If, therefore, prices could be stabilized (or their rate of increase reduced) then large demands would be more likely to be moderated. In these circumstances, a government commitment to try to control the cost of living was an essential element in the winning of trade union support for a prices and incomes policy.

After mid-1968, influences from the external sector ceased to be a factor restraining the rate of price increase and became strongly inflationary. For countries other than the United States, the major factor was the change in the U.S. situation as the result of the acceleration of the Viet-Nam war and the incurring of large budget deficits. However, the effects of this change were enhanced because it coincided with a cyclical

---

Reports issued by the Cost of Living Council. See also Bosworth (1972) and (1974); Doeringer (1972); Weber (1973); Dunlop (1974 a) and (1974 b); Hamilton (1974); and Mitchell and Weber (1974).

29 Sellier (1971).

©International Monetary Fund. Not for Redistribution
CHART 1. SELECTED OECD COUNTRIES: CALENDAR OF DIRECT ACTION ON PRICES AND INCOMES, 1970–73

upturn in Europe and Japan and occurred at a time of pronounced secular change in the climate and practice of wage bargaining in many countries outside North America. Because of these latter factors, the sharp rise in U.S. demand for imported manufactures, especially durable goods, and the steep rise in raw material prices had a stronger and swifter impact on the level of prices and wages in the other industrial countries than would have occurred in the late 1950s or early 1960s. The weakening of monetary restraint by heavy inflows of capital, induced by exchange rate speculation and encouraged at times by interest rate differentials, also contributed to strengthening the upward pressure on costs and prices. As a result of these developments outside the United States, the restraining influence of foreign price movements on price and wage increases in the United States was also lessened.

The United States has a uniquely important role in the international system as by far the largest, and therefore the most independent, unit of control in the system. Before the integration of the Common Market, financial restraint in the United States imposed a powerful constraint on the rate of wage increase in other industrial countries under fixed exchange rates. By the mid-1960s, however, the European market had become an integrated area of trade comparable in importance with the United States, but conditions in that market were far less susceptible to control by the authorities, as no single authority was responsible for a coordinated financial policy. Thus, even had the need for action been recognized, it was inherently difficult to achieve a coordinated response when the weakening of restraint in the United States urgently required concerted measures to forestall the upsurge of inflationary tendencies in other industrial countries.

Meanwhile, an important secular change in wage-fixing practices was occurring with the shift of bargaining power from the union headquarters to workers at the plant level. This shift, which represents a factor of fundamental importance for the implementation of incomes policy, was apparent during the late 1960s in nearly all the Western European countries, except the United Kingdom, where it had occurred earlier. The change was less significant in North America and Japan, where collective bargaining has traditionally taken place between unions and particular enterprises.

Most authorities agree that the shift in bargaining power came about in part because workers were less afraid of losing their jobs and therefore were more prepared to strike (or work to rule, etc.) at the plant level. Another important factor was the dissatisfaction of wage earners

31 Albeda (1971); Reichel (1971); Delamotte (1971); Giugni (1971).
with union policies of moderation in wage bargaining.\textsuperscript{33} Moreover, the change in the attitude of wage earners was conditioned by the changed situation of the enterprise in an economy where the authorities have successfully fulfilled a commitment to maintain a low level of unemployment for a number of years. This context justifies the belief that the enterprise will concede wage increases because it has the "capacity to pay" higher wages without necessarily losing business (thereby reducing employment). If the firm is a large producer and "price leader," it may be ready to concede wage increases and raise prices because other firms are likely to raise their prices in line when it does so, especially if their scope for expanding output is restricted by the difficulty of hiring much additional labor. Or, a firm may do so simply because it knows that, under full employment conditions, other firms are, or soon will be, subject to similar wage pressures.\textsuperscript{34}

By the early 1970s, there was a tendency to write off attempts at incomes policy as a failure. This was, perhaps, natural, since incomes policies had broken down or been abandoned in the United Kingdom, Canada, Finland, and the United States; and coordinated wage fixing continued only in the face of extreme tensions in the Scandinavian countries, while national wage fixing under compulsory arbitration had virtually collapsed in New Zealand\textsuperscript{35} and seemed to be evolving into something more similar to collective bargaining in Australia.\textsuperscript{36}

The disillusion was partly due, however, to judging the policies by inappropriate standards. Ulman and Flanagan, for instance, concluded that "incomes policy, to generalize from the experience of the countries studied . . . has not been very successful." Their accumulated experience suggests "that in none of the variations so far turned up has incomes policy succeeded in its fundamental objective, as stated, of making full employment consistent with a reasonable degree of price stability."\textsuperscript{37}

This objective is unlikely to be attained in an open economy at full employment under fixed exchange rates unless the external situation is one of stable or falling prices. In an inflationary external situation, what Harry Johnson has referred to as the basic fallacy of incomes policy philosophy, the closed economy assumption, becomes clear. One must

\textsuperscript{33} Wildcat strikes in the United Kingdom, France, Italy, the Federal Republic of Germany, Sweden, and elsewhere were sometimes directed against the central union negotiators as well as against the employers. Ulman and Flanagan (1971), pp. 236–37.
\textsuperscript{34} Romanis (1967), pp. 174–75.
\textsuperscript{35} Holmes (1971).
\textsuperscript{36} Isaac (1972); Braun (1974).
\textsuperscript{37} Ulman and Flanagan (1971), p. 216.
conclude, therefore, that the late 1960s and beginning of the 1970s was an exceptionally unpropitious period for incomes policy if its success is to be judged by this criterion.

III. Strengthening International Transmission of Inflation

It is important to recognize the changing context of incomes policy produced by the growing "openness" of the industrial economies. The influence of conditions in the international market for industrial goods on wage developments can be visualized as increasing progressively from the end of World War II until the adoption of flexible exchange rates in 1973. During the immediate postwar period, the international market was fractured by high tariffs and direct controls imposed by most industrial countries: imports of nonessentials were severely limited, and much trade was carried out under bilateral agreements. Even for essential manufactures, such as capital equipment, "the market" was, in general, limited to the home country. Thus, for the time being, wage decisions were largely insulated from the influence of current price developments abroad; and in this regard, the world consisted of virtually closed economies.

As long as the industrial economies approximated "closed economies," measures to limit the rise in wages and salaries in any one country were likely to be effective in checking price increases. If wages and salaries rose no more than average productivity, aggregate money demand was prevented from rising much faster than real output, provided that the authorities avoided large budget deficits or excessive credit expansion, and the average level of prices and profit markups was likely to be maintained. When trade barriers were reduced, the influence of international prices on price movements within the national markets was at first comparatively slight because national markets were not fully penetrated by foreign products and because domestic producers were not conscious of, or capable of, quickly seizing export opportunities.

During the early 1950s, conditions were conducive to the rapid development of a high-productivity export sector in countries where the lack of investment during the War and destruction of the capital stock had created abnormal possibilities of raising output per man by new investment, while there were also exceptional constraints on wage claims in the form of abnormally heavy unemployment, the inflow of refugees, the inflow of refugees,

38 In the immediate postwar years, however, there was an exceptional complicating factor in the form of large pent-up liquid personal savings in some countries, notably the United Kingdom and the United States.
and the wartime suppression of the unions in some countries. At the exchange rates prevailing after the devaluations in 1949, unit wage costs in industries utilizing new, technically advanced equipment were very low in relation to world market prices set in dollar terms. High profit margins on exports permitted continuing heavy investment and the expansion of high-productivity, capital-intensive industries dependent on export sales. (Export prices needed to be only slightly below those of major producers in the United States and elsewhere in order to secure a growing share of markets. Hence, profit margins continued to be high, there was scope for continuing economies of scale, and a high rate of investment was maintained.)

The second phase of strong interest in incomes policy in the early 1960s occurred during a period of unusually strong competition in the international market for manufactures resulting from the coming into production of much new capacity in Western Europe and the Far East; the liberalization of direct controls and tariff reductions; and the creation of the European Economic Community and consequent efforts of firms within the area to enlarge their markets, and of foreign concerns to establish themselves within the area. "Collusive" pricing behavior was limited by the struggle to acquire dominant positions in the markets that had been newly opened up. Easy labor market conditions and the weak collective bargaining position of newly organized or reorganized labor unions in many countries, such as the Federal Republic of Germany, Japan, Italy, Taiwan, and Hong Kong, were conducive to price competition. As the scale of exports from these countries grew, their price competitiveness became an increasingly important factor in restraining price increases in other centers of production.

During the late 1950s and early 1960s, wage movements over a widening "open" sector of each economy came to be directly influenced by demand conditions and price movements in international markets. As long as substantial unemployment, underemployment in agriculture and distribution, and weak organization and bargaining power of labor existed in some important industrial countries, the growing integration of the world market was a factor tending to lessen inflationary tendencies in other industrial countries.

The relatively weak forces of cost-push in certain countries led to a tendency for their currencies to become, or remain, undervalued, and for those of other industrial countries to be overvalued. For some considerable period, therefore, the regime of fixed exchange rates enabled certain countries, which gave a high priority to price stability and shunned expansionary budgetary and monetary policy, to raise the level of
employment under the stimulus of favorable exchange rates. At the same time, those countries that accorded a lower priority to price stability, and were prepared to protect the level of employment by expansionary financial policies, were shielded from inflationary repercussions and prevented from applying unduly expansionary policies by the rise in net imports associated with expansionary policies. The balance of payments constraint on these economies was not oppressive, however, as long as the production, income, and imports of the former group, and of the industrial world in general, were expanding rapidly.  

With the absorption of unemployed and underemployed manpower and the strengthening of cost-push forces in the former group of countries, the integration of the industrial economies ceased to have an important moderating influence on the rate of inflation in most industrial countries. By the late 1960s, the general economic setting had changed, following the maintenance of a high degree of manpower utilization throughout the industrial countries for some years and with the adaptation of pricing behavior and wage-bargaining institutions and practices to the expectation that full employment would be more or less continuously maintained. Less strong competition now prevailed in the international market under generalized full employment and stronger unionization. Consequently, there was a greater risk that a temporary increase in the pressure of demand for certain industrial goods, or a raising of prices by producers in a major economy affected by inflationary pressures, would be reflected in a generalized price rise in the international market, which, in turn, would lead to an upward movement of costs in the open sectors of most economies (under the combined influence of external pricing conditions and domestic cost-push forces).

In a world of fixed exchange rates and of confident expectations of the maintenance of full employment in the industrial countries, employers in the open sector will tend to judge the "room" for wage increases by the growth of productivity and the movement of prices for their products in the international market. That is to say, the movement of prices for competing foreign products both in the domestic market and in export markets. Enterprises with access to export markets and exposed to foreign competition in the domestic market would be unlikely to cut back prices in that market when domestic demand was restrained by the authorities, if export markets were buoyant. Foreign enterprises

39 Romanis (1965).
40 Firms will generally be disinclined to charge prices that are much below the going rate, or to keep down prices when other producers are raising prices, unless they can foresee being able to expand output and employment considerably without causing the existing level of wage rates to rise.
competing in the domestic market also would have little incentive to initiate price reductions because demand in a single market was weak, although they would most probably match price reductions initiated by domestic producers, or by other exporters to the market, in order to protect their share of the market (which represents an asset acquired by investment in advertising, sales organization, and management time). The likelihood of this occurring would be a deterrent to price reductions. In effect, oligopolistic pricing behavior would now be liable to extend over the area of the international market.

Under these conditions, measures of demand restraint in any one country, with the exception of the United States, are likely to have a slight impact on price and wage developments in the open sector of the economy. That effect will be dispersed over the much wider area of the international market, in the form of some easing of demand and intensification of competition between suppliers, tending to restrain the rate of price increase to a slight degree. Easier conditions in the domestic labor market are unlikely to have a marked effect in reducing the size of wage claims, given the existence of powerful labor unions in the open sector. It also seems unlikely that firms will radically change their behavior with respect to such wage claims; for instance, that they will be much more insistent on preventing their unit labor costs from rising if prices in the international market are foreseen to be increasing. To achieve that result would seem to require the exchange rate to be altered. With fixed exchange rates and integrated markets, measures of monetary and fiscal restraint implemented in the face of strong international demand conditions will impinge mainly on the sheltered sector, in areas such as construction, public utilities, domestic transportation, local and central government, and public services.

The power of the authorities to restrain wage and price increases in the “sheltered” sector had also weakened in many countries by the late 1960s, as a consequence of the strengthening of the bargaining power of wage earners with the absorption of underemployment and the establishment of more powerful labor unions in these fields. The fact that

---

41 Because of its larger size, the United States is a much more important component of the international market than any other industrial country, and a less open economy.

42 The ultimate tendency for all wages to move upward in line with wages in the open sector in a small economy where the whole labor force is organized in a strongly coordinated union movement and the open sector is dominated by large high-productivity enterprises is exemplified in the Scandinavian model of wage movements (Aukrust, 1970; Edgren, Faxen, and Odhner, 1969).

These authorities suggested that under fixed exchange rates and strongly coordinated wage bargaining, the rate of wage increase in the “exposed” sector should rise approximately in line with the increase in labor productivity in that
prices in international markets were under less competitive constraint than formerly further increased the difficulty of restraining wage and price increases in the sheltered sectors. When prices are rising quite rapidly in the international market, domestic restraint will soon disturb the relative level of wages and salaries in the open and sheltered sectors. Mounting pressures for catching up with pay in the open sector and militant action in key industries and services may eventually result in large wage increases, leading to a round of cost-push apparently originating in the sheltered sector. After a period of restrictive financial policies, housing shortages and inadequacies of basic urban services and social infrastructure are also liable to force a relaxation of monetary and budgetary restraint.

The wage explosion in recent years can thus be seen in large part as the outcome, under the existing system of fixed exchange rates, of the exceptionally strong demand conditions that prevailed in the international market in 1968–69 and again in 1972–73; first as a result of the coincidence of a resurgence of the Viet-Nam war and excess demand conditions in the United States with a cyclical upturn in Western Europe and Japan, and later as a consequence of expansionary measures simultaneously applied in almost all industrial countries following measures to restrain demand and curb price increases in late 1971 and early 1972. During the early 1970s, large wage increases in the open sectors of these economies had more effect than hitherto in inducing similar wage claims sector plus the increase in world market prices for its products, in order to leave the exposed industries “reasonably competitive” (Aukrust, 1970, p. 38). (In other words, employers should resist wage claims that would require larger price increases than were occurring in the world market prices if their existing percentage markups for depreciation and profits were to be maintained. The reasoning was apparently that enterprises needed to maintain the existing markups to be sure of maintaining their competitiveness (by investment, promotion efforts, etc.) vis-à-vis foreign concerns that were presumed to be following the same rule.) Wages would increase at much the same rate in the sheltered sector, and since average profit margins there tended to be maintained, the rate of price increase would be determined by the rise in world market prices for the “exposed” sector and the difference between the rate of productivity growth in the two sectors (Lindbeck, 1972, pp. 252–53).

The Scandinavian model of wage determination illustrates the incompatibility with price stability of income distribution goals involving the maintenance both of the share of wages in income generated in the open sector and of relative wage and salary levels between sectors, even when world market prices are stable. Such goals clearly expose the economy to a risk of substantial domestic price inflation should world prices for industrial products rise. Although the published versions of the model appeared as late as 1969, when the external constraint on the “exposed” sector had greatly weakened with strong demand conditions and rising prices for durable goods in world markets, they contain almost no reference to this danger. Both studies are shot through with the idea that the “exposed” industries are facing stiff competition. (“If their costs increase, they must sustain the whole effect in the form of reduced profits,” Aukrust, 1970, p. 8.)
in other sectors, owing to the secular changes in the bargaining position of wage earners referred to earlier. Measures of demand restraint impinging most heavily on sheltered sectors could only temporarily contain pressures for matching wage increases there, often at the cost of subsequent unrest and eventual large percentage increases, which in turn generated higher expectations concerning possible rates of wage increase throughout the economy.\textsuperscript{43}

In these circumstances, national authorities faced a choice, provided that a balance of payments deficit was not a critical constraint. They could maintain a fixed rate of exchange and accept the tendency for wages throughout the economy to rise at a rate approaching the rise in per capita productivity in the open sector plus the rate of price increase for industrial products in the international market, this implying a substantially higher rate of increase in the general level of prices within the economy. Or, they could seek to maintain domestic price stability by absorbing the "room" for wage increases in the open sector in excess of the average rise in per capita productivity within the economy by allowing the exchange rate to appreciate.

The present problem of intractable world-wide inflation might possibly have been mitigated if the industrial countries, other than the United States, had agreed upon a joint appreciation of their currencies vis-à-vis the U.S. dollar in 1969.\textsuperscript{44} Many influences worked against such a solution, however; notably, the opposition of powerful interests in the open sectors of the economies; the unwillingness of deficit countries to weaken their balance of payments position vis-à-vis the United States; and the reluctance of central banks to see a reduction in the real value of their international reserve holdings. Furthermore, the U.S. balance of payments was strengthened temporarily by heavy capital inflows induced by restrictive monetary policy in 1969. Another influence of some importance was the fact that the consequences of international integration, in rendering wage developments less susceptible to control by the national authorities, had as yet been masked by the unusually strong forces of

\textsuperscript{43} "Britain provides a very clear example of this. Attempts to restrain wage movements in the public sector (a sheltered sector) between 1971–72 eventually resulted in a coal miners' stoppage (1972) which was settled by the awarding of a 25 per cent wage increase. This resulted in a general increase in the level of wage settlements during 1972 and in November of that year the Government was forced to introduce a statutory wage freeze followed by a gradual relaxation. The relaxation was more freely applied in the "open" sectors of the economy than in the sheltered sectors. Attempts to prevent wage increases in this sector matching the "open" sector again led to a coal miners' stoppage (1974) and the end of statutory wage restraint." (Professor B. C. Roberts in correspondence with the author.)

\textsuperscript{44} Johnson (1969).
competition prevailing in international markets during the early and middle 1960s.

In the absence of a coordinated change in exchange rates, the authorities sought to curb inflationary pressures originating in the external sector by monetary and fiscal policies impinging on the domestic level of demand and by enforcing direct controls on wage and price increases. The isolated appreciation of the deutsche mark (accompanied only by the Dutch guilder) led to intensified external pressures on its trading partners and competitor countries, whose domestic costs and prices were not out of line with those in the Federal Republic of Germany. The evident disparities in the development of disposable real income produced by these policies were an important factor in exacerbating the climate of wage and salary determination in the early 1970s.

IV. The Case for Incomes Policy

THE PRESENT CONTEXT

The early 1970s was a period of intense controversy among economists concerning the problem of stabilization in an open economy. Growing awareness of the inflationary impact of international conditions led to calls for measures to control the growth of international liquidity and to enforce greater discipline through balance of payments constraint; and for the use of exchange rate appreciation as a weapon against "imported inflation." Although incomes policies were implemented in several countries, including the United States, some economists dismissed the need for such policies on the grounds, first, that inflation was a purely monetary phenomenon, caused by the laxity of control over the world money supply, and was "not a matter of various political and sociological problems, even though in many individual countries these factors may be deduced as an explanation of the particular sequence of events or mechanism"; \(^{45}\) and, second, that inflation itself was not a serious economic problem requiring to be corrected, except insofar as a faster-than-average rate of inflation produced a balance of payments deficit. That problem could be solved by flexible exchange rates.

The argument that the rate of inflation was not necessarily a matter of concern rested on the belief that "the institutional mechanisms of a society based on freedom of choice and competition will, if the system of contract is reasonably flexible and inflation not too erratic, act to

bring about the elimination of major inflationary injustices." Once the rate of inflation is correctly anticipated. That happy situation did not, of course, apply in the period following the onset of more rapid inflation in 1968–69. As the monetarists themselves emphasized, in the initial phase of inflation the rate of inflation is likely to be held down by “the persistence of belief in the stability of prices”; thereafter, for a period, the rate of inflation will be enhanced by “the effects of growing belief in the continuance of inflation in reducing the demand for real balances.”

In this instance, the change in the climate of expectations occurred at the same time as institutional changes conducive to stronger and more generalized inflation. Given levels of employment were now associated with higher rates of increase in prices and money incomes, which, if not validated by the monetary authorities, were liable to give rise quickly to marked problems of unemployment in particular sectors of the economy. Thus, it had become more difficult for the monetary authorities in many countries to enforce restraint. Consequently, the incentive to alter the exchange rate, or to permit it to vary as a means of protecting the economy from inflationary pressures abroad, had strengthened by the time that the realignment of rates took place under the Smithsonian agreement at the end of 1971, and when fixed rates were subsequently abandoned.

It is too early to assess the impact of flexible rates on the industrial countries’ efforts to control inflation. Recent price developments have been affected not only by the all-pervasive effects of the extraordinary increase in oil prices and by reduced supplies and higher prices for foodstuffs but also by the correction of misalignments of international price levels at the exchange rates ruling when flexible rates were adopted; possibly also by lack of expertise in operating a new system. It is clear, however, that rapid inflation remains a cause of political and economic disturbance, and that its control poses an urgent problem.

Nor is it possible here to review the results achieved by incomes policy in particular countries over the past three decades. The reader is referred to the literature, notably Roberts (1958), Edelman and Fleming (1965), David C. Smith (1966), Turner and Zoeteweij (1966), the ECE Study of 1967, the OECD Study of 1970, Ulman and Flanagan (1971), and Fels (1972).

A growing number of econometric studies have attempted to measure the results achieved by incomes policy in moderating the rate of price

48 See pp. 12–13 and 16–18.
and wage increase, by comparing the rate of change during periods when the policy was or was not applied. While these analyses have been valuable in advancing economists' knowledge of the behavior of prices and wages over the whole economy, few if any of the studies can be treated as a reliable measure of the actual results achieved by incomes policy. Most of the aggregative models employed are not able to capture all the other influences affecting the rate of price (or wage) change sufficiently well to justify the interpretation that the difference in the observed relationship with explanatory variables during "policy-on" and "policy-off" periods solely reflects the influence of the incomes policy. In many cases too little attention has been paid to the way in which shortcomings of the wage and price series used affect the results. Moreover, the brief historical account given here suggests that an econometric assessment of countries' experience of inflation will need to allow for the effect of changes in the organizational framework and industrial structure within the country, and of changes in the degree of integration with the international market, in causing the basic price and wage equations to change over time.

Some broad conclusions can be drawn here. It seems clear that, despite breakdowns, failures, and even at times perverse effects in worsening the inflationary climate and enhancing the rate of increase in prices and wages, incomes policy in its various manifestations was a valuable instrument for the economic authorities. In a number of European countries, incomes policy contributed to the attainment of full employment and to the maintenance of relative price stability for lengthy periods, facilitating the achievement of a high rate of investment and consequent rapid rise in productivity and real income, and aiding in the maintenance of political stability. In many other instances, incomes policy provided a temporary measure of restraint through price and wage freezes, controls, provisions for justification of particular increases, or even merely by a well-timed effort to influence public opinion. There were occasions, however, when the temporary success in holding down increases resulted in a buildup of pressures, producing an upsurge of inflation when the policy was lifted (or collapsed).

Commentators agree that the impressive performance of the Dutch economy in terms of rapid growth despite limited natural resources, reasonable price stability, low cyclical and structural unemployment, and considerable narrowing of income differentials represents an achievement of democratic economic planning to which the successful implementation
of wage and price policies contributed greatly, at least up until 1963. Even in recent years, management of the economy has been made easier, in times of crisis, by the possibility of re-activating the institutions and the legal powers to control prices and wages still left to the Government.

For more than a decade after 1956, the Swedish system of centralized national wage bargaining, with carefully specified provisions for arbitration in cases where agreement could not be reached, constituted an important element in the realization of the policy goals of minimal unemployment, moderate price inflation, rapid growth of productivity, and rising real income, and greater equality of income distribution, especially through the provision of pension benefits and health insurance. In Norway, incomes policy based on similarly centralized bargaining but with direct participation by the Government in the process, enabled the authorities to keep the rate of unemployment generally below the European average and to secure steady and rapid economic growth. In the absence of coordinated incomes policy, the same degree of pressure on resources would probably have resulted in considerably more inflation, as seems evident from the much larger wage increases and substantial labor unrest experienced in those years when decentralized bargaining applied.\(^{51}\)

The experience of Finland, however, shows that centralized wage bargaining in itself is no panacea for inflation, if conditions for achieving a consensus favoring moderation of claims are lacking.

The results achieved by recent price/wage controls in the United States are the subject of controversy between the proponents and opponents of government intervention. It is generally agreed that the controls had a significant effect in restraining wage increases in particular sectors, notably construction and health care; \(^{52}\) and that the measures had an effect in reducing the average rate of inflation during 1971 and 1972, although the magnitude of the reduction is uncertain because the rate of inflation was already declining when controls began.\(^{53}\) In 1973, when controls were first relaxed and then intensified, and when the increase in prices was more than twice as large as in 1972, the Council of Eco-

\(^{51}\) OECD (1971 a).
\(^{53}\) The Economic Report of the President (1973) described the purpose of the controls as being to reduce the risk that the rate of inflation would rise again and to increase the probability of a further decline, so as to enable the Government to follow a more expansionary policy (p. 53); it concluded that the controls had made "a very significant contribution" in this respect during 1971 and 1972 (p. 62). "The fact of the controls, plus their initial success, had reduced inflationary expectations, held down total spending, restrained the tendency to boost wages and prices, and permitted output to rise more rapidly than it would otherwise have done" (Economic Report of the President, 1974, p. 99).
nomic Advisers found it "more difficult to believe" that they had had a significant effect in reducing the rate of inflation. The faster rise in prices was, however, due mainly to sharp increases for food, fuel, and primary commodities that were not subject to control. The administration was reluctant to claim that controls had an effect in moderating wage increases during 1973; but first-year increases in wages and fringe benefits under major collective bargaining settlements were actually smaller in 1973 than in 1972. In the opinion of Professor J. T. Dunlop, formerly Director of the Cost of Living Council, "the existence of controls in place also significantly restrained inflation when the international price surge suddenly developed from the oil embargo in the fall of 1973 . . . . The impact more generally on wages and prices was of a small but perceptible order. For the longer run many of the most significant effects of controls are likely to be in the area of structural changes" in industrial relations.

The role of labor market structure in determining the feasibility and effectiveness of incomes policy as a continuing instrument can hardly be overemphasized. The existence of strong central organizations, or representative bodies, of the labor unions and employers was a major factor in making possible the consistent implementation of wage and price policy for lengthy periods in the Netherlands and the Scandinavian countries. In Australia and New Zealand, the compulsory arbitration system provided a similar factor of continuity. In countries where such powerful institutions did not exist—notably, the United Kingdom—it proved difficult to maintain a consistent course in the pursuit of price and wage stability. Thus, although incomes policies in the United Kingdom were distinguished by their inventive use of new institutions and devices, the results achieved in total were disappointing. For this reason, proposals for institutional changes bulked large in discussions of incomes policy in the United Kingdom during the late 1960s and early 1970s.

Phelps Brown's proposals for a "workable incomes policy" provide an informed view of the problem of implementing an incomes policy. He stated the basic considerations as follows:

54 Ibid.
55 The average increase, excluding increases resulting from cost of living escalator adjustments, was 7.1, compared with 8.5 in 1972 and 13.1 in 1971 and 1970 (Dunlop, 1974 a, p. 466).
57 Phelps Brown actually stated the object of his proposals as "to improve on the present system of collective bargaining so as to provide means of pay-fixing that will do more to meet" such requirements as the avoidance of cost inflation; equity for the individual employee and a say in fixing his own terms of employment; the adjustment of differentials in accordance with the job requirements; and adjustment of the broader pay structure in accordance with macroeconomic and social considerations (Phelps Brown, 1972, pp. 31–32).
(i) The greater the degree of self-government in the shaping and application of an incomes policy, the better the prospects of implementing it.

(ii) Those who take part in reaching a settlement must have regard to its relation with other settlements, so that they can be satisfied that "fair relativities" are being observed.

(iii) A breakthrough by a particular group will generate pressure, perhaps on a wide front. Legal prohibition of wage increases exceeding some norm is undesirable, but deterrents short of that are needed, if they can be found.

(iv) Incomes policy must be brought to bear at the points where the effective decisions are taken; in large-scale private industry, the effective bargaining units have become the firm or the plant: incomes policy must reach down to wage fixing on the shop floor, and must put managers under effective pressure to keep wage structures and labor costs under control.\(^{58}\)

(v) The number of firms is too large for such a policy to be applied to them all. The solution may be to control wage decisions in major negotiating units, say, those affecting at least 5,000 employees.\(^{59}\)

(vi) Detailed price control is cumbersome. It can be readily evaded unless there is extensive and close inspection. However, an early warning system for price increases, with discretionary power to refer proposed increases for investigation and to delay them pending report, can provide a useful deterrent to unnecessary or excessive price increases and can help to establish a code of price behavior. While the policing of prices in most firms is not practicable except as an emergency measure, it should be possible to secure the adherence of larger firms and public bodies to the code of price behavior.

(vii) There is a great advantage in the implementation of incomes policy by a standing and independent body, with a specialized staff and the ability to follow a flexible approach, case by case. No general norm should be promulgated.\(^{60}\)

Phelps Brown advocated that policy for wages and salaries covered by major negotiating units should be determined by a small tri-partite council, composed of independent members appointed on a permanent footing by the government and of representatives of the wage-bargaining parties, elected by an assembly, composed of one representative of each

---

\(^{58}\) Clegg (1972) also emphasizes this point.

\(^{59}\) In Great Britain about 300 such units would include large firms, the nationalized industries, public administration, the Agricultural Wages Board, and the Wage Councils for other industries, and would cover about one third of all employees.

\(^{60}\) Dunlop (1974 b) is of a similar opinion.
side from each major negotiating unit. The assembly would receive and 
debate reports from the council but would have no legislative or execu-
tive functions. The independent members of the council, who would be 
qualified by experience in industrial relations or by specialized knowl-
edge, would formulate policy for modification or acceptance by the coun-
cil. The council would also direct the work of a permanent staff, who 
would maintain liaison between the council and negotiating units; it 
would also investigate and report on specific cases concerning pay or 
prices.

The machinery advocated by Phelps Brown may be thought of as 
tending to produce a wage-bargaining situation similar in some respects 
to that existing under centralized bargaining in Sweden, combined with 
elements of the Australian compulsory arbitration system. A basically 
similar system was outlined for the United States by Gardner Ackley in 
August 1972.

TOWARD A SOCIAL CONTRACT

Not surprisingly, the direct results of incomes policy in restraining the 
rate of wage and price increase were more apparent in the early postwar 
period than in later years, when the forces making for the international 
transmission of inflation had become more powerful. The fact that 
policies then had little apparent effect in moderating the current rate 
of inflation does not, however, preclude the possibility that incomes 
policy measures commanding some degree of popular support never-
theless had a psychological effect in lessening the buildup of inflationary 
expectations and conflicts. In some countries the whole climate of income 
determination worsened dramatically after efforts to achieve an incomes 
policy were abandoned; this does not always seem to have been the 
result of pent-up pressures accumulated while the price/wage policies 
were in force. It would appear that the long-run benefit derived from 
popularly supported measures of incomes policy consists not only of the 
moderation of the rate of inflation that may be achieved but also of the 
contribution that the existence of the policy can make to the smoother 
working of the political and economic system. However, there is no

61 Professor Dunlop, in his illuminating lecture on recent U.S. experience with 
price and wage controls given at Monash University (October 1974), cites exam-
pies of improvement in the collective bargaining structure for an industry as a 
result of a wages stabilization scheme. In his view, wage restraint cannot be 
concerned exclusively with holding down the current rate of increase in compen-
sation. "Wage stabilization is also concerned with changes in the structure of 
collective bargaining, in the development of voluntary dispute settling machinery, 
in encouraging the joint study and introduction of new technology and changes 
in work rules, in the development of new sources of wage and benefit data for
doubt that incomes policy is an instrument that demands extremely skillful management—an essentially political art—as well as a correct appreciation of the economic circumstances in which the policy is being applied and of the limits that these circumstances set for the policies to be pursued.

At current rapid rates of price inflation and substantial unemployment, there is growing recognition of the threat that inflation poses to the political and economic institutions of the industrial world, and of the need to utilize any available measure that may serve to lessen inflation without increasing unemployment. Although the results achieved by incomes policy in the last few years have not been striking, there are grounds for supposing that present circumstances may be more conducive to its success. "The record suggests that [incomes policy] may operate most efficiently in the short run under conditions of excess supply. Then it might help to hold down wage and price increases in an economy short of full employment." Moreover, under the regime of flexible exchange rates, an economy that does succeed in moderating the rate at which domestic costs and prices are increasing can be insulated against the effect of inflationary developments elsewhere by an appreciating exchange rate.

Two somewhat different uses of incomes policy are now envisaged in the industrial countries, depending on the time-horizon involved. In North America especially, incomes policy is generally regarded as an essentially short-term weapon, involving temporary intervention by the government aimed at forestalling or reversing increasingly inflationary price expectations. Inflation is treated, by economists at least, as an economic phenomenon that arises from such causes as the lagged effect of mistakes in fiscal management, the impact of external price movements, and special factors such as the rise in oil prices and large wheat sales that may impinge on the generally satisfactory working of a neoclassical competitive economy. In many European countries, however, cost inflation is not regarded as merely the outcome of efforts to ward off the effect of rising prices on real income but is seen as an essentially political phenomenon, resulting from deliberate attempts by various organized groups to secure a larger share of the national income.

the parties, and a host of other activities which over the long run will improve the quality of collective bargaining and create a less inflation-prone sector of the economy. . . . in my experience a better job of short-term restraint can in fact be accomplished if the stabilization agency is genuinely assisting the parties in a particular industry or sector to approach systematically problems which they previously have ignored or patched up temporarily" (Dunlop, 1974 b, pp. 18–19).


Ibid., p. 217.
Hence, as Christopher Saunders has pointed out, “It is evident that incomes policy cannot be regarded simply as an instrument of economic management, short-term or long-term, on the same plane as monetary policy. It is political, in the widest sense.”

When rapid inflation represents the means of resolving the competing claims of different groups to real income while avoiding open political conflict (at least for the time being), the antidote of an incomes policy must comprise deliberate efforts to devise and to utilize institutions for working out a compromise between the competing claims of the various income groups. The case for some form of indexation of wages and financial claims needs to be considered in this connection. The former would be a means of assuring partial protection of real income in the face of price increases and of encouraging a deceleration of wage claims when price increases moderate under the influence of easier demand conditions and greater stability in commodity markets. The latter would support investment by protecting borrowers from the risk of having to pay much higher real interest rates should the rate of price increase slow down but nominal interest rates not be adjusted downward.

The vitally important ingredient of public support for an incomes policy compromise as the lesser evil may be forthcoming for various reasons. There is widespread dislike and fear of the dislocations, tensions, and uncertainties of an inflationary economy, per se; and in industrial countries, groups adversely affected by inflation often wield considerable political power. Hence, the possibility of “stop-go” government policies or the imposition of direct price and wage controls exists as a threat to both sides of industry. Despite maintenance of full employment, in open economies wage and salary earners may cooperate for fear of sectoral unemployment or of reduced real earnings resulting from balance of payments difficulties. Business interests may support an incomes policy involving some restraint on prices or profits because they fear disruptions to production, wildcat strikes, and unrest at the plant level; or because they are aware of the risk of a political wage explosion, such as occurred in France; or fear a shift in the political climate against business, strengthening left-wing influence in government, or threatening political stability. When a labor government is in office, labor organizations may collaborate because they wish the gov-

65 Ulman and Flanagan (1971), pp. 255–56; Isaac (1973). Isaac also points out the need to revise progressive income tax schedules to take account of the effects of inflation in raising nominal incomes, causing higher rates of tax to become payable at a given level of real income. “The pay packet contains pay net of tax, and in their wage demands it is with this that the workers are concerned” (p. 253).
ernment to remain in power, and business may collaborate because it is afraid of government intervention in pricing and wage decisions. When a business-oriented government is in office, business may take the initiative in incomes policy (as the Confederation of British Industry did under the last Conservative government). Thus, essentially, there is a process whereby checks and balances of political power may enforce restraint in a democratic system with power divided between two or more major income groups.

Under normal conditions, it might be held that such coordinated income-determination procedures would leave insufficient scope for the working of market mechanisms. But under the highly abnormal conditions of the present time, with the need to secure the "winding-down" of the current rapid inflation and the attainment of viable balance of payments positions in the face of the large aggregate current account surplus of the oil-producing nations, it is doubtful whether market mechanisms can be trusted to operate swiftly enough or necessarily in the right direction. One benefit of an incomes policy approach involving coordinated negotiations of increases in wages and salaries and other incomes in this setting is precisely that it provides a locus where the problems facing the economy can be discussed, and where the authorities can seek to inform and to bring pressure to bear on parties concerned. The practice of central bargaining means that overall economic and social considerations cannot be excluded from the settlement as they can where bargaining is conducted industry-by-industry, or with individual enterprises. Such a system means that the representatives of different groups are enabled and forced to grasp the issues, and they are in a position to influence unions' and employers' attitudes. Hence, the system may have the advantage that government policy and business decisions are more closely meshed and more consistent with each other than they would be otherwise.

Greater exchange rate flexibility represents a new context for incomes policy, which needs to be taken into account in framing such measures but does not eliminate the need for incomes policy. An appreciating rate will serve to protect the country that is relatively successful in avoiding domestic cost pressure from the impact of more rapid inflation abroad. However, in those countries that experience a more rapid rise in domestic costs and prices, the depreciation of the exchange rate will protect the economy from a worsening of the balance of payments on current account but will increase the difficulty of restraining the rate of price increase. Particularly if imports of food and other essential consumer goods constitute a large component in the cost of living, feedbacks
from the effect of depreciation on the cost of living will be liable to induce sustained, or even accelerating, cost-push inflation. The desire to put an end to this frustrating process may provide a powerful inducement for the support of a coordinated system of wage and price restraint. A strong motivation for incomes policy may also arise from the need to forestall the threat of adverse movements on capital account occasioned by fears of a weakening of the exchange rate brought about by some especially unfavorable development of domestic costs or industrial unrest, etc. In order to permit the maintenance of a satisfactory balance on capital account under flexible exchange rates, it may be essential to restrain cost-push forces sufficiently to avoid widespread fear of a large unforeseen decline in the exchange rate.

BIBLIOGRAPHY

I. Descriptive Studies of Incomes Policies and Selected Theoretical Articles


Campolongo, Alberto, Incomes Policy, ed. by Mediobanca (Milan, April 1966).


Clegg, Hugh, How to Run an Incomes Policy and Why We Made Such a Mess of the Last One (London, 1971).


©International Monetary Fund. Not for Redistribution


—— (1972 a), Inflation and the Monetarist Controversy (Amsterdam, 1972).


Massé, Bloch-Lainé and Marselin, Rapport sur la situation des salaires du secteur nationalisé, La Documentation Française (March 1963).


National Board for Prices and Incomes (London), *General Reports*, 1966–71, Cmnd. 3087, August 23, 1966; Cmnd. 3394, August 31, 1967; Cmnd. 3751, July 25, 1968; Cmnd. 4130, July 29, 1969; and Cmnd. 4649, April 29, 1971—Fifth and Final Report. (For references to other NBPI Reports, see Fels, *The British Prices and Incomes Board*.)


———, "Lessons for Britain from European Experience," in *An Incomes Policy for Britain*, ed. by Blackaby (1972), pp. 89-98.


II. Selected Econometric Studies of the Effects of Incomes Policy


