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WAGE AND PRICE POLICIES IN AUSTRALIA, AUSTRIA, CANADA, JAPAN, THE NETHERLANDS, AND WEST GERMANY

A STUDY

PREPARED FOR THE USE OF THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

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LETTERS OF TRANSMITTAL

JUNE 21, 1982.

To the Members of the Joint Economic Committee:

Transmitted herewith is a volume of essays entitled "Wage and Price Policies in Australia, Austria, Canada, Japan, The Netherlands, and West Germany," prepared by the Congressional Research Service as part of the committee's broad examination into cures for inflation.

The chapter on Australia was prepared by Raymond Ahearn, Specialist in International Trade and Finance; Austria and The Netherlands by David Driscoll, Consultant in International Economics; West Germany by Arlene Wilson, Specialist in International Trade and Finance; Canada by Julius W. Allen, Economic Consultant, Economics Division; and Japan by Dick K. Nanto, Analyst in International Trade and Finance.

Each of these countries supplement traditional anti-inflation macroeconomic policy with explicit or implicit wage and price policy, designed to minimize the social and economic costs imposed by deflationary economic policies—policies which only succeed in moderating inflation by creating substantial excess productive capacity and unemployment.

The views expressed in this volume are those of the authors and do not necessarily represent the views of the Joint Economic Committee or of its members.

Sincerely,

HENRY S. REUSS,
Chairman, Joint Economic Committee.

JUNE 15, 1982.

Hon. HENRY S. REUSS,
Chairman, Joint Economic Committee,
Congress of the United States, Washington, D.C.

DEAR MR. CHAIRMAN: Transmitted herewith is a collection of essays entitled "Wage and Price Policies in Australia. Austria, Canada, Japan, The Netherlands, and West Germany." The study was conducted by the Congressional Research Service of the Library of Congress at the request of the committee. The collection was coordinated by William Cox and John Henderson.

The papers review the policies utilized in recent years by these six mature capitalist democracies to moderate wage and price increases. In combination with hearings held by the committee on wage and price policies in Austria (June 2, 1981) and Scandinavia (October 20, 1981), this study provides an extensive background of information on the use of wage and price policies to moderate inflation. Because these policies do not impose massive unemployment, social dislocation, stagnating investment and productivity, and declining real growth, they are more cost-effective than conventional macroeconomic policies alone.

Sincerely,

JAMES K. GALBRAITH,
Executive Director, Joint Economic Committee.

FOREWORD

By Chairman Henry S. Reuss

This volume, "Wage and Price Policies in Australia, Austria, Canada, Japan, The Netherlands, and West Germany," attempts to fill a void in the analysis of comparative economic systems.

Traditional deflationary monetary and fiscal policies work only slowly and inefficiently to moderate wage and price pressures. In the postwar period, wages and prices have increasingly become rigid downward. As the late Arthur Okun described this reality of today's economy, participants in the price-setting and taking process are unresponsive to short-term fluctuations in demand and supply. As a result of what Okun termed "implicit contracts" or "invisible handshakes," employers and employees, suppliers and customers act to reinforce and stabilize their long-term relationships. They price their services and purchases to maintain existing commercial relations, rather than always selling at the dearest or buying at the cheapest price. The result is the insulation of wages and prices from market forces in all but severe circumstances.

Wage and price inflexibility downward has rendered the use of a deflationary monetary policy to moderate inflation grossly inefficient and wasteful, for that approach only works by disrupting market relationships and forcing market participants into crisis. Yet time and again in recent decades, Administrations and Federal Reserve Boards of Governors have launched assaults on inflation with contractionary monetary policies alone. Their effect can be measured by the wasteful excess production capacity, unemployment, and foregone income which these policies created. Wage and price moderation was won only through the fear of diminishing profits on the spectre of unemployment.

The disruption in economic activity due to the workings of this system—excessive interest costs and credit rationing by lenders—falls very unevenly across society as well. Interest-sensitive sectors, such as small business, housing, autos, agriculture, and capital investment, bear the brunt of tightening credit and rising interest, while some large firms enjoyed both conitnued access to ready credit and the ability to pass rising interest costs on to others. In labor markets, the brunt of anti-inflationary tight money policies falls on the unskilled, women, and minorities with the least seniority protection.

This pattern is being repeated by the current Administration. The result is a sharp rise in excess capacity and in unemployment to record postwar levels. More, the Administration's present economic policy mix presents a greater threat than did earlier postwar episodes of deflationary monetary policy. The present blend of extraordinarily expansionary fiscal policy and tight monetary policy ensures that real short- and long-term interest rates—after adjustment for inflation—will remain far above traditional levels. In turn, these rates will limit the scope of any economic recovery which may occur, severely limit prospective market growth for goods and services, and extinguish hopes for a resurgence of capital investment and productivity growth. The Administration has thus planted the seeds for another decade of economic stagflation, and for a further diminution in the role and prestige of the United States on the world stage.

It is easy enough to fault a failed policy. To devise a blend of polices to modearte inflation more efficiently is the greater challenge. Over the last 20 years, Democratic and Republican Administrations have adopted a variety of incomes policies which have not carried the enormous cost of traditional contractionary macropolicies.

There is not much scope for optimism in these experiments. But neither do they establish that wage and price or incomes policies have no value in controlling inflation.

We have long needed a careful, thorough review of incomes policies to assess what role they may hold as a cost-effective supplement to macropolicies in combatting inflation. As a first step in this review, the committee has looked abroad for information on incomes policies. This selection of papers and committee hearings held on June 2, 1981, and October 20, 1981, are the first results of that exercise. Incomes policies in most Western societies contain three key features:

They have been an effective complement but not a substitute for macroeconomic stability. Their ability to offset the inflationary effects of external monetary and terms-of-trade related events is limited at best.

A climate of cooperation and consensus is more important than any specific institutional incomes policy framework involving market participants or the government.

Many institutional frameworks are compatible with successful incomes policies. But, some specific institutional features such as annual wage bargaining and standby authority to control certain prices, appear to be most helpful.

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Chapter I. WAGE AND PRICE POLICY IN AUSTRALIA

By Raymond J. Ahearn*

INTRODUCTION

During the 1950s and 1960s, Australia enjoyed a long period of noninflationary and generally stable economic growth. Specifically, from 1952 through 1960, inflation (as measured by the Consumer Price Index) averaged 2.7 percent per year, the unemployment rate fluctuated between 1.0 and 2.0 percent, and the economy grew at an annual rate of 4.9 percent. Between 1961 and 1970 inflation averaged 2.3 percent per year, the unemployment rate averaged about 1.5 percent, and the economy grew at an annual average rate of 5.3 percent.[1] In comparison with other OECD countries, Australia's price performance (as measured by the GDP deflator) was significantly below average during a substantial portion of these periods and only Germany enjoyed a significantly lower average level of unemployment.[2]

After these two decades of noninflationary growth and low rates of unemployment, Australia began experiencing acute difficulties in the 1970s. As in most other OECD countries, inflation accelerated, economic growth slowed, and unemployment rose. Both in Australia and around the world, the dual problem of inflation and unemployment took on a new and intractable dimension.

From 1970 through 1972, Australian inflation increased to 5.9 percent per year, the unemployment rate averaged 1.8 percent and the rate of economic growth fell slightly to 4.5 percent per year.[3] The economy deteriorated sharply from 1973 through 1976. During this period, inflation increased rapidly to over 14 percent per year, the unemployment rate averaged 3.0 percent (and increased to more than 4 percent in 1975 and 1976) and the average annual economic growth rate fell to 2.6 percent.[4] Contractionary fiscal and monetary policies helped to moderate inflation to about 10 percent in 1977, but the reduction was associated with a renewed downturn in economic activity. Although the economy experienced a modest recovery in 1978, inflation and unemployment pressures have persisted. In fact, from 1975

*Specialist in International Trade and Finance, Economics Division.

[1] Jolley, Ainsley. Macro-Economic Policy in Australia. London, Croom Helem,. 1978. p. 241–242.
[2] OECD Economic Surveys. Australia. December 1972. p. 16–17.
[3] Jolley, op. cit., p. 242.
[4] Ibid.

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through 1980, inflation (as measured by the CPI) has averaged close to 11 percent and the unemployment rate has fluctuated between 4 percent and 6 percent.[5] Since the mid-1970s and continuing today, the Australian economy has remained trapped in a stagflationary straightjacket, characterized by low levels of output, double-digit inflation rates and unacceptable levels of unemployment.

The Government has attempted to deal with stagflation partially through tight fiscal and monetary policies and currency devaluation. In Australia, there is no incomes policy that sets maximum wages and prices, accompanied by penalties for transgressions. However, there is a national wage determination system which establishes minimum wage levels and influences the general wage level, and a short history of attempts to limit price increases. Australia's experience with wage and price policy is the focus of this report.

I. Wage Policy in Australia

The Arbitration System

Since the early 1900s, wages and working conditions have been influenced by findings of independent Federal and State tribunals created to arbitrate industrial disputes. Although the arbitration system was created to deal with industrial disputes between employees and employers, the system has evolved into a tribunal for formulating and applying a national wages policy. The effectiveness and impact of the system on the level and structure of wages are today issues of national debates.[6]

The most important of the tribunals is the Australian Conciliation and Arbitration Commission (hereafter referred to as the Commission). This body has the function to settle, through compulsory arbitration, disputes ". . . extending beyond the limits of any one state . . ." Since the Commission can be involved only in interstate industrial disputes, the employers and unions must create such a dispute to initiate a national wage case which provides general increases in minimum wages for various categories of employment. These minimum levels are called awards. Federal awards or determinations take precedence over State awards if the two are in conflict.[7] Although an award constitutes the legally binding minimum wage for a particular line of work, there is nothing to prevent negotiations for higher wages or special conditions giving rise to "overaward" payments. Thus, collective bargaining influences the wages of many employees who are covered by arbitration awards.

Almost 90 percent of all employees are directly affected by State or Federal awards. By custom or for legal reasons, decisions of the Commission tend to set national standards and are reflected in the decisions

[5] Various issues of Australian Government publication entitled Treasury Round-up of Economic Statistics.
[6] In April 1981, the Government announced the establishment of a commonwealth inquiry into the wage determination system and industrial relations. The inquiry is charged with looking into alternative systems, including free collective bargaining.
[7] OECD, Australia, 1972, p. 82–87.

of the State tribunals. State tribunals tend to follow closely the determination of the Federal Commission.[8]

Early in its existence the Commission (then called the Court of Conciliation and Arbitration) formulated the concept of a basic wage, based on the principle of the *needs* of an average family man. The basic wage was essentially a minimum wage for unskilled workers. Over time, a change in the basic wage affected the wage of all workers, skilled and semi-skilled alike, and thus constituted a movement in the general wage level. As a means of maintaining the purchasing power of the basic wage, quarterly *indexation* was formally adopted in 1922. This involved automatic increases (or decreases) in the basic wage in accordance with changes in retail prices. (Indexation was kept in effect until 1953. It was again adopted in 1975 and once more abandoned in 1981).

In addition to the basic wage, skilled and semi-skilled work and work involving special requirements was paid a margin above the basic wage component. The determination of margin awards involved the principle that the relative pay of different jobs should correspond to their relative requirements in skill, training, responsibility, etc. Margins were varied less frequently than the basic wage, representing less concern over the effects of inflation on the purchasing power of skilled and semi-skilled workers. As a result, in inflationary periods, the wage relativities between the unskilled and more skilled workers tended to decrease.[9] In 1967, the Commission abolished the distinction between a basic wage and margins. It formulated a "total" wage award for every job classification in national wage cases.

In determining the total wage, the Commission moved away from a criterion based on "need" toward one based on what the economy could afford to pay. But the later concept has never been precisely defined. Although the Commission considers economic evidence in its deliberations, it has explicitly refused to interpret capacity to pay in terms of the increase in money wages compatible with price stability. In effect, the major economic standard utilized by the Commission in the past has been increases in the cost of living.

The Commission justifies its position on two grounds. First, although it has become a de facto wage-setting body, the Commission has no control over other measures (e.g. prices, profits, level of aggregate demand) that would make the policy fully effective as an instrument of national economic policy. In addition, as mentioned above, a substantial portion of wage increases take place outside the arbitration system in the form of *over-award* payments. Secondly, the Commission's statutory function is the prevention and settlement of industrial disputes. It is limited as to sanctions it can apply to enforce its wage determination decisions. Thus, the Commission must be primarily concerned with the acceptability of its decision by the relevant parties. In cases where unions fail to accept the award, strikes can and often do occur.

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[8] Ibid.
[9] Perry, Len. Wages and the Australian System. In Veale, John M. ed. Australian Macroeconomics. Prentice Hall of Australia, 1980. p. 66.

Effects of the Arbitration System: 1970–75

The effect of the arbitration system on wages, prices and the distribution of income is a key issue in Australian economic policymaking. During the 1950s and most of the 1960s, a period of stable growth, low inflation, and low unemployment, arbitration system appeared to work well. Between 1953 and 1965, for example, the nominal minimum weekly wage rate increased at an annual rate of 3.1 percent and the consumer price index rose by 2.2 percent. Real wages, thus, increased during this period by less than 1 percent, which was well below the productivity trend of 2.5 percent.[10]

Difficulties began to appear in the late 1960s and early 1970s when wages and prices began to rise at a very fast rate, culminating in the wage and price explosion of 1974. As shown in table 1, sharp increases in average weekly earnings (W), which had registered around 4.5 percent in the 1960s, began in 1969. Similarly, the consumer price index (P), which had averaged 2.5 percent in the 1960s, more than doubled by 1971 to 6 percent. The OECD concluded that the proximate cause of accelerating price inflation was wage inflation, first mainly through "wagedrift" (rising over-award rates and overtime) and, from late 1970, increasingly through wage awards made by the arbitration authorities.[11]

Government efforts in 1972 to fight inflation through fiscal and monetary restraint solidified simultaneously with a leveling off of investment. Consequently, economic growth slowed and unemployment, though still moderate, rose to its highest level in a decade. The OECD maintains that restrictive demand policies helped arrest the acceleration of inflation, but that cost-push inflation intensified and peaked in

TABLE 1.—INDICATORS OF ECONOMIC ACTIVITY, 1966–78

[In percent]

Period	W [1]	P [2]	WR [3]	WA [4]	DR [5]	U [6]
1966	4.82	2.98	1.79	4.14	0.65	1.57
1967	6.69	3.19	3.39	5.80	.84	1.88
1968	6.32	2.65	3.58	5.97	.33	1.83
1969	8.71	2.92	5.63	6.85	1.74	1.82
1970	8.46	3.91	4.38	5.76	2.55	1.65
1971	12.37	6.06	5.95	13.01	−.57	1.91
1972	8.19	5.87	2.19	10.19	−1.82	2.61
1973	12.47	9.47	2.74	14.32	−1.62	2.31
1974	22.49	15.11	6.41	31.06	−6.54	2.67
1975	18.46	15.07	2.95	20.87	−1.99	4.90
1976	14.51	13.51	.88	15.17	−.57	4.77
1977	10.16	12.31	−1.91	11.21	−.91	5.63
1978	8.77	7.92	.79	6.61	2.03	6.41

1 W=percentage rate of change in the annual value of average weekly earnings for each calendar year.
2 P=percentage rate of change in the annual average value of the Consumer Price Index for each calendar year.
3 WR=percentage rate of change in real average weekly earnings, where WR=(W−P)100÷100+P.
4 WA=percentage rate of change in annual average value of male and female award wage rate for each calendar year.
5 DR=earnings drift, where DR=(W−WA)100÷100+WA.
6 U=the percentage of the labor force unemployed; annual average for each calendar year.

Source: Perry, Len. Wages and Arbitration—Some Australian Aspects. In Veale, John M., ed., Australian Macroeconomics, p. 73. Prentice-Hall of Australia.

10 Downing, R. I. The Australian Economy. London, Winfield and Nicholson, 1973. p. 156–157.
11 OECD, Australia 1972. p. 44.

1974 when increases in average weekly earnings (W) and award wage rates (WA) ballooned to 22 percent and 31 percent respectively (see table 1).

Most strikingly, the increase in real wage rates (WR) in 1974 reached 6 percent, a level far in excess of productivity growth. Table 2 documents that Australia's gap between real wage and productivity from 1972 to 1975 was the largest among OECD countries. Such large increases in real wages over productivity growth undoubtedly placed a severe strain on the economy. Some analysts further argue that the growth of real wages outstripping productivity advances contributed significantly to subsequent higher levels of unemployment.[12]

TABLE 2.—REAL WAGES AND PRODUCTIVITY GROWTH OF REAL WAGES MINUS THE GROWTH OF PRODUCTIVITY, TOTAL CHANGE SINCE 1972 PERCENTAGE POINTS [1]

	Up to 1975	Up to 1976
United States	0.4	−1.1
Germany	3.5	1.9
Switzerland	4.1	3.4
Sweden	5.9	12.6
Netherlands	6.6	2.7
Italy	7.0	8.4
Canada	8.0	10.6
France	8.3	9.3
Belgium	8.8	7.5
United Kingdom	10.9	8.8
Demark	12.0	10.8
Finland	12.2	13.7
Austria	13.6	11.8
Japan	13.7	9.4
Australia	14.6	11.8

[1] The growth of productivity is adjusted for changes in the terms of trade.

Source: OECD. Economic Survey of Australia. April 1978, p. 18.

Three factors, all related to the nature of the arbitration system, are commonly set forth as partial explanations of the 1969–1974 period of rising wages. First, the total wage system established in 1967 was more inflationary than the old system. As discussed above, the new total wage system applied wage adjustments to all categories of employment, whereas the previous system, although it adjusted the basic wage annually and sometimes less frequently, adjusted margins for skilled and semi-skilled workers even less frequently. This meant that under the pre-1967 system the real wages of skilled and semi-skilled workers declined during inflationary periods, which tended to dampen the wage-price spiral.[13] The post-1967 system, however, does not have the dampening effect.

The second factor concerns the resistance of employees to changes in relativities or wage gaps between industries or skill categories. As relatively unskilled workers are awarded a wage increase, relatively more skilled workers are motivated to agitate for wage increases to compensate for the relative deterioration in their position. The force of coercive comparison is strong in Australia because of the high concentration of workers in a few cities, which facilitates the spread of information and a high percentage of union membership over a wide

[12] Perry, Wages and Arbitration, p .72.
[13] Ibid., p. 67.

area of employment, thus enlarging coverage of wage settlements.[14]

A third factor explaining the sudden and rapid wage inflation during 1969–1974 relates to an increase in agreements reached between employees and employers outside the national arbitration system. Although the settlements were eventually ratified by the Commission, the process arguably intensified the campaign of other wage groups to increase their wages.

Wage Indexation: June 1975–August 1981

As previously mentioned, from 1923 through 1953, the Commission (then the Court) operated a system of automatic quarterly adjustments of minimum wages based on changes in the consumer price index. Partly as an adjunct to the Court's decision to switch from a need criterion to a capacity to pay criterion for wage determination cases, the Court dropped indexation. According to the Court, changes in the price level did not necessarily indicate an increase in the capacity of an industry to pay higher wages. The Court added that automatic quarterly adjustments had contributed to inflation and that abolition of indexation would contribute to greater community expectations of price stability.

After indexation was dropped, unions frequently complained that their real wages were being eroded by inflation. With the acceleration of inflation in the early 1970s, proponents of wage indexation began to argue that its restoration was necessary not only to maintain real wages, but also to reduce inflation. Full indexation, it was now argued, would reduce the rate of inflation when the actual rate was less than the expected rate on which successful wage demands were based. Furthermore, it was maintained that in an inflationary environment in the absence of indexation, workers would ask for large wage increases to insure against the worst possible price increase.[15]

Despite the fact that the Commission had abolished wage indexation in 1953 in order to create greater expectations of price stability and despite the fact that indexation was not made part of an overall package, the system was reinstituted in April 1975. Beginning in April 1975 the newly instituted system indexed wage increases every quarter (which was changed to every six months beginning in 1980) to the most recent movement in the consumer price index.

Table 3 presents the results of the 18 decisions under wage indexation. Full indexation was granted in six of the eighteen cases and partial indexation in the remaining 12 cases. According to the OECD, the extent of indexation has been higher than the Government has supported on general economic grounds.[16]

Opinions differ on the impact of indexation on inflation. One view is that indexation has reduced cost-push inflationary pressures. Cited in support of this view is the decline in real wages after 1975 (see table 2). The opposite view is that indexation has intensified inflation and unemployment. Data supporting this view include continuing

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[14] Nieuwenhuysen, John P. and J. Sloan. Wages Policy in Australia. In Gruen, F. H. ed. Surveys of Australian Economics. Sydney, George Allen and Unwin, 1978. p. 96.

[15] Ibid., p. 100.

[16] OECD Economic Surveys. Australia, June 1980. p. 48.

high levels of inflation after 1975 and an increase in the unemployment rate.

Whatever the real effects of wage indexation, the system was abandoned in 1981. The President of the Arbitration Commission announced in August 1981 the termination of wage indexation due to strikes in the telecommunications, transport, and auto industries. Moreover, because of widespread industrial strikes and disputes involving some 50,000 workers, the future of the Arbitration Commission is also at present unsettled. The Government in April 1981 in fact announced the formation of a national inquiry into the whole wage determination system. Free collective bargaining, with market forces being allowed to determine wage rates, is the system supported by the Australian Treasury.[17]

The main argument in favor of retaining the arbitration system without indexation is that its elimination would create immense uncertainty during a return to collective bargaining and might lead to an acceleration of wage increases. On the other hand, a more flexible and decentralized system might encourage workers to move from inefficient sectors such as manufacturing to more profitable sectors such as construction, mining, and mineral processing.[18]

TABLE 3.—DECISIONS IN NATIONAL WAGE CASES

Quarters	CPI change (percent)	Change in award wages (percent)	Effective indexation rates
March 1975	3.6	3.6	100
June 1975	3.5	3.5	100
Deptember 1975	.8		
December 1975	5.6	6.4	100
March 1976	3.0	(1)	72
June 1976	2.5	(2)	68
September 1976	2.2	2.2	100
December 1976	6.0	(3)	57
March 1977	2.3	(4)	77
June 1977	2.4	2.0	83
September 1977	2.0	1.5	75
December 1977	2.3	(5)	55
March 1978	1.3	1.3	100
June 1978 to September 1978	4.0	4.0	100
December 1978 to March 1979	4.0	3.2	80
June 1979 to September 1979	5.0	4.5	90
March 1980 to September 1980	4.7	4.5	95
October 1980 to March 1981	4.5	4.2	93
April 1981 to September 1981	4.5	3.6	80

[1] 3 percent up to $125 per week $3.80 flat rise above that.
[2] 2.5 percent up to $98 per week; $2.50 up to $166 per week; 1.5 percent above that.
[3] Flat $5.70 per week.
[4] 1.9 percent up to $200; than flat $3.80.
[5] 1.5 percent up to $170 per week; flat $2.60 per week above that.

Source: OECD. Australia. OECD Economic Surveys. June 1980, p. 47. Updated with data from Treasury Round-up of Economic Statistics.

II. Price Policy

In the early 1970s, as the pace of inflation accelerated, a recurrent trade union concern was that wages, but not prices, were subject to regulation. The Labor Party position was articulated by Gough

[17] Financial Times (London). June 25, 1981. p. 3.
[18] Australian Economic Review, Fourth Quarter, 1980. p. 3.

Whitlam prior to the November 1972 general election: "We will establish a Prices Justification Tribunal not only because inflation will be the major economic problem facing Australia over the next three years, but because industrial cooperation and goodwill is being undermined by the conviction among employees that the price of labor alone is subject to regulation and restraint".[19] Thus, the Labor Party support for surveillance over prices rested on an implicit belief that it would slow down inflation and would contribute to harmonious industrial relations.

Subsequent to the election of a Labor Party Government in December 1972 (which ended 23 years of Liberal-Country coalition rule), a Prices Justification Act was enacted on June 1, 1973. The Act established a Prices Justification Tribunal to monitor prices and proposed price increases by major companies. The Tribunal became operational on August 1, 1973. The jurisdiction of the Tribunal applied to all companies whose sales during the previous year were greater than $20 million.[20]

All companies covered by the Act were required to inform the Tribunal of intended price increases. The Tribunal was required to notify the company within twenty-one days if it proposed to hold a public inquiry. If it decided to do so, the Tribunal had three months to submit a report. In its report, after all public investigations had been completed, the Tribunal made a determination whether the proposed price increase was justified.

The Act provided no guidelines as to what constituted a justified price increase, but the Tribunal, in carrying out its functions, developed certain guidelines and criteria. The most important guidelines for considering a price increase were the following: (1) the cost increases, upon which a price rise was based, must have actually occurred, but not all cost increases (e.g. advertising, or those due to inefficiency) were allowable; (2) the cost increases should be unavoidable (e.g., extravagant wage increases were considered avoidable); and (3) highly profitable companies might be asked to absorb a greater percentage increase in costs.[21]

Table 4 lists the 45 public inquiries undertaken by the Tribunal from August 1, 1973 through June 30, 1975. As can be seen, the Tribunal in only 6 cases failed to reduce the proposed increase by more than 10 percent. In most of the cases, the reduction was substantially greater. The figures, however, do not provide the basis for concluding that inflationary pressures were restrained. The majority of requests for price increases did not trigger a public investigation (e.g., the first 2,000 requests led to only 9 public investigations). In addition, company requests for price increases could be made on a frequent basis.

Amendments to the Tribunal's operations in 1976 and 1979 watered down its mandate from a price justification body to a price surveillance and inquiry body. In April 1981, the Minister for Business and Consumer Affairs announced that it would introduce legislation to abolish the Tribunal. However, a new Petroleum Pricing Authority would be established to monitor petroleum product prices.

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[19] Nieuwenhuysen, John P. The Australian Price Justification Tribunal. Melbourne University Press, 1977. p. 5.
[20] OECD Economic Surveys. Australia. April 1974. p. 51.
[21] Nieuwenhuysen, John P. The Australian Price Justification Tribunal. p. 131–133.

TABLE 4.—PERCENTAGE PRICE INCREASES PROPOSED AND GRANTED AT PUBLIC INQUIRIES OF THE PRICE JUSTIFICATION TRIBUNAL TO AUGUST 1976

Notifying company	Price increase proposed by company	Increase approved by Tribunal	Proposed increase approved	Date of Tribunal report
BHP	9.42	5.50	58	Oct. 10, 1973
APM	6.75	6.00	89	Oct. 24, 1973
GMH	6.00	4.60	77	Dec. 21, 1973
South Australian Brewing Co.	3.20	2.40	75	Jan. 16, 1974
BHP	6.91	5.00	72	Mar. 28, 1974
CUB	3.10	1.80	58	Apr. 9, 1974
Cascade Brewery Co.	2.60	2.20	85	Apr. 19, 1974
Shell Securities	(1)	(1)	80	May 3, 1974
Bradmill	6.24	3.90	63	May 13, 1974
Tara Towels	9.85	4.43	45	Do.
Lever & Kitchen	5.60	3.80	68	Do.
Bunge	10.20	7.80	76	May 24, 1974
Swan Brewery	3.97	(2.10)	53	June 7, 1974
Kellogg	12.76	(6.70)	53	July 19, 1974
Southern Old Dairy				
E & T Industries	10.92	10.92	100	July 31, 1974
Mayne Nickless	18.00	12.00	67	Aug. 2, 1974
Brick and Pipe	(8.10)	(7.20)	89	Aug. 5, 1974
Alcoa				
Philips Industries Holdings	(2)	(2)	(2)	(2)
ACI	11.00	8.40	76	Aug. 20, 1974
GMH	6.73	5.10	76	Aug. 23, 1974
W. D. & H. O. Wills	1.80	0	0	Do.
J. Gadsden	9.53	9.00	94	Aug. 29, 1974
Arnotts	10.50	7.30	70	Sept. 2, 1974
John Fairfax & Sons	24.00	15.00	63	Sept. 13, 1974
H. J. Heinz	10.17	7.80	73	Oct. 3, 1974
Ready Mix (Products)	(1)	(1)		Oct. 7, 1974
Ready Mix (Cartage)	.80	.77	98	Do.
	1.35	.90	67	Do.
Bonds-Wear	13.46	9.10	68	Oct. 18, 1974
Tooth	5.50	4.30	78	Do.
Colgate-Palmolive	4.27	2.80	66	Oct. 30, 1974
Samuel Taylor	3.93	2.60	66	Do.
Nestle	14.87	13.24	89	Nov. 7, 1974
Berger Paints	11.70	(9.80)	84	Nov. 11, 1974
A & K. Cement	[3] 7.30	[3] 6.10		Nov. 14, 1974
Containers	2.12	2.12	100	Nov. 18, 1974
APPM	13.81	11.75	85	Nov. 19, 1974
Blue Circle Southern Cement	9.70	8.80	91	Nov. 29, 1974
Australian Estates	19.70	(1)		Dec. 10, 1974
BPH	8.45	7.82	93	Dec. 12, 1974
Austral Motors	1.34	1.34	100	Dec. 17, 1974
Caltex Oil	(1)	(1)		Feb. 27, 1975
Ampol Petroleum	(1)	(1)		May 5, 1975
Alcan Old	32.38	25.00	77	June 19, 1975
Radio Rentals			100	July 4, 1975
Thorn Holdings	13.66	13.66	100	
	14.81	10.00	67	July 4, 1975
BHP	14.00	10.50	75	July 28, 1975
Watsons Foods Holdings and subsidiary companies and others	8.00	4.23	53	Nov. 14, 1975
H. C. Sleigh	(1)	(1)		Dec. 23, 1975
Ford Motor Co. of Australia	3.86	3.72	96	Apr. 12, 1976
BP Austrailia, Ltd	(1)	(1)		Do.
Mount Isa Mines, Ltd				Aug. 11, 1976

1 Not available.
2 New product (average 3 percent below proposed price).
3 Plus timing costs.

Source: Nieuwenhuysen, John P. Melbourne University Press, 1977, pp. 36–27.

The Price Justification Tribunal and Inflation

Was the Tribunal a successful anti-inflation instrument? In its first annual report, the Tribunal claimed that it was. The report mentioned that about one out of eight of the notices of higher prices were partly or completely disallowed, and that the savings accountable to these reductions amounted to about $253 million. This figure represented slightly less than 1 percent of the value of non-government,

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private production at market prices at the start of 1973–74. On this basis the Tribunal argued that it had reduced the inflation rate during 1973–74 to 15 percent from a hypothetical 16 percent level.[22] However, any claims concerning the Tribunal's anti-inflation effects must be balanced against the possibility that many businesses, with eight month's prior notification of the decision to create the Tribunal, might have raised prices in anticipation of its establishment.

The effect of the Tribunal's work on inflation during the second year of its existence appears less positive. One analyst, in fact, determined that not only did the Tribunal do little to lessen inflation, but that it probably contributed to inflation. The view was that price increases sanctioned by the Tribunal made it easier for companies to apply price increases that otherwise would not have stuck in a depressed market.[23] In addition, the consequences of the price pressures on profitability must be considered. There is evidence to suggest that a profit squeeze occurred, leading to reduced investment, which may have led ultimately to higher prices.

Overall, any assessment of the impact of the Tribunal on inflation raises a number of difficult questions. To what extent did the price justification system increase the lag between cost and price increases? To what extent did the system lead to a reduction in profit margins in areas where they had previously been excessive? To what extent did the price system make wage restraints more acceptable? To what extent did the system increase the resistance of the Wage Arbitration Commission to grant excessive awards? Finally, to what extent would the inflation record have been different in the absence of the Tribunal?

III. Conclusion

Assertions that the centralized wage determination system in Australia and the short-lived activities of the Price Justification Tribunal served as a form of incomes policy are generally misleading. The primary function of the Wage Commission was to serve as an instrument of industrial relations and the Tribunal was designed for the purpose of monitoring price increases. Arguably, both institutions could have been utilized more effectively had there been a broader framework of an incomes policy. However, the Commonwealth government lacks the constitutional power to control wages and most prices. Interestingly, in 1973, a national refendum turned down a constitutional amendment to provide the government with such powers. (The "no" vote on price controls was 56 percent and the "no" vote on wage controls was 64 percent.)

Given the more limited functions of the Commission and Tribunal, observers provide varied views on their effectiveness. One analyst argues that the arbitration system helped to limit wage pressures in several ways:

> The whole procedure of wage determination by means of national basic wage and margins cases, and by means of arbitration in specific disputes, almost certainly exercised a greater degree of constraint on the scale of particular wage increases than would have applied under collective bargaining. At the same high

[22] Ibid., p. 209.
[23] Ibid.

level of employment, in the absence of compulsory arbitration there would probably have been more unrest and a faster increase in wages and prices in strongly unionized sectors than that which actually occured, coupled with a tendency for a real wages to decline in other lower wage sectors. Such a tendency might in turn have generated political pressures for the raising of low wage increases.[24]

Other analysts maintain that the range and frequency of wage settlements outside the Commission's purview undermined centralized control. Furthermore, in the wage settlements where the Commission had an impact, a wage floor rather than a ceiling was established. The wage floor arguably served as a benchmark from which negotiations outside the system would begin, thus leading to higher wage settlements than what otherwise might have been achieved.

The price justification mechanism encountered its own difficulties. An elaborate bureaucracy of 2,500 employees was created. Subjective judgments concerning exemptions and criteria for improving price increases were necessitated. An alleged advantage of the Tribunal to allow employers to stiffen their resistance to wage demands by threatening to refuse to allow the passage of excessive wage increases into higher prices never materialized, due in part to lack of coordination between the Tribunal and the Wage Commission. Most importantly, business was willing to tolerate the price policy only as the price for harmonious industrial relations. As strikes and disputes increased, support for the policy diminished.

A central challenge of wage and price policies appears to be in obtaining the restraint of producers and workers in the name of the public interest. Without agreement between unions and employers over the distribution of income and general acceptance on how wage and price policies might affect that distribution, the chances that such policies will help reduce inflation appear to be reduced. In Australia, the high growth of mineral and energy-based industries in recent years and a subsequent increase in the demand for skilled labor is an important factor undermining such an agreement.

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[24] Braun, Anne Romanis. Compulsory Arbitration As a Form of Incomes Policy: The Australian Case. International Monetary Fund Staff Papers, March 1974. p. 205.

Chapter II. WAGE AND PRICE POLICY IN AUSTRIA

By David D. Driscoll*

A small, relatively homogeneous nation (population: 7.5 million), with a well-educated workforce, a relatively diversified industrial economy, and a postwar tradition of social cooperation, the Republic of Austria enjoys distinct advantages in combatting inflation. Because virtually all basic industry in Austria is nationalized, the government as major or sole shareholder in many large enterprises can exercise an unusual degree of influence on wage and price policies in these sectors. But the chief advantage is perhaps an institution unique to Austria, the Joint Commission on Wages and Prices, with was established in 1957 and now represents the most sustained effort by an industrialized nation to restrain wages and prices. The Commission is more than an instrument of wage and price control: it has become a system of economic and social partnership. The Commission has been a major factor in achieving Austria's relatively low rate of inflation, the advance in real earnings, the maintenance of full employment, and the absence of debilitating swings in the Austrian economy over the past decade.[1]

The Commission has not, of course, been the sole cause of the relative economic stability Austria has enjoyed during the 1970s. Though this paper will concentrate on incomes and prices policy, the influence of monetary and fiscal policy and particularly the importance of exchange rate policies in stabilizing the economy during the turbulent 1970s should not be ignored. These other aspects of economic policy will be dealt with first.

Fiscal Policy

Between 1968 and 1974, the Austrian economy experienced very rapid growth in production, running at more than 5 percent a year with strong advances in both domestic and foreign demand. This growth was accompanied by an accelerating rise in the cost-of-living index, speeded by exogenous inflationary factors such as the introduction in 1973 of a value added tax of 16 percent, soaring world commodity prices, and, of course, the oil price hike. The Federal Government's fiscal response (embodied eventually in eight phases) to the inflationary surge of the early 1970s contained little that was novel or untried by other governments which had chosen restrictive fiscal policies to counteract inflation. The response consisted in cancelling or postponing federal expenditures, reducing subsidies, restricting loan

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[1] The Honorable Hans Seidel, Minister of State, Federal Ministry of Finance, has recently given testimony before the Joint Economic Committee on Austrian income policy. U.S. Congress. Joint Economic Committee. Austrian Incomes Policy. Hearings. June 2, 1981. U.S. Government Printing Office, 1981. p. 3–6.

and guarantee programs, encouraging the states (Laender) to invest in certificates issued by the Austrian National Bank, and freezing revenue transfers from the federal to state and local governments.

These fiscal attempts to dampen the economy were of course modified when the effects of the worldwide recession of 1974–75 forced the government to shift its fiscal policy to an expansionary stance. The shift from price to employment stabilization was accompanied by additional budget appropriations, an adjustment of income tax schedules to compensate for fiscal drag, an increase in family allowances to raise personal income, and the release of accumulated reserves to finance additional investment, mainly in construction. These measures led naturally enough to a rapid increase in the size of public debt. Consequently by 1977 the federal government reduced its net borrowing requirement, shifted its emphasis again from generalized support of demand to more selective stimulus of productive investment, and (on the revenue side) increased taxes and social security contributions.

Monetary Policy

In the early 1970s, the Austrian federal authorities attempted to gain stricter control over the money supply through the use of the Limes—a limit of 1 percent a month on expansion of bank credit.[2] As a secondary means of restricting money, the Central Bank also revised upwards the whole interest rate structure. The aim of these measures was to stabilize domestic interest rates, in the conviction that the elimination of wide interest-rate fluctuations would assist the orderly development of domestic credit markets. After 1974, worldwide inflation and increasing international mobility of capital made it difficult to continue this policy, so that maintaining a stable schilling exchange rate gradually replaced stabilizing domestic interest rates as the principal objective of monetary policy. To secure this objective, the Central Bank has emphasized the instruments of monetary policy such as credit ceilings, control of new bond issues, establishment of limits on deposit interest rates, and selective control of capital movements.

Exchange Rate Policy

The size of the external sector in the Austrian economy—exports and imports are equal in value to about a third of the gross domestic product—heightens the importance of exchange policy. Since the early 1970s, Austrian exchange rate policy has linked the schilling to a basket of European currencies. In mid-1976 this system was abandoned and the schilling was tied exclusively to the Deutsche Mark (DM), and it has remained through the intervention of the Austrian monetary authorities within a narrow band around the German currency. The schilling's relationship to the DM is very important because about one-third of Austria's foreign trade is conducted with Germany. Fluctuations in the schilling-mark exchange rate would have major effects on exporting and import-competing industries and on the domestic inflation rate.

[2] The Limes was introduced in 1972. The penalties for exceeding the Limes are an interest charge on the excess credit granted and the denial of refinancing facilities.

In sum, except for the fixed relationship of the schilling to the DM, nothing unusual nor particularly innovative can be found in Austrian fiscal and monetary approaches to cycles of inflation and recession. The federal government has had recourse to well-known fiscal and monetary controls, which it has applied with sound timing and apparently in the correct mix. The novelty of the Austrian approach lies not in unusual monetary or fiscal policy, but in its imaginative control mechanism on wages prices.

Wage and Price Policy

The Joint Commission for Prices and Wages has been the principal instrument of incomes policy since 1957. The Commission consists of delegates from four interest groups, two representing labor (the Trade Union Federation and the Chamber of Labor) and two representing employers (the Chambers of Agriculture and the Chamber of Industry and Trade).[3] The Commission reviews important requests for higher prices and higher wages and has the final say in their determination. The Commission operates in complete informality with no statutory authority and no direct means of enforcement. Because all decisions must be unanimous and must be arrived at within a specified time, the commissioners, despite differing constituent interests, have shown themselves flexible in modifying their demands and in searching for compromise solutions. Although the requirement of unanimity may seem harsh if not impossible, the system has worked for twenty-five years, indicating the determination of the commissioners to make it succeed. The economic vulnerability of Austria as a small country heavily exposed to international competition contributes to the willingness of the interest groups to collaborate for the common good. Furthermore, the relative ease of controlling wages and prices in nationalized industries (that is, most of the basic industries in Austria) constitutes another reason for the policy's success.

In contrast to the customary practice of agencies charged with incomes policy in most nations, the Commission has adopted no quantified guidelines for wage or price increases but deals with requests for such increases on a case-by-case basis. The Commission operates through two subcommittees, one on wages, the other on prices.

Wages Subcommittee

Wage claims proceed through several stages. A union wishing to revise its contract submits its request to the Trade Union Federation which processes the request to sift out demands it considers unreasonable. The Federation then submits the processed demands to the Sub-

[3] The so-called Chambers for Commerce, Labor, and Agriculture were established by law. Membership is compulsory and expenditures are financed by taxes. This type of interest group representation has no parallel in most other countries. In addition to these Chambers, workers are represented by the Federation of Trade Unions, in which union membership is voluntary. The tight union federation in Austria is a centralized organization which leaves less room for interunion competition than in most other countries: there are only 16 different unions. The Federation controls the finances of the unions; the methods by which members elect their representatives leave those officials free from direct rank-and-file pressure.

The Chamber of Industry and Trade consists of a voluntary membership drawn from business interests. Hans Seidel, Minister of State, Federal Ministry for Finance. Statement before the Joint Economic Committee. June 2, 1981. p. 4.

committee on Wages with the request that negotiation between the union and the employer be allowed to proceed on the basis of the processed claims. The Subcommittee may approve or disapprove the request to begin negotiations. (If the claims are vital to the general economic health of the nation or are likely to lead to large price increases, the Subcommittee is required to refer the matter to the Commission itself.) Only when the Subcommittee (or the Commission) has agreed that the parties may go ahead with the negotiations, may the contract be negotiated. The negotiated contract is ultimately submitted to the Committee for final scrutiny.

Prices Subcommittee

The Subcommittee for Prices considers requests by business firms or business associations to raise prices on goods and services. At first the Subcommittee attempted to act on almost all price changes, but this proved unnecessary and impractical. Because of difficulty of supervision, such items as fashion articles and restaurant meals are excepted from scrutiny by the Subcommittee as (for obvious reasons) are imported goods. About one-third of all consumer expenditures fall within the jurisdiction of the Commission, which now confines itself to setting prices for industrial goods, raw materials, staple commodities, and a few services.[4] About 200 standard articles are encompassed by the Subcommittee's review.

The operation of the Subcommittee on Prices is analogous to that of the wages subcommittee. Applications for price increases are channeled through the Chamber of Trade and Industry which acts as the first level of review by determining which requests should be passed on to the Subcommittee and in what form. Like the Wage Subcommittee on Prices must act within six weeks or pass the matter on to the Joint Commission, which must come to a decision within five weeks.

Requests for price changes must be accompanied by information on changes in costs since the last price increase. Price increases are allowed only if justified by increased costs not offset by productivity gains, and requests based only on favorable market conditions, such as stronger foreign or domestic demand, are simply not considered. Firms which raise prices without the Subcommittee's approval run the risk of having the federal government set prices for a period of six months. Except for this rule, the opertaion of the Commission and its subcommittees carries no sanction but depends entirely on the voluntary cooperation of the parties involved.

Economic and Social Advisory Board

In addition to the subcommittees on wages and prices. a third subcommittee, the Economic and Social Advisory Board, assists the work of the Joint Commission. The purpose of the Advisory Board is to study questions of broad economic and social policy and to make rec-

[4] The federal government itself (independent of the Commission) has also imposed price ceilings on certain basic foods, energy, and public services, which together account for between a fifth and a fourth of consumer expenditures.

ommendations on changes in fiscal and monetary policy as well as on investment, taxation, and the labor market. The Board forwards these recommendations through the Commission to the federal Government itself. About 300 technicians participate in the Board's work. Like the Commission and the other two subcommittees the Advisory Board has no executive power to enforce its recommendations.

Effectiveness

How effective has the Joint Commission been in controlling wages and prices? Its success is difficult to measure statistically because it is impossible to gauge what would have happened had the Commission not been established. Furthermore, prices exempt from the supervision of the Commission, such as the price of imports and of officially controlled items, tend to restrict the influence of the Commission on the overall development of the Austrian price level. Structural shifts in employment over the past twenty-five years during which the tertiary sector (principally services) with its slowly rising productivity expanded more rapidly than the secondary sector (fabricating industries) also caused a rise in wages and exerted inflationary pressure on prices. These factors tend to obscure the achievements of the Commission.

Neverthless external criteria, such as comparison with other countries, suggest the Commission has met with some success, as the following facts indicate:

1. Austrian inflation averaged about 7.2 percent from 1971 to 1976 and about 4.8 percent from 1977 to 1980. These rates lie well below the average for OECD countries and certainly well below the U.S. average. The low intensity of inflationary expectations in Austria can be attributed in part to the work of the Commission.
2. The rate of unemployment generally hovers under 2 percent in Austria, suggesting a favorable trade-off between unemployment and inflation.
3. The performance of the Austrian economy during the 1970s was satisfactory on the whole, for not only was inflation lower than in other industrialized countries (with the exception of Switzerland and Germany) and unemployment at what may be regarded as its irreducible "natural" rate, but the economy grew at an annual rate of 5 percent, which was 1 percent higher than the OECD average. The Austrian worker is better off now than before: though prices doubled between 1969 and 1980, wages trebled during the same period. Output per employee is now about 150 percent of what it was in 1979.
4. Strikes do not exist in Austria. Wage claims are negotiated in an apparently open and reasonable atmosphere. Attitudes of social cooperation have much to do with this circumstance, but the forum of the Subcommittee on Wages has made a significant contribution to the success of the system.

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Chapter III. WAGE AND PRICE POLICY IN CANADA*

By Julius W. Allen**

INTRODUCTION

Canada's single experience with mandatory price and wage controls in peacetime lasted from October 1975 through December 1978.[1] This three-year episode followed upon the third major inflationary period in Canada since the end of World War II, and the first which was not directly associated with wartime or postwar readjustment. The first inflationary period, from 1946 to 1948, was a direct outgrowth of Canadian participation in World War II and followed the termination of controls in 1945. The second period, 1950 to 1951, occurred during the Korean war, at which time more informal and short-lived attempts to control prices were undertaken.

The third major inflationary episode, from 1971 to 1974, provided the rationale for the incomes policy with which this report is primarily concerned. Not only was it the first inflationary period in Canada's history not associated with war, but it was also more protracted than either of the other two major post-war inflationary periods.

A fourth period of inflation started in 1977 and is continuing, although at a lesser rate than in some other industrial countries.

I. VOLUNTARY ANTI-INFLATIONARY EFFORTS, 1965–75

During the 1960s, the Canadian government took a number of steps to curb wage and price increases as supplements to monetary and fiscal policy, including several forms of voluntary incomes policy.

In 1965, the Federal government requested the Economic Council of Canada [2] to commission a study of foreign experiences with incomes policies with a view toward their applicability to Canada. The study, by David Smith of Queen's University, suggested that several characteristics of the Canadian economy and government would make it difficult to adopt a successful incomes policy.

Smith argued that the division of authority in Canada between the Federal government and the provincial governments on labor matters and on price regulation would limit the effectiveness of a national policy in these areas. Further, the decentralized power of labor and management organizations would make it difficult to obtain a nationwide consensus on the criteria of an incomes policy and restrict the

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*Adapted from a report, dated June 10, 1980, prepared for the Congressional Research Service. CRS Report No. 80–109 E.

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[1] Like most belligerents in World War II, Canada had a program of mandatory price and wage control during the war, lasting from October 1941 to the spring of 1945.

[2] The Economic Council of Canada was established by Act of Parliament in 1963. It consists of 28 members, none of them from the government, appointed by the Governor in Council to advise the government on economic issues.

role that leaders of economic interest groups can play in committing their members to specific wage and price control guidelines. Finally, the openness of the Canadian economy, and especially its close economic ties with the United States, would make it impossible to isolate Canada from inflationary pressures originating abroad, and so greatly limit the scope for an independent incomes policy.[3]

In its third annual review, entitled "Prices, Productivity and Employment," issued in November 1966, the Economic Council of Canada, concurring with Smith, concluded that under the given circumstances of the Canadian economy and government, adoption of an incomes policy was inadvisable.

However, from 1967 to 1969 economic growth slowed down, unemployment rose, and prices rose at an increasing rate. As a result, interest in some form of incomes policy grew. In June, 1969, a four-man Prices and Incomes Commission (PIC) was established, "to inquire into and report upon the causes, processes, and consequences of inflation and to inform those making price and income decisions, the general public and the government on how price stability may best be achieved."[4] Its powers, however, stopped short of enforcement.

On August 6, 1969, the PIC announced a plan to enter into negotiation with major economic interest groups—business, labor and the professions—in order to seek voluntary over-all cooperation in an effort to scale down income and price increases. Despite support by most business groups, this effort failed. On October 17, 1969, the leaders of both leading labor organizations, the Canadian Labour Congress and the Confederation of National Trade Unions, formally rejected the PIC's attempt to obtain an across-the-board agreement on income and price restraints.

Thereafter the PIC tried a piece-meal approach to curb prices through consultations with business representatives. During much of 1970 it had some success in persuading businesses to forego part of the net profit margins which they might otherwise have been able to obtain. However, without labor participation success could only be very modest. As Eric Schiff wrote in a survey of Canadian income policy:

> The voluntary adoption of a guideline for price increases by practically all Canadian business could justly be regarded as a promising initial success for this second phase of the commission's efforts. However, the commission was convinced that despite willingness on the part of business to accept profit squeezes (a willingness that had its inevitable limits anyhow), the Canadian price level would continue to rise as long as collective agreements provided (as they did) for pay increases of 8–10 percent per year in the face of an annual rise in labor productivity of only about 2–2½ percent.[5]

The renewed efforts of the PIC to obtain labor cooperation continued throughout 1970, but without conspicuous success. In the hope of enlisting public support for some restraint on inflationary wage increases, the PIC on June 9, 1970, announced a guideline of 6 percent as the maximum justifiable wage and salary increase under existing circumstances. This was arrived at as a composite of 2½ percent for the

[3] Smith, David C. Incomes Policies: Some Foreign Experiences and their Relevance for Canada. Ottawa, Queen's Printer, 1966. p. 203.

[4] Canada. Order-in-Council, P.C. 1969–1249, dated June 19, 1969.

[5] Schiff, Eric. Incomes Policies Abroad. Washington, American Enterprise Institute, 1971. p. 38.

current annual increase in labor productivity and $3\frac{1}{2}$ percent for the current rate of annual increase in the Consumer Price Index. The commission also indicated that pay increases over 6 percent per year were justified in certain circumstances: for example, where there were abnormally low current earnings in individual cases, or where it was necessary to attract manpower into some particular industry.

The PIC hoped to enlist Federal and provincial government support for its 6 percent guideline. However, provincial governments were generally dissuaded by labor opposition from giving the guidelines any official endorsement. Labor attacked the guidelines from the outset.

Efforts to achieve voluntary restraint of incomes and prices came to a halt at the end of 1970. The Prices and Incomes Commission dropped its 6 percent guideline for wage and salary increases. In addition, it prepared contingency plans for mandatory control of prices, wages, salaries and other forms of income, in case the government should at some future date decide to undertake such a program. This contingency planning was continued in the Department of Consumer and Corporate Affairs after the PIC was terminated on March 31, 1973.

In its summary report, published on June 20, 1972, the Prices and Incomes Commission suggested, with certain qualifications, that the Canadian government should consider adoption of a mandatory price and wage policy. It stated:

> In conjunction with policies aimed at creating and maintaining a more stable demand environment, temporary resort to controls offers a means of bringing cost and price increases more promptly and reliably into line with the change in demand conditions. This can speed up the process of adjustment and reduce the transition loss of jobs and output in bringing inflation under control. Even so, the process is unlikely to be quick or easy, and the results will not be lasting unless inflationary expectations can be changed...
>
> Two essential conditions must be satisfied for a temporary control program to work effectively and then to be phased out with minimum risk of a renewed outbreak of inflation. First, the public must be convinced that such measures are necessary and that there exists on the part of governments a strong determination to make them operate as effectively and equitably as possible. Second, governments must be prepared to demonstrate a resolve and capacity to maintain relatively stable prices and costs over a sufficiently long time span, embracing not only the control period but also its aftermath, to convince the public that inflationary expectations and patterns of behavior are no longer justified . . .
>
> It is our view, therefore, that temporary price and income controls should only be used as part of a longer-run policy aimed at maintaining underlying demand conditions both during and after the control period consistent with the target rates of increase in average price and income levels.[6]

The effectiveness of the 1969–70 voluntary program is difficult to assess. Canada's price performance in 1970 was better than in 1969, and also better than that of the United States and most other industrialized western countries. To some extent the improvement was due to depressed market conditions which made it impossible for firms to raise prices enough to cover the full increase of costs. The restraint program of the PIC may also have helped.

As the PIC reported on Dec. 1, 1970, "many firms with opportunities open to them to raise prices during 1970 have deferred, limited

[6] Canada. Prices and Incomes Commission. Summary Report, p. 7, 8. Published as Appendix B in: Inflation, Unemployment and Incomes Policy. Ottawa, Information Canada, 1972.

or reduced the size of these increases in order to conform with the price restraint criteria."[7]

Finally, success in restraining prices at this time can also be attributed in considerable measure to tightened monetary and fiscal policy. During most of the 1960s, macroeconomic policy in Canada was directed at high employment and output goals, with little consideration of the potential inflationary impact. In the latter part of 1969, and throughout 1970, stabilization policies were tightened severely, and the growth of monetary aggregates was cut back. The Canadian dollar was allowed to appreciate on world markets. These policies contributed to the economic downturn of 1969–70 and thus to a lessening of inflationary pressures.[8]

However, the slackening of price increases was short-lived. Beginning in 1971, commodity prices rose substantially. Late in 1972, food and energy prices climbed rapidly, and commodity prices continued to be a major factor contributing to inflation throughout the first half of the 1970s. This led to a squeeze in real labor incomes during most of 1973 and 1974, with resultant pressure for higher wages and salaries. The consequence was an upward push of labor costs.[9]

In addition, the increase in unemployment induced by the 1969–70 recession led to a policy switch from restraint to stimulation. In particular, monetary policy was expansive, and the growth rates of the monetary aggregates accelerated sharply. As the Anti-Inflation Board concluded in 1979:

> In retrospect, the macroeconomic efforts to push the economy out of the 1969–70 recession involved a degree of stimulus which was too intensive and lasted too long. These policies would have caused severe inflation problems in the mid-1970s even if no additional strains had occurred.[10]

The Canadian government also took little action to prevent inflation in other nations from spilling over into Canada. The strength of world demand in 1972–73 not only boosted demand for Canada's exports but put upward pressure on Canadian domestic prices and wages. If Canada had permitted its exchange rate to appreciate, as it had in 1970—thus slowing the demand for Canadian goods—the impact of foreign inflation would have been smaller.

The Economic Council of Canada attributed the inflation of the mid-1970s primarily to the volatility of the external environment along with unrealistic policy formulation.[11] It pointed out that although Canada's price performance was not out of line by international standards up to the mid-1970s, Canada benefited greatly from the commodity price boom because of its role as a major producer and exporter of resources. Between 1972 and 1974, Canada achieved the largest improvement in terms of trade in its history. But this very success, combined with the depreciation of the Canadian dollar, were major factors in the inflation of the mid-1970s.

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[7] Canada. Prices and Incomes Commission. National Conference on Price Stability. Concluding Statement. Dec. 1970. cited in Schiff, Eric. Op. cit., p. 41.

[8] Organisation for Economic Co-operation and Development. OECD Economic Surveys, Canada, October 1971, p. 28–31.

[9] See table 1.

[10] Canada. Anti-Inflation Board. Inflation and Public Policy. Ottawa, Minister of Supply and Services Canada, 1979, p. 32.

[11] Canada. Economic Council of Canada. Two Cheers for the Eighties, 16th Annual Review, 1979, p. 5.

A few additional anti-inflationary measures taken in the two and a half years before the imposition of controls in October 1975 may be briefly mentioned. As a result of the sharp increases in food prices in 1972 and early 1973, and the recommendation of a House of Commons Special Committee on Trends in Food Prices, a Food Prices Review Board was created on May 25, 1973. It was designed to monitor price movements of a comprehensive series of food products, to issue quarterly reports, to inquire into the causes of particular food price increases and to make recommendations. Its functions were extended to the end of 1975.

II. Events Leading to Imposition of Mandatory Controls in October 1975

The serious deterioration of the Canadian economy in 1974 and 1975 on several fronts can be seen from the data in table 1. Consumer prices were rising at an annual rate of nearly 11 percent. Unemployment was rising. Productivity growth measured by output per man-hour was reduced to zero. Unit labor costs were rising even more rapidly than consumer prices. Increases in Canadian production costs were getting seriously out of line in comparison with those of the United States, jeopardizing Canada's international position. Wage demands were threatening a further cost-push spiral. And public sector employees were pushing for wage increases above those being granted in the private sector.

TABLE 1.—SELECTED CANADIAN PRICE, WAGE, PRODUCTIVITY, UNEMPLOYMENT, INDICATORS, 1972–79

	Percentage change from previous year							
	Consumer Price Index			Average hourly earnings in manufacturing	Average weekly wages, manufacturing	Unit labor costs [1]	Productivity [2]	Unemployment as percent of labor force
	All items	Food	All items except food					
1971	2.9	1.0	3.4	9.0	8.4	2.9	5.2	6.4
1972	4.8	7.7	3.7	7.8	8.4	4.6	3.7	6.3
1973	7.6	14.1	5.1	8.9	7.3	7.3	3.5	5.7
1974	10.9	16.3	8.8	13.5	10.8	13.5	.6	5.5
1975	10.8	12.9	10.0	15.7	15.0	15.0	0	6.9
1976	7.5	2.7	9.4	13.8	13.0	8.3	5.0	7.1
1977	8.0	8.4	7.8	10.8	10.3	6.3	2.7	8.1
1978	9.0	15.5	6.4	7.2	7.4	4.7	.9	8.4
1979	9.1	13.2	7.9	8.8	9.2	7.6	0	7.5

[1] All commerical industries.
[2] Output per man-hour.

Sources: Canada. Statistics Canada. Canadian Statistical Review, April 1980. Canada. Department of Finance. Economic Review, April 1980. Organisation for Economic Cooperation and Development. Main Economic Indicators, March 1980. U.S. Department of Commerce. International Economic Indicators. September and December 1979.

Thus, although the Liberal government in the campaign preceding the July 1974 general election had strongly opposed temporary wage and price control, within a year it was showing signs of a major modification of its opposition. In June 1975, the Minister of Finance, John N. Turner, stated:

> In contrast to the situation in 1973 and 1974, when our inflation primarily reflected international forces, and controls couldn't possibly have worked, we are now faced with escalating domestic costs in an under-employed economy. In those circumstances, controls could provide the most direct response to the problem.[12]

[12] Canada. House of Commons Debate, Ottawa, June 23, 1975, p. 7024.

The Government was also increasingly concerned with the habit of more and more Canadians to make bargaining and other economic plans on the assumption of future inflation. As Donald S. MacDonald, Minister of Finance after Turner's resignation, stated in late 1975:

> People, whatever their economic sector, were looking not only to catch up with the increased cost that had come through in the past, but also to leap ahead and anticipate what they believed would be the continuing rate of inflation in Canada. And it is the anticipation, the result of that anticipation in terms of real cost to the Canadian community, which has most concerned the government and has caused us to bring on the selective program of controls and the general appeal for restraint.[13]

Fifteen months after his Liberal party won a general election on a platform in opposition to wage and price control, Prime Minister Pierre Trudeau, on October 13, 1975, announced the government's program to institute mandatory price and wage control, for the first time in peacetime in Canadian history.

The program went into effect the next day, October 14, 1975, initially under authority of the Inquiries Act. With no basic change, the anti-inflation program announced by the Prime Minister was incorporated in the Anti-Inflation Act,[14] which passed the House of Commons on December 3, 1975, and received Royal Assent on December 15, 1975. Under the Act, controls were to expire no later than the end of 1978.

III. Major Features of the Anti-Inflation Program Beginning October 1975

The anti-inflation program consisted of four main elements:

1. Restrictive fiscal and monetary policies providing for a lowering in the rate of growth of demand and production;
2. Slowing the rate of growth of government expenditures;
3. Structural policies to deal with special programs of energy, food and housing, to ensure a more competitive economy, and to improve labor-management relations; and
4. A prices and incomes policy establishing enforceable guidelines for price and income determination, and machinery for administering them and ensuring compliance. Contrary to incomes policies adopted in the United States and Britain, this policy did not involve impositions of an initial price and wage freeze, but instead took the approach of gradually bringing down inflationary pressures.

A. Coverage

The price and incomes policy guidelines applied to prices received and wages paid by (1) all firms employing over 500 persons (in the construction industry, over 20 persons); (2) all firms with employees who bargain in association with employees of other firms; (3) the federal government and participating provincial governments; and (4) all persons in receipt of professional fees. About half of the labor force and 3,400 firms or groups of firms were specifically affected.

Prices of raw materials and imports were excluded from coverage under the Anti-Inflation Act. These prices, which are set in world mar-

[13] MacDonald, Donald S. The Federal Government's Anti-Inflation Program. Address to the 27th Tax Conference, Quebec City, Nov. 10–12, 1975. In: Canadian Tax Foundation, 1975 Report of Proceedings. Toronto. Canadian Tax Foundation, 1976, p. 819.

[14] Bill C–73, First Session, 30th Parliament, 23–24 Elizabeth II, 1974–75.

kets, included prices of agricultural commodities, fishery products, paper and allied industry products, primary metal products, and petroleum and coal products. According to a study of the Conference Board in Canada, given the structure of costs in the Canadian economy in 1975, between 34 and 44 percent of the nation's overall price level was not subject to mandatory control.[15]

B. *Administration*

Three governmenal entities were directly involved in the administration of price and wage control: the Anti-Inflation Board; the Administrator; and the Anti-Inflation Appeal Tribunal.

1. THE ANTI-INFLATION BOARD

The Anti-Inflation Board (AIB) was the central controls agency, responsible for monitoring changes in prices, profits, wages, dividends, and professional fees; for disseminating information about guidelines; and for identifying violations of guidelines. If the board was unable to achieve a resolution of a violation, the violation was to be reported to the Administrator. After a few months' experience, appeals could be made to the Administrator without a violation of guidelines having occurred.

In the words of one student of Canadian incomes policy: "The functions of the Board were consultative, advisory and interpretive. The means to achieve compliance with the Anti-Inflation Guidelines were persuasion, publicity and public education. The approach was that of the carrot and the stick: comply and be a good citizen. Fail to comply and face the penalty of the law." [16]

2. THE ADMINISTRATOR

The Administrator was responsible for enforcing guidelines. Where a guideline had been violated, the Administrator had the authority to order the cessation of the violation. In compensation cases, he could require the employer or employee to pay to the federal treasury an amount equal to any remuneration in excess of the guideline. In case of price or profit violation, he could order a refund to the purchaser or payment to the federal treasury. The Administrator also had the power to impose fines. It was up to the courts to enforce the Administrator's decisions by further fines and imprisonment. The Cabinet was allowed, within thirty days of a decision of the Administrator, to instruct him to change his decision.

3. THE ANTI-INFLATION APPEAL TRIBUNAL

Orders of the Administrator were appealable to the Tribunal. The Tribunal could dismiss the appeal, allow it in full or in part, or refer the matter back to the Administrator for reconsideration and varia-

[15] Letourneau, Reginald S. Inflation and Incomes Policy in Canada. Conference Board in Canada. Executive Bulletin No. 9, May 1979, p. 1.
[16] Firestone, O. J. Canada's Anti-inflation Program and Kenneth Galbraith. Ottawa, University of Ottawa Press, 1977, p. 113.

tion of the orders. On questions of law the Tribunal's decision could in turn be appealed to the Federal Court of Appeal. Appeal could also be made to the Canadian cabinet.

C. Program Guidelines

1. COMPENSATION

Originally, maximum allowable increases in compensation, including fringe benefits and incentive plans, were to be computed to include four basic parts: (a) a basic protection factor, designed to cover the expected rate of inflation, which was set at 8 percent for the first year of a contract, 6 percent for the second, and 4 percent for the third. Should the actual increase in the Consumer Price Index exceed this factor, the excess was to be added to the basic protection for the following year; (b) a productivity factor of 2 percent a year; (c) an experience adjustment factor to permit certain employee groups to catch up or to be restrained, depending upon whether the group was above or below the national average rate of increase prior to the beginning of the program; and (d) regardless of past compensation experience, the sum of parts (a), (b) and (c) must fall within a range of $600–$2,400 per year, for the average increase for the numbers of a bargaining group.

In the third year of the program, factors (a) and (b), the basic protection and the productivity factors, were deleted and replaced by a basic guideline rate of 6 percent.

Two exceptions to these guidelines were permitted. First, an employer who could demonstrate that he could not attract or hold workers at levels of compensation within the guidelines could be granted an exception to the guideline limits. Second, some increases in guidelines were permitted if deemed "necessary to maintain long-established historical relationships between wages in closely related groups." [17]

2. PRICES AND PROFITS

Allowable increases in prices were to be limited to the amounts required to cover net increases in costs. Prices received by farmers and fishermen were exempt from this guideline. Where firms could allocate costs to individual products, prices were to be controlled on a day-to-day basis in terms of increases in allowable costs of materials and labor. Where firms could not allocate costs to individual products, profits were to be controlled, mainly through year-end tests based on the profit histories of such companies. Pricing should leave the firm's percentage pre-tax profit margin no higher than 95 percent of the average figure for the last five years.

The key element of the prices and profits regulations was to be the calculation of excess revenue—the earnings which would accrue to a firm if prices were in excess of allowable levels. Excess revenue was to be eliminated in the subsequent period either by lowering prices

[17] Organization for Economic Co-operation and Development. OECD Economic Surveys, Canada, June 1976. Paris, 1976. p. 47–48.

relative to costs, by issuing rebates to customers, or by paying the amount of the excess revenue to the government.

During the second year of the program, there was a shift from the two-control system—day-to-day price control and year-end and profit tests—to a generalized application of profit margin control for all firms, except those in the retail and wholesale trades. The profit restraint was tightened from a level of 95 percent to one of 85 percent of the average pretax net profit margins for the last five years. In addition, a special incentive to firms to expand and improve plant capacity the government permitted business firms to keep a portion of excess income for such investments.

3. PROFESSIONAL FEES AND INCOMES

These guidelines incorporated elements of both compensation and of price and profit regulations. The objective generally was to limit the income of professionals to the amounts necessary to cover increased costs. In cases of increased workloads, increases in professional income in excess of cost escalation were permitted.

4. DIVIDENDS

The basic principle of the regulations was that dividend rates were not to be increased above their October 13, 1975, level. An exception was provided for the first year of the program, allowing companies to pay shareholders up to 25 percent of after-tax earnings in the last fiscal year terminating before October 15, 1975. Furthermore, dividends in excess of the maximum amounts could be paid, if approved by the Anti-Inflation Board, on the grounds of being necessary to raise new equity capital, or if it could be demonstrated that the last year's dividends, prior to October 1975, were atypically low.

IV. Gradual Phasing In of Controls

In one important respect, the initial phase of Canada's wage and price control experience was quite different from that of other industrialized countries. As noted above, Canada did not adopt a price and wage freeze at the outset of its period of wage and price control. There were a number of reasons for this different approach. A political reason was that a price and wage freeze was part of the program of the opposition party, the Progressive Conservation Party.[18]

A second reason was that only a gradual deceleration of inflation was sought. This approach was deemed feasible since the price situation at the time the new incomes policy was announced, on October 13, 1975, was not as critical as it had been earlier in the year. The rate of increase of almost all indicators of prices, base wage rates and earnings had peaked on or before the second quarter of 1975. The situation was, however, still quite serious. As the OECD survey of Canada in 1976 noted:

> While not explosive, the price situation was felt by the authorities to provide signs of serious inflationary difficulties in the absence of changes in policy or behavior. The deceleration of wage settlements by the third quarter was only

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[18] See pp. 22 and 23.

slight and from a very high rate which was much higher than in the United States. The deceleration of prices which had occurred appeared to reflect temporary factors, as confirmed by the small reacceleration in the third and fourth quarters. In these conditions, the prices and incomes policy was seen mainly as an aid to bringing about a steady, firmly based deceleration of prices without increasing unemployment. This was felt to be all the more necessary since the Canadian economy, unlike its most important trading partners, had not experienced a severe recession with its attendant favorable effects on the inflation rate. In addition, it was felt that the introduction of a prices and incomes policy at that stage of the cycle would be assisted by the general economic environment. A substantial deceleration in wholesale prices, industry selling prices, and import prices had already occurred and some productivity gain seemed likely in the course of 1976.[19]

V. Program Difficulties

The absence of a price and wage freeze created problems for the administration of Canada's incomes policy from the outset. It mean that the Anti-Inflation Board had to make decisions before guidelines were explicitly formulated, and in some cases, before the enforcement machinery had been put in place. The guidelines and administrative regulations were widely considered to be complex and difficult to interpret. The administrators were confronted with the task of finding the proper middle ground between controls so vague that avoidance could be rampant and the program totally ineffective, or so strict that it would have severe negative impact on the economy, diminish confidence in the Canadian dollar, and evoke labor protests, strikes, and other disruptions.

A further difficulty resulted from the division of responsibility and authority between the federal and provincial governments. Although the bulk of the Anti-Inflation program was under federal jurisdiction, provincial governments were permitted to retain discretion on wage control over their own government employees and on rent control. Labor relations was also a matter primarily within the constitutional jurisdiction of the provinces.

The Organization for Economic Cooperation and Development characterized the Canadian price and incomes policy as notable for its comprehensiveness and degree of detail on the one hand, but also for its potential flexibility on the other. "It is comprehensive in that it applies to prices, profits, wages and salaries, rents, dividends, and professional fees, the only major exception being the price of agricultural and fish products. It is extremely detailed in that it allows for a range of possible income increases depending on past experience, a choice of either 'cost pass-through' or 'profit margin' criteria for price setting and differential treatment of companies by sector (e.g., distribution, finance, construction, etc.). Its flexibility is apparent from the provision for exceptions to the guidelines in cases where it is thought that adherence would impose a severe strain or where important 'historical relationships' would be violated." [20]

This flexibility is also evident in the wage decisions of the Anti-Inflation Board. According to a survey of these decisions, "most agreements submitted to the board in excess of the compensation guideline applicable to that group have received approximately the guideline

[19] OECD Economic Surveys, Canada, June 1976, p. 35.
[20] OECD Economic Surveys, ibid., p. 34.

increase plus one half of the excess in the first year of the collective agreement."[21]

As with the previous voluntary incomes policy of the late 1960s and early 1970s, the greatest opposition to the mandatory controls of 1975–78 came from organized labor. Opposition was based on the grounds that controls were discriminatory, that they interfered with collective bargaining, that they failed to reduce the gap between the haves and the have-nots, and that they interfered with the freedom of choice of the individual. Symptomatic of this opposition was the one day protest against the Anti-Inflation Act, on October 14, 1976, when over a million workers stayed off the job.

VI. Termination of Mandatory Controls

As announced in October 1977, two years after the beginning of the program, the controls program began to be phased out in mid-April 1978. Employee groups and firms became exempt from controls as wage contracts and company fiscal years ended respectively on or after April 14, 1978. As a result, about half of the controlled employees and a quarter of all firms were freed from controls before the end of 1978, when by law the controls program expired.

The termination of the Anti-Inflation Board was followed by the establishment of a Center for the Study of Inflation and Productivity (CSIP) within the Economic Council of Canada. Its function was to monitor price and income movements during the transition post-controls period; it was given neither mandatory powers over prices and wages nor authority to require information from companies. In March 1979 it was replaced by the National Commission on Inflation and the power to require pricing information from companies was restored.

VII. Post-Controls Experience of the Canadian Economy

Virtually all the reports that have attempted to assess the impact of Canada's anti-inflation program of the mid-1970s, suggest that the controls program had a substantially greater impact on wages than on prices. This can be seen at the outset from table 2, prepared by the Organization for European Cooperation and Development, and published in its 1979 Economic Survey of Canada. The OECD reached the following conclusion on the Canadian wage and price control experience:

> On the face of it, the controls program, after easily achieving its price objective in the first year (covering the twelve months to October 1976), fell short in the two succeeding years. Whereas in the first period exogenous factors—the exchange rate of the Canadian dollar and food prices—remained propitious, they subsequently exercised an unfavorable influence. Corrected for food and energy, consumer price increases in a year-average basis declined over the period . . . The [OECD] Secretariat in its 1977 Survey of Canada suggested that, on the basis of the then available information, it appeared that there had been a direct restraining influence on wages, but that the impact on prices was mainly indirect through the slowdown in labor costs. While recognizing the extreme degree of

[21] Osberg, Lars. A Note on the Wage Decisions of the Anti-Inflation Board. Canadian Public Policy, v. 3, Summer 1977, p. 378. See also: Maslove, Allan M., and Gene Swimmer. Wage Controls in Canada. Regulation, v. 3, January–February 1979, p. 31–36.

uncertainty which attaches to such estimates—in particular given the abnormal inflationary conditions prevailing just prior to the program's introduction which may well have had a lasting effect on inflationary expectations—subsequent studies covering a longer period of control tend to support this finding.[22]

TABLE 2.—PRICE AND COMPENSATION GUIDELINES AND OUTCOME

[In percent]

	Prices [1]		Compensation [2]		
	Guideline	Outcome	Guideline	Submissions	Outcome
Pre-program [3]			11.0	15.5	14.2
Program year 1 [4]	8	6.2	9.7	10.0	9.3
Program year 2 [5]	6	8.8	7.5	7.4	7.1
Program year 3 [6]	4	8.7	5.7	5.6	5.4

[1] Change in total Consumer Price Index in 12 mo to October of each year.
[2] Covers report received by Anti-Inflation Board up to Sept. 1, 1978.
[3] Contracts under negotiation on Oct. 14, 1975, but due to have come into force prior to that date.
[4] 12 mo prior to October 1976.
[5] 12 mo prior to October 1977.
[6] 12 mo prior to October 1978.

Source: OECD Economic Surveys. Canada. June 1979, p. 36. Based on annual reports of Canada's Anti-Inflation Board.

Other analyses of the impact of Canada's anti-inflation program, notably those of Letourneau and the University of Guelph economists [23] have indicated that the success of the program would depend a great deal on the way in which prices and wages behaved once controls were terminated. The fear of a "bubble" in wage settlements was often expressed, while at the same time several observers expressed doubt that such a significant wage hike would materialize.

Two tables show that although there was no sudden spurt in prices or wages following the phasing out of controls between April and December 1978, neither was it possible to achieve a stable level of these wages and prices. Table 1, above, demonstrates that the annual percentage increase in both wages and prices since the phasing out of controls in 1978 has been less than the rate of increase in the immediate pre-control years, 1974 and 1975. However, consumer price increases continue to exceed the rate of increase before 1974; and increases in average weekly wages in manufacturing, except in 1978, are also faster than in the 1960's and early 1970's.

Table 3, below, compares the rates of change in consumer prices and in hourly wage rates in manufacturing for the five years, 1975–79 inclusive, in four countries: Canada, the United States, the United Kingdom, and West Germany. As this table shows, both the United States, after a three year period of wage price control, and Canada, in a period that included three years of controls, had lower rates of wage and price inflation than the United Kingdom but considerably more than experienced in West Germany. With two exceptions, Canada's inflation record in this period was similar to that of the United States, a result reflecting the interlocking relationships between the two countries. However, Canada did show a progressive decline in the rate of increase

[22] Organization for Economic Cooperation and Development. OECD Economic Surveys. Canada. June 1979. Paris. OECD. 1979. p. 36–37.
[23] Letourneau, Reginald S. Inflation and Incomes Policy in Canada. Executive bulletin (Conference Board in Canada) No. 9, May 1979, 16 p.

in hourly earnings from 1975 to 1978, largely as a result of its anti-inflation program, while that of the United States showed little change. In addition, from 1975 to 1978 Canada's rate of increase in the consumer price index was slightly above that of the United States, but in 1979 it rate of increase was only slightly higher than in 1978 whereas the United States experienced the largest annual increase since 1947. This contrast may be due to several factors, including greater slack in the Canadian economy and lesser vulnerability to the sharp increases in prices of imported oil.

TABLE 3.—COMPARATIVE TRENDS IN CONSUMER PRICES AND HOURLY EARNINGS IN MANUFACTURING IN CANADA, THE UNITED STATES, THE UNITED KINGDOM, AND WEST GERMANY, 1975–79

[Percent increase over previous year]

	Canada		United States		United Kingdom		West Germany	
	Consumer prices	Hourly earnings	Consumer prices	Hourly earnings	Consumer prices	Hourly earnings	Consumer prices	Hourly earnings
1975	10.7	17.6	9.3	8.7	24.2	30.0	5.9	8.7
1976	7.5	14.0	5.8	8.0	15.8	19.8	4.5	7.0
1977	8.0	10.5	6.4	9.3	16.0	4.8	3.9	6.5
1978	9.0	7.1	7.6	8.5	8.9	11.2	2.5	5.3
1979	9.2	8.9	11.3	8.6	13.4	14.8	4.7	5.8

Source: Organization for Economic Cooperation and Development. Main Economic Indicators, 1978 and March 1980.

The ability of Canada to escape a post-controls bubble has been attributed to a number of factors, including the gradualness of decontrol over a period of nearly nine months, and the fact that the economy was in a considerable slump at the time.

That inflation remains one of the most serious questions for Canada, as for most other industrialized nations, is universally acknowledged. Higher energy prices as well as higher labor costs due to increased wages and slower productivity growth are basic factors in Canada's inflation, which is widely expected to remain in the 1980s. These do not appear to be factors that can be effectively treated on a long-term basis by mandatory incomes and price controls.

CONCLUSION

For Canada, there is likely to be extended debate as to the benefits and costs of the controls that were in effect between October 1975 and the end of 1978. It seems clear that, as has already been suggested, the Canadian incomes policy was a limited program that had limited success. In the short run, there appears to be general agreement that the controls brought about a slight dampening of price increases directly, and a more significant diminution of wage hikes. The latter had some indirect effect on price increases as well. Price controls were more effective in the first year of the program than in the last two. Controls became increasingly unpopular the longer they lasted. In addition, it must be noted that Canada was also vulnerable to such major inflationary factors as energy prices and the prevalence of serious inflation in its major trading partner, the United States, and elsewhere abroad, factors which were largely exempt from the existing wage and price controls.

The flexibility of Canada's incomes policy and the gradual rate at which it was phased out contributed to a relatively smooth transition to the post-controls economy, which avoided the wage "bubble" or price hikes that were commonly experienced by other countries when they terminated a period of mandatory wage and price control. The costs of the incomes policy experience in terms of misallocation of resources, impact on morale, and on efficiency within the economy as a whole, are matters on which there appears to be little consensus. Some feel that such effects were relatively small, particularly due to the limited nature of the program, while others believe that their negative influence was substantial, even if largely unmeasurable. The United States experience with price and wage controls in 1971–74 and the Canadian one in the next three years had many similarities as well as significant differences, some of which have already been mentioned.

The United States freeze on wages and prices in 1971 had no parallel in Canada. In general, authority for the anti-inflation program was more diffuse in Canada than in the United States, with significant powers being held by the provincial governments. In both countries, the first years of the program were more successful and more readily accepted than the third year. In both countries a sharp rise in food prices contributed significantly to the difficulties of wage control. In both countries the termination of the program occurred over a period of several months. In both countries recessions in the economy at the end of the respective control periods eased the transition and prevented severe price and wage explosions.

Chapter IV. WAGE AND PRICE POLICY IN JAPAN

By Dick K. Nanto*

Introduction

Japan initially borrowed the concept of anti-inflation economic policies from the West. As with other economic ideas, however, Japan seems to have succeeded in refining the concept and applying it in an unusually effective manner.

Japan's record in controlling inflation, however, has not always been exemplary. Until the mid-1970s, Japan's rate of inflation was consistently higher than that in the United States. Of course, Japan's economy also was growing at rates averaging around 10 percent per year—which would cause some inflation in any economy.

Japan's experience with inflation after 1975 appears to be the most interesting for U.S. policymakers. Despite rising prices for imported petroleum and a high rate of economic growth, Japan has been able to maintain remarkable price stability at the consumer level.

While Japan relies mainly on traditional tools of monetary and fiscal policy to keep inflation within bounds, it also has employed direct price controls and has a system of labor relations that effectively works to keep wages in line with changes in productivity.

In this paper, Japan's experience with inflation, its system of emergency price controls, public service fees, and price supports through import controls are briefly examined. Japan's labor institutions and their effect on moderating wage increases are also surveyed.

Summary

After several decades of inflation rates higher than in the United States, Japan has enjoyed relative price stability during the last half of the 1970s. The Japanese government's anti-inflation policies are based primarily on traditional monetary and fiscal measures but also include emergency price conrols, restrictions on prices of government services or activities regulated by government, and influencing prices through import controls. Japan also has a labor relations system that tends to keep wage increases in line with the ability of enterprises to pay them.

Japan's current emergency price control laws were enacted during 1973–74. They authorize the government to intervene in markets for petroleum products and commodities essential for life in order to control prices and prevent hoarding. By 1976, however, all emergency controls actually imposed had been lifted, although statutory authority allows them to be revived if necessary.

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The Japanese government has direct control over about 15 percent of the components of its consumer price index. These consist primarily of charges for government services or prices for items which require government approval, and include: freight and passenger fees; electricity, gas, and water charges; prices for tobacco products and salt; the wholesale price of rice; fees for medical treatment under national health insurance; and tuition at national universities. The government takes national anti-inflation policies into account when approving changes in these prices.

Japan also supports some prices of agricultural products through import controls. During inflationary periods, these prices can be stabilized by allowing the gap between domestic and foreign prices to narrow.

With the exception of the wages of public employees, Japan generally does not intervene extensively into wage settlements between unions and employers. The institutional structure of Japan's labor market, however, produces some of the results that a policy of wage controls seeks to obtain. Furthermore, during the spring wage bargaining season the government will occasionally meet with labor leaders to ask for their cooperation in holding wage increases to the rise in labor productivity or to the increase in consumer prices.

Trends in Japanese Inflation

During much of its modern history, Japan has been engaged in a running battle with inflation. Following World War II, in particular, Japan's surrender brought a burst of hyperinflation. In 1946, Tokyo's wholesale prices soared by 398 percent, although that rate subsided to 196 percent in 1947. In 1949, as the U.S. occupation of Japan began winding down, General MacArthur aimed his last major reform at stabilizing prices.

During the 1960s, Japan's inflation rate for consumer prices averaged 5.8 percent, or twice the U.S. average of 2.7 percent. During the 1970s, the average inflation rate for both countries increased, but the gap between them narrowed, as Japan averaged 8.9 percent and the United States 7.6 percent.

Beginning with the 1973 oil embargo, the Japanese economy suffered three years of double-digit inflation with a peak inflation rate of 24.3 percent in 1974. The harsh anti-inflationary measures leading to the 1974–75 recession combined with an appreciating yen, however, caused the inflation rate to drop steadily until by 1978 it was only 3.8 percent followed by 3.6 percent in 1979 and 8.0 percent in 1980.[1]

Only during the second half of the 1970s did Japan's inflation rate drop below that of the United States. During this period, Japan's experience in combatting inflation can be instructive, because many of the policy tools open to Japan for reducing inflation parallel those in the United States. Japan also is even more dependent on imported oil (the commonly cited source of much of U.S. inflation) than is the United States.

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[1] For an overview of recent experience with inflation, see Pigott, Charles. Wringing Out Inflation: Japan's Experience. Federal Reserve Bank of San Francisco Economic Review, Summer 1980. p. 24–42.

After the disruptive inflation during 1973–74, the Japanese government, partly afraid of a repeat of the hyperinflation following World War II, took stern economic measures to curb price increases. The Japanese citizenry has tended to support these policies despite their adverse effects on certain segments of the economy.

The Japanese have gone through a learning process somewhat comparable to that which Americans currently are experiencing. After Japan's high rates of inflation in the past, the people are now willing to accept harsh economic measures to prevent a reoccurrence.

The Japanese government relies primarily on fiscal and monetary policy, the traditional macroeconomic tools to control inflation. It also exercises, however, some controls over prices, and it benefits from harmonious labor relations.

Fiscal Policy

Japan applies fiscal policy, or changes in government taxes and expenditures, aimed at controlling inflation in much the same manner as other market economies. During the later half of the 1970s, in particular, the Ministry of Finance often reduced major budgetary items, such as public works expenditures, or even increased taxes in order to create slack in the economy and ease upward pressures on prices.[2]

During 1980 and 1981, for example, rising inflationary pressures and a huge government budgetary deficit in Japan forced the government to keep expenditures for public works at virtually the same level as in 1979. During 1981, taxes were also raised on corporate earnings, stamp duties, eleven commodities (including automobiles), and on liquor.[3]

The Japanese Ministry of Finance traditionally also has followed a type of incomes policy for the government sector through its fiscal policy. During the high-growth years of the 1960s and early 1970s, the Ministry adjusted government tax schedules annually (mainly downward) in order to keep tax revenues at about 20 percent of national income.[4]

Monetary Policy

Monetary policy in Japan is conducted in much the same manner as in other industrialized countries of the world.

The Bank of Japan, however, generally exerts more direct controls over credit through a process called "window guidance," a system of specific quantitative ceilings placed on the total lending of each bank. These controls might be described as the cutting edge of monetary policy. They allow precise centralized control over credit expansion and force individual banks to ration their loanable funds among customers. On occasion, the Bank of Japan has even indicated which types of business activities are to be discouraged and which preferred in allocating loans.[5]

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[2] Ackley, Gardner and Hiromitsu Ishi. Fiscal, Monetary, and Related Policies. In Patrick, Hugh and Henry Rosovsky, eds. Asia's New Giant. Washington, Brookings, 1976. p. 210–32. Also see Japan. Economic Planning Agency. Economic Survey of Japan (English translation.) Tokyo. Annual editions.

[3] Government draft of fiscal 1981 budget. Fuji Bank Bulletin, April 1981. p. 68–72.

[4] Ackley and Ishi. Fiscal Policies, p. 225.

[5] Ibid., p. 202–204.

Price Controls

Price controls in Japan generally can be separated into three types: (1) Specific controls that are imposed in times of severe emergency; (2) restrictions on prices for goods and services either furnished by government organizations or requiring governmental approval; and (3) prices supported by import controls. The government also suppresses price increases through administrative guidance, a type of informal government directive.

Emergency price controls.—The current statutory authority which allows the Japanese government to mandate controls over the prices of specific commodities rests in the "Seikatsu Niho" or the "Two Laws on Livelihood." These were enacted following the virulent inflation of 1973–75, which the Japanese refer to as the period of "frenzied prices." In 1973, consumer prices in Japan increased by 11.8 percent followed by 24.3 percent in 1974 and 11.9 percent in 1975.

The first of the two laws was passed in 1973 after the OPEC oil embargo. At that time, not only were prices of petroleum and products rising rapidly, but shortages of basic commodities caused tremendous speculative fever and hoarding in Japan. At the corporate level, buyers rushed to sign contracts for delivery of soybeans, wool, lumber, and other products. At the consumer level, housewives lined up for blocks waiting for stores to open to buy bathroom tissue and other essentials.

As a result, the Law Concerning Emergency Measures Against Hoarding or Cornering Markets in Commodities Related to Living Conditions was enacted. This law prohibits the hoarding or buying up of items which are essential to life. The law gives the government authority to designate certain commodities as experiencing severe market pressure; conduct investigations concerning their supply, demand, and prices; and direct any firms hoarding the commodity to release it for sale.[6]

The Law of Emergency Measures to Stabilize the National Livelihood and the Law for the Adjustment of Supply of and Demand for Petroleum are usually considered together. These laws authorize the government to intervene whenever the price of an essential commodity (including petroleum products) begins to rise faster than the general price level. The government can single out that commodity, set standard prices, levy certain charges, and provide guidance on production, imports, and investments in facilities that produce it. The law dealing with petroleum also empowers the government to secure an appropriate supply of oil and to determine measures to reduce its consumption.

The anti-hoarding law, enacted in 1973, brought 24 commodities (including soybeans, composition board, and gasoline) under government monitoring. The stabilization law also resulted in investigations being conducted and standard prices being set for four commodities (including household kerosene, propane gas, and toilet paper). Prior government approval also had to be obtained for price increases in products whose cost of production is related to the price of petroleum.

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[6] Japan. Keizai Kikakucho (Economic Planning Agency). Bukka Repoto '80 (Price Report 1980). Tokyo, Okurasho Insatsukyoku, 1980, p. 83. (Hereafter cited as Keizai Kikakucho.)

Markets soon stabilized enough, however, that by June 1974 the standard price system was rescinded for 3 of the 4 commodities (except for household liquefied propane gas). In September 1974, 10 of the 24 commodities designated under the anti-hoarding law had been dropped. Two years later, in 1976, both the standard price for propane gas and the anti-hoarding provision for the remaining 14 commodities were abolished. Also in May 1976, the prior approval system for price increases in petroleum products was dropped.

As inflation began to resurge in 1980, the Japanese government did not intervene extensively to control specific prices, with the exception of some emergency imports of vegetables, beef, and marine products. It did, however, monitor supply and demand conditions in certain markets. It also took measures to prevent hoarding by directing inventories to be sold off and material shipments speeded up when necessary.[7]

In Japan, therefore, statutory authority has existed for the government to exert direct control over prices of petroleum products and commodities essential to life. Although considerable public opinion in Japan favors the exercise of these controls, the government views them as tools to be used only in times of extreme emergency.[8]

Japan's philosophy of price controls seems to be based on the premise that markets work well most of the time. Sometimes, however, they "get out of kilter," and governments should intervene, but withdraw once normalcy has returned.

Public fees and prices.—In addition to emergency intervention to control prices of essential commodities, the Japanese government also is required to either set or approve several other prices. These consist primarily of fees for public services and prices for commodities, in particular agricultural products, that the government fixes under its price support programs.

In Japan, public fees and prices can be divided into the following three broad categories:

1. Prices determined by the Diet or central government.—The Diet (parliament) determines rates for the national railway, post office, and the telephone and telegraph company, as well as prices for items produced or distributed by government corporations, such as tobacco products and salt. Government ministries also determine the tuition at national universities, the wholesale price of rice and other major agricultural products,[9] fees for examinations and treatment under national health insurance, and some other miscellaneous charges.[10]

2. Prices requiring government approval.—The central government approves increases in rates for electricity, propane gas, private railway transportation, buses, taxis, trucking services, ferry boats, and airplane services.

3. Prices determined by local public corporations.—Local or regional public corporations approve water charges, rates for public baths, and tuition at public colleges.

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[7] Cullison, A. E. Japan Acts to Control Inflation. Journal of Commerce, March 20, 1980. p. 1A, 19A.

[8] Keizai Kikakucho, p. 84.

[9] The government supports producer prices of rice, barley, wheat, potatoes, sugar beets, sugar cane, soybeans, rapeseed, tobacco, silk cocoons, milk, and pork. It also determines the wholesale price for rice, barley, and wheat. For current support price levels, see Japan. Ministry of Agriculture and Forestry. Abstract of Statistics on Agriculture, Forestry and Fisheries. Tokyo, Norin Tokei Kyokai. Annual.

[10] Keizai Kikakucho, p. 95.

In Japan's consumer price index, the above price-controlled items receive a weight of 1,562/10,000 or 15.6 percent of the total index. Since increases in these rates also receive wide public attention, they are important in terms of their effect on the inflationary expectations of the public.

The Japanese process for determining these prices and charges seems essentially similar to that used in the United States for items whose prices are regulated, supported, or set by government. A major difference, however, is that in the United States each price is usually determined by the government body in charge based primarily on the economic conditions of the activity in question and usually with only minimal consideration given to national price policies. In Japan, final government approval for price increases must clear the Council of Cabinet Ministers Concerned with Prices.[11]

The Council can postpone some price increases, even though each might be justified, in order to moderate the rate of inflation. The Council also tends to keep prices for items such as medical care, electricity, and transportation fairly standard nationwide. Such standardization tends to be more rational in Japan, however, because Japanese firms face far less geographical variability in cost of production than their U.S. counterparts.

The Council of Cabinet Ministers also generally insists on internal-cost-cutting measures before allowing fee increases and, in some cases, allows deficits to be borne by the central government treasury rather than raising prices. In exereme circumstances, the government will suppress public fee increases in order to exhibit a harsh posture with respect to the price policies of the government. This helps to weaken inflationary psychology and tendencies for bandwagon price rises.[12]

During the oil crisis in 1973–74, for example, the Japanese cabinet first decreed (in December 1973) that public fees were to be strictly controlled. The increases in the price of rice and in railway fares which had already been approved also were postponed for six months.

In 1974, however, upward pressures on costs forced the government to allow increases in user fees most closely associated with the price of petroleum. Priority was given to electrical and gas utilities, private railways, buses, and taxis.

Government enterprises, meanwhile, were suffering a tremendous profit squeeze caused by the large wage increase granted by the government during 1974 on one side and the freeze on the price of their products on the other. In 1975, therefore, postal rates, national railway fares, and tobacco product prices were revised upward. Increases in telephone and telegraph rates, however, were spread out over the next two years in the interest of price stability and the well-being of the population.

By 1976, Japan's inflation rate had subsided to 9.3 percent. Further upward revisions were allowed in prices of utilities, railroads, and medical treatment. In 1977, increases were allowed in taxi fares, the price of rice, and again in medical treatment.

In 1978 and 1979, with the inflation rate falling to less than 4 percent, catch-up increases were allowed in nearly all public fees. Even

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[11] An overview of Japan's structure for administering prices is in Keizai Kikakucho. p. 181–83.
[12] Ibid., p. 97–99.

with inflation re-emerging in 1980, further increases were allowed, although the scope and implementation period for some were adjusted.

Table 1 shows annual price changes for several publicly managed goods and services in Japan as reflected in the data collected for the consumer price index. Note that for most items, price increases during the early 1970s were small. Later, however, catch-up increases were so large that for national railway fares, tuition at national universities, telegram charges, and rice, the total increases over the 1970s actually exceeded that for the consumer price index.[13] Note also, however, that for medical treatment, telephone charges, tobacco products, and electricity the total increase over the 1970s was far below that for all consumer prices.

TABLE 1.—ANNUAL CHANGES IN PRICES FOR SELECTED PUBLICLY MANAGED GOODS AND SERVICES IN JAPAN, 1972–79

[In percent]

	All consumer prices	Medical treatment	National railway fares	Telegram charges	Telephone charges	Tobacco products
1972	4.6	11.5	0	106.8	0.4	0
1973	11.8	−3.3	0	10.4	1.8	0
1974	24.3	6.2	5.4	0	.7	0
1975	11.9	13.0	16.4	0	.1	0
1976	9.3	6.3	17.9	8.3	4.1	49
1977	8.1	2.0	38.7	84.7	59.4	0
1978	3.8	12.2	5.8	0	3.4	0
1979	3.6	.7	13.8	0	.1	0
1970–79	119.0	60.1	141.6	356.6	77.6	49
	Gasoline	**College tuition (national)**	**Rice**	**Beef**	**Salt**	**Electricity**
1972	1.9	11.7	3.6	6.3	0	−0.1
1973	13.3	72.3	8.3	37.8	0	−.2
1974	50.8	26.1	13.7	20.8	0	14.1
1975	11.9	41.6	29.4	8.2	0	4.8
1976	6.4	17.1	14.7	14.8	58.0	7.5
1977	2.7	43.0	10.0	2.4	25.3	11.2
1978	−11.3	34.6	5.9	1.0	−.6	−1.8
1979	16.6	31.2	2.1	2.4	−.1	0
1970–79	136.4	916.5	126.4	143.0	96.7	39.5

Source: Based on: Japan. Sorifu (Prime Minister's Office). Shohisha Bukka Shisu Nenpo (Annual Report on the Consumer Price Index) 1979. Tokyo, Sorifu, 1980, pp. 130–68.

Prices supported by import controls.—A third category of prices directly influenced by the Japanese government comprises commodities, mostly agricultural, whose prices are kept high either by import quotas or by a sliding tariff rate. The most obvious examples are beef, pork, and mandarin oranges.

These commodities have either implicit or explicit price supports designed to maintain the income of domestic producers. Government intervention in these markets is aimed primarily at limiting competition from low-cost imports and at establishing a producer price that covers the cost of production in Japan's land-scarce agricultural sector.

The initial effect of these actions is inflationary, not anti-inflationary. Yet, during periods of rapid inflation the Japanese government can keep domestic prices of the protected commodities relatively stable by

[13] Since the price of rice in table 1 is at retail, increases can be attributed only in part to government increases in the wholesale rice price.

not allowing them to rise along with world prices. This can be accomplished by expanding import quotas, which increases market supply and reduces upward pressures on prices.

The result is a type of illusion. Since inflation measures price changes, not absolute price levels, price stability can be achieved by maintaining continually high prices. Thus, current inflation is lower because past inflation has been higher.

Of course, domestic producers usually will oppose increasing imports during periods of severe inflation. A government has the option, however, of "taking the heat" from such interest groups and keeping the prices of such products relatively stable by narrowing the gap between international and domestic prices. Such an anti-inflation policy is feasible only in a country that already is protecting some commodities.

In Japan's beef market, this process is somewhat institutionalized. In response to a beef shortage in 1973–74, Japan revised its Law Concerning the Stabilization of Livestock Product Prices and from May 5, 1975, established a system for controlling the price of beef. This new system calls for the government to determine a price band that places upper and lower bounds on fluctuations in the wholesale price of beef.

The Livestock Industry Promotion Corporation (Chikusan Shinko Jigyodan), a group of wholesalers and producers of beef, is allowed to handle most beef imports and to regulate beef supplies. The Corporation earns large profits on its markup of imported beef (about 42.1 billion yen in 1979), which it uses to increase the efficiency of domestic producers and to reduce prices for consumers.[14]

The Livestock Industry Promotion Corporation, of course, has little incentive to increase imports and reduce beef prices. Still, the existence of the price band along with pressures from beef exporting countries to expand their sales to Japan have combined to keep beef prices fairly stable. During the four years following the revision of the law in 1975, beef prices rose by 21.5 percent compared with 27.0 percent for all consumer prices.

Wage Controls

With the exception of wages of public employees, Japan generally does not intervene extensively into wage settlements between unions and industries. The institutional structure of Japan's labor market, however, produces some of the results that a policy of wage controls seeks to obtain in other countries.

Industrial relations in Japan are based on three pillars: Enterprise unions, lifetime employment, and seniority wage increases. Other important characteristics include strong company loyalty among employees, annual wage agreements negotiated during a "spring offensive," large semiannual bonuses partly dependent on a firm's profits, potential for union members to rise to management and executive levels, and in many cases salary increases for managers determined by the union wage settlement.[15]

Japan's system of industrial relations, however, is typical only of a core of regular employees (about 25–30 percent of the labor force)

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[14] Keizai Kikakucho, p. 121–24.

[15] For further details see Yakabe K. Labor Relations in Japan. Tokyo, Ministry of Foreign Affairs, 1977 or Shimada, H. The Japanese Employment System. Tokyo, Japan Institute of Labor, 1980.

who work in large firms. For these workers, permanent employment brings job security. The enterprise union (rather than craft union) creates an identification with other workers within a company and not with similar craftsmen in other firms. And since semiannual bonus payments depend partly on short-term profits, and future wages and job security depend on the long-term viability of the company, workers have a strong incentive to strive for the profitability of the enterprise. Labor-management relations tend to be less adversarial, because most managers once belonged to the labor union, and many labor leaders expect to rise to management positions.

Japanese labor unions in the private sector usually will not jeopardize the financial health of a company by a long strike. Labor unions learned a bitter lesson from the 1960s when enterprise unions occasionally engaged in militant struggles with their employers. Since such strikes were not industry wide, the enterprise's product tended to lose market share. This led to reduced employment opportunities for the striking union.[16] Japanese firms, therefore, generally can engage in annual wage negotiations without fear of annual labor unrest.

Labor relations in Japan, therefore, tend to be quite harmonious despite the ostensible militancy of union rhethoric. In 1979, for example, with a labor force slightly more than half that in the United States, Japan lost fewer than one million working days to labor disputes compared with 35 million in the United States.[17] During the spring wage negotiations in 1981, strike actions were unusually limited, and work stoppages generally were held to a few hours each day—usually before or after normal working hours.[18]

In industrial societies, government wage controls generally are aimed at breaking the "wage-price" spiral by restricting wage increases to the growth in labor productivity. This reduces the "cost-push" pressures on firms to raise prices and at the same time allows them to maintain their rate of profits. The Japanese system of labor relations seems to attain these goals quite well without formal government controls.

The government, however, occasionally does "jawbone" to keep wage increases moderate. Over 70 percent of all organized labor concludes wage settlements during the annual "spring offensive" (April–June). These wage increases also are used as an important reference point in determining changes in the wages of government employees, the price of rice, and health insurance fees. At this time, the strategy of the labor unions is to first demand wage increases that they know are too high. They also attempt to settle with the more prosperous industries first, in order to set a pattern for weaker industries.[19]

At the beginning of the spring offensive, government officials may meet with labor leaders and ask for moderate wage increases or even suggest a specific percentage change. In December 1974, for example,

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[16] Koshiro, Kazutoshi. Anti-inflationary Wage Determination Under Free Collective Bargaining in Japan from 1974 to 1976 (II). Japan Labor Bulletin, v. 13, June 1, 1976. p. 5–7.

[17] International Labor Office. 1980 Year Book of Labour Statistics. Geneva, International Labor Office. 1980. p. 636–37.

[18] Japanese Accept Moderate Pay Hikes. Journal of Commerce, May 18, 1981. p. 16.

[19] For more detail, see Ono, Tsuneo. The Extent of Union Inflation in Japanese Wage Negotiations (Shunto Formula)—Recent Trends and Historical Review. Japan Labor Bulletin, v. 15, August 1, 1976. p. 5–8.

Prime Minister Miki met with union leaders and asked that wage increases be kept to 15 percent, the government's target for the rate of inflation. While such guidance from the government does not hold the force of law, it, nevertheless, is given serious consideration.[20]

A formal wage (incomes) policy was seriously considered by the Japanese government following the 32-percent wage increase obtained by labor in 1974. The Economic Planning Agency, which was charged with examining the problem, however, recommended that, at that time, no such policy was necessary. It reasoned that the current inflation was temporary, that strong export earnings were enabling firms to pay higher wages, and that by the very nature of "enterprise unionism," Japanese unions tend to be very sensitive to the economic conditions of their respective companies. Decreased profits or a slackening of labor market conditions would eventually cause enterprise unions to be more flexible in formulating wage demands.[21]

Table 2 shows average wage increases in manufacturing industries, the growth rate in labor productivity for manufacturing industries, changes in the consumer price index, and the ratio of job openings to applicants from 1972 to 1980. Note that while wage increases have been smaller recently, they do allow for some increase over the rate of inflation.

The data on wages and productivity in table 2 show that Japan's high growth in labor productivity (except for 1974–75) has usually covered wage increases. Japanese manufacturing industries, therefore, could grant wage increases without pushing up unit costs of production.

After 1974, Japan experienced a drastic softening in its labor market. Before 1975, there was more than one job available per applicant. After 1974, the ratio of offers to applicants dropped to about 0.6, or 6 jobs per 10 applicants. This is another factor behind the moderate wage demands of Japanese labor unions.

TABLE 2.—ANNUAL CHANGES IN WAGES AND LABOR PRODUCTIVITY IN MANUFACTURING AND CONSUMER PRICES IN JAPAN, 1972–80

[In percent]

Year	Wages in manufacturing	Labor productivity in manufacturing	Consumer prices	Ratio of job offers to applicants
1972	15.7	[1] 11.1	4.5	1.16
1973	23.4	[1] 20.1	11.7	1.76
1974	26.2	–.5	24.5	1.20
1975	11.5	–3.9	11.8	.61
1976	12.3	12.3	9.3	.64
1977	8.5	5.1	8.1	.56
1978	5.9	8.0	3.8	.56
1979	7.4	12.1	3.6	.71
1980	8.1	(2)	8.0	.75

1 Percentages for 1972–73 are based on an old series that has not been linked to the series after 1973.
2 Not available.

Sources: Based on Bank of Japan. Economic Statistics Monthly, March 1981, p. 9–11, and Economic Statistics Annual, 1977, p. 5.

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20 Koshiro, Kazutoshi. Anti-inflationary Wage Determination Under Free Collective Bargaining in Japan from 1974 to 1976 (I). Japan Labor Bulletin, v. 13, May 1, 1976, p. 8–10.

21 Ibid. See also Ono, Tsuneo. Some Notes on the Background of the Recent Discussions on an Incomes Policy. Japan Labor Ministry, v. 10, April 1, 1971. p. 4–6.

In short, Japan has no formal wage policy. It does, however, have a social contract buttressed by the structure of its industrial relations that invokes a kind of soft incomes policy.

The effectiveness of Japan's current anti-inflation policies and voluntary wage restraint by labor can be illustrated by comparing changes in Japan's wages and prices during the first (Oct. 1973–Dec. 1974) and second (Dec. 1978–Feb. 1980) oil crises. As shown in Table 3, the increase in wholesale prices, which depend largely on the price of imported petroleum and raw materials, increased by 29.3 percent in the first and 23.1 in the second crisis. The price of raw materials alone increased by more than 30 percent in either case. Consumer prices, however, rose by 27.6 percent in the first case compared with 7.7 percent in the second. The major reason for their difference appears to be in the small increase in wages during the second oil crisis, when wages rose by 9.5 percent compared with a 28.1 percent increase during the first oil crisis.

TABLE 3.—CHANGES IN WHOLESALE AND CONSUMER PRICES, WAGES, LABOR PRODUCTIVITY, AND UNEMPLOYMENT DURING JAPAN'S 2 OIL CRISES

[In percent]

	1st oil crisis (October 1973 to December 1974)	2d oil crisis (December 1978 to February 1980)
Wholesale Price Index	29.3	23.1
Raw materials	34.1	39.0
Industrial goods	25.0	18.1
Consumer Price Index	27.6	7.7
Wages in manufacturing	28.1	9.5
Labor productivity in manufacturing	−11.7	[1] 12.5
Number of wholly unemployed	51.7	−4.3

[1] December 1978 to December 1979.

Source: Koshiro, Kazutoshi. Wage Determination Under the Second Oil Crisis. Japan Labor Bulletin, vol. 19, July 1, 1980, p. 5.

Japan's economy, however, was better prepared in 1979 than in 1973 to cope with an increase in petroleum prices. Labor productivity, for example, fell by 11.7 percent over the first oil crisis while rising by 12.5 percent over the second. This allowed firms to absorb some of the higher costs of raw materials without raising prices. The number of wholly unemployed also declined by 4.3 percent in the second oil crisis compared with an incredible rise of 51.7 percent during the first. This indicates that enterprises probably had already trimmed away excess labor costs by 1979.

Perhaps the most interesting aspect of the Japan's experience during the second oil crisis, however, is that consumer prices stability was maintained with little formal government intervention into market.

Chapter V. WAGE AND PRICE POLICY IN THE NETHERLANDS

By David D. Driscoll *

Dutch wage and price policy during the 1970s has been characterized by ambivalence and experimentation. The Dutch government, relying on laws in place since the close of World War II, has the authority to set wages and prices and thus to the exert a strong influence on the domestic inflation rate toward a level consistent with national economic goals. Moreover, at the start of the 1970s, the government attempted to strengthen further its already considerable control over inflation by authorizing itself to intervene directly in wage negotiations at the national level, reserving to itself the power to veto settlements it considered inflationary and in conflict with the national interest. In theory, the Dutch government now enjoys almost absolute control over wages and prices. In practice, however, political and social realities prevent the government from the full exercise of this authority and have created a climate in which Dutch inflation has hovered around the average rate for the European Community as a whole.

Emphasis on Wage Policy

Up until the 1970s the Dutch government had emphasized price control as the principal instrument in moderating inflation. The events of the 1970s soon showed, however, the vulnerability of the Netherlands to imported inflation and the powerlessness of the government to prevent external events (such as the rise in the price of oil) from influencing domestic prices, despite its theoretical ability to control them. Simultaneously, the realization grew that even the government's faltering control over prices would soon be eroded if the seemingly inexorable rise in wages went unchecked. In response to this realization, the Dutch government has tended in recent years to place more emphasis on wage control in its fight against inflation and has attempted to intervene in the market to moderate wage demands. Intervention has variously taken the form of limits on wage increases and outright freezes, but as the 1970s progressed, such intervention met with growing resistance from the social partners. Gradually it has been replaced by an effort to secure stability less through the exercise of government authority than through reasoned consensus and cooperation by employers and trade unions.[1]

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[1] The government is assisted on important questions of social and economic policy by consultation with the Social Economic Council, an official advisory body consisting of labor and employer representatives and of independent exports nominated by the crown.

A Failed Experiment

Because of strong labor market pressures (skilled labor was temporarily in short supply), widespread inflationary expectations at home, and general inflation abroad, the decade began without great success as far as the establishment of a wage policy in the Netherlands is concerned. Conditions favoring inflationary wage demands were not ameliorated by the passage in early 1970 of an ill-advised Wages Act authorizing direct government intervention in collective wage settlements. The authorization met with immediate and intractable resistance from the social partners. In protest against what they considered high-handed government intervention, several central union organizations withdrew from collective bargaining at the national level.[2] This effectively spelled collapse of the institutional framework for a Dutch incomes policy and led to inflationary wage negotiations at the sectoral level, outside direct control of the government. The Act was a double failure. Not only were the sectoral wage settlements inflationary, but unpopular intervention in the process of wage settlement earned the government the opprobrium of both social partners and temporarily poisoned the atmosphere of cooperation on the issue of inflation.[3] As a consequence of these developments, by 1971 the government had virtually renounced the powers it had voted itself in the Wages Act and was seeking to approach wage inflation from a different direction.

Abandoning its attempt to intervene in wage settlements in accordance with the disputed articles of the Wages Act and relying on its general authority to regulate wages dating from the immediate postwar period, the government in the spring of 1971 established a six-month ceiling on pay increases. (The government extended all wage contracts expiring before June 1971 for a period of six months with stipulated maximum pay increases.) The leadership of the trade unions felt it could go along with a general ceilings on wages, although it could not accept government intervention in specific wage settlements. In August, 1971, the government eliminated control over prices. These steps the government regarded as necessary to improve the relationship between itself and the social partners. Unions seemed appeased by the shift to general wage control and management was pleased with the opportunity to adjust prices.[4]

Linking Wages to Prices

These gestures at improving the political climate proved effective, and as antagonism between government and the social partners abated, new controls on wages and prices were gradually introduced and strengthened. During 1972, with government urging, the social partners concluded a central agreement limiting wage increases to 3.5 per-

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[2] Dutch employers and unions negotiate wage settlements at the national level, hoping to arrive at an agreement which will be acceptable throughout the nation. If negotiations at the national level fail to result in a settlement they continue at the sectoral and local level.

[3] OECD Economic Survey. Netherlands for the Economic Cooperation and Development. Paris. November. 1971. p. 27.

[4] Ibid., p. 28–29.

cent above the rate of price increases, thus linking wage policy to price policy. Simultaneously a system of selective price control was gradually imposed. Because of this system and of other factors such as slackening demand and the revaluation of the guilder, inflation was limited during 1972 and 1973 to 8 percent, a moderate rate compared with the experience of most members of the European Community.

The first oil shock of November 1973 and its immediate inflationary impact induced the social partners to accept further government intervention in wages and prices. The government took advantage of this atmosphere and succeeded in mandating minimum waiting periods for passing on to consumers external cost increases, regulating fees more tightly, and limiting rent increases. The process of allowing government intervention in setting wages and prices under threat of the oil crisis culminated in January 1974 in the Special Powers Act which gave the government authority to act on prices and incomes without prior parliamentary consent.

Despite the authority conferred by the Special Powers Act, consumer price rises during 1975 were substantial because consumers finally had to come to terms with higher costs till then delayed by price and wage regulations. The influence of inflated world prices on domestic prices could no longer be restrained by government fiat. Inflation reached 9 percent. In reaction, the authorities invoked their power to impose a six-month wage freeze, effective in January 1976, and to establish stricter controls on prices, setting tight limits on costs which would be passed on in the form of price increases. The quantitative impact of wage and price controls during 1976 is difficult to ascertain, although it is probable that the wage freeze resulted in smaller increases in wage costs than would have occurred in the absence of a freeze. The effect on prices is more difficult to assess. Though price increases decelerated and some part of this deceleration can be ascribed to the smaller increase in the wage bill, more modest import price rises also had a dampening effect.

Throughout 1976 and 1977 price controls were applied which allowed price changes attributable to taxation and to increases in the cost of materials, but not those based on wage increases. This policy naturally narrowed profit margins considerably. Meanwhile, though authorities did not directly intervene in wage negotiations, they stressed there should be no increase in real wages for the average worked in 1978. It is important to note that the Dutch government has never formally relinquished its authority to veto wage agreements absolutely if it considers them contrary to the national interest, although political considerations make the use of this statutory authority most unlikely.

In any discussion of Dutch prices, the exchange rate of the guilder cannot be ignored. Exports from the Netherlands amounted in 1979 to over 41 percent of the gross domestic product, while imports accounted for over 44 percent. In an economy dependent to the extent of the Netherlands' on foreign trade, the currency's exchange rate is of prime importance. In this the Dutch have been fortunate: During the past decade the guilder has retained its value and even appreciated relative to most foreign currencies. Underlying this appreciation are significant amounts of repatriated capital (in part from the former

Dutch colonies) and earnings from the export of natural gas from under the North Sea. Furthermore, the guilder has been consciously tied to the DM and has by and large moved upward in tandem with the German currency over the past decade. The strength of the guilder has raised the value of Dutch exports (though diminishing the volume) and has generally moderated for the Dutch consumer the price of imports.

Developing a Consensus

There has consequently been little use of statutory powers related to incomes policy in the late 1970s. Policies have tended to rely rather on maintaining a broad consensus between government and the social partners, a consensus which the central wage bargaining process is meant to implement. The elements of this consensus are an acceptance of the principle of wage indexation, which imples moderate additions to contractual wages and the maintenance of purchasing power. Indexation of wages, salaries, and unemployment compensation occurs at mid-year and year's end for price increases during the six-month periods ending in mid-April and mid-October. By and large, all parties have accepted the complementary objectives of recovery of profits and maintenance of workers' living standards, though different parties have naturally placed different emphasis on the relative importance of these objectives.

To encourage and to a certain extent to direct the consensus, the government annually makes clear the course it believes the economy should take. To prevent the erosion of purchasing power through taxation, budget proposals (announced before opening of negotiations between employers and trade unions) begin with specific assumptions on the development of contractual wages. These assumptions constitute quasi-statutory guidelines. Since both employers and trade unions oppose direct government intervention in the bargaining process, wage negotiations have proven, over the years, lengthy and arduous. No central agreement has been concluded since 1977, but subsequent negotiations at the sectoral level have ultimately led to agreements. To contain public expenditures the growth of public sector pay and of social benefits has been held at 1 percentage point below the growth of contractual wages.

Price constraints in the Netherlands have proven unnecessary during the past few years for two reasons. First, the appreciation of the exchange rate of the guilder, impelled partly by large increases in foreign exchange earnings from Holland's North Sea natural gas production, has reduced the cost of imported elements in products sold domestically and subjected domestic industries to intensified foreign competition. Second, increases in labor costs have outrun initial assumptions. Because this has narrowed profit margins, the government has authorized compensatory price increases rather than restrained prices to reverse the unintended compression on profits. In 1979 the allowable increase in prices was 4.3 percent, a figure virtually identical to the actual outcome at the retail level.

Conclusion

Dutch policies to dampen inflation contain few novelties since they are based on the traditional practices of wage and price control. The government's power to set prices, however, is severely circumscribed in a world of relatively free trade by developments in world markets. The government's authority to regulate wages is also limited by social and political considerations, though the government did succeed throughout the 1970s, after a bad start, in making some progress in convincing the social partners to work toward moderation in wage demands. Convincing the social partners has largely been a matter of developing the realization that unreasonable rises in wages will benefit nobody and of achieving cooperation in linking wage demands to unavoidable rises in prices through the acceptance of wage indexation. If there is a lesson to be learned from the Dutch experience it is this: control of inflation depends less on the government's legal authority to set prices and wages than on developing a consensus between employers and unions that their own best interest will be served by accepting the interrelation between wages and prices and by attempting to maintain a balance between them.

Chapter VI. WAGE AND PRICE POLICY IN WEST GERMANY

By Arlene Wilson*

Introduction

Wage and price policy is generally understood to include government actions, other than monetary and fiscal policies, designed to control the rate of increase in wages and prices. Usually such policies include government-promulgated guidelines (or targets) for wage and price increases and some mechanism (such as public censure or retaliation by some form of government action) to encourage compliance by labor organizations and businesses. By this definition, incomes policies have not existed in West Germany during the postwar period. Although some suggestions to establish guidelines have occasionally been made, such as that by the president of the German central bank in early 1960 for a guidepost for wage increases of 4 percent based on estimates of productivity gains, they were not adopted.

In this paper, therefore, wage and price policy is defined more broadly to include institutional developments in the postwar German economy that are thought to contribute to wage or price restraint. Defined in this way, the German preference for cooperation instead of conflict between labor and management, codetermination (worker participation in management mechanisms) and concerted action (meetings between national representatives of labor, business and government to exchange information regarding macroeconomic objectives) may be considered as wage and price policy.

The main purpose of this paper is to explain how mutual trust, codetermination, concerted action and other factors contribute to wage restraint in West Germany, with particular emphasis on the 1970s. Since no obvious structural factors contributed to price restraints in West Germany, the discussion concerns only wage restraint.

Cooperation Between Labor and Management

Underlying labor-management relations in the postwar period is a spirit of cooperation and trust that has been greater in Germany than in many other industrial countries. To some extent, this cooperation may result from the German system of national values in which a desire for order and fear of social conflict are important. The need to rebuild the war-torn economy of the 1940s probably contributed

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NOTE.—For further discussion of the West Germany case, see Richard Medley, "Monetary Stability and Industrial Adaptation in West Germany", in *Monetary Policy, Selective Credit Policy, and Industrial Policy in France, Britain, West Germany and Sweden*, a Staff Study prepared for the use of the Joint Economic Committee, June 26, 1981.

to a practice of working together for common goals that lasted long after the immediate reconstruction period. While labor-management cooperation contributed to Germany's postwar economic success, the attainment of rapid growth and prosperity also facilitated the maintenance of labor peace.

Labor unions are considered more cooperative in Germany than in other countries. For example, from 1968 to 1978, the number of work days lost to strikes per 1,000 employees was 49 in West Germany, compared with 139 in Japan, 191 in France, 446 in Great Britain, 545 in the United States and 1,549 in Italy.[1]

There is some evidence, however, that the cooperative spirit is lessening and tension is increasing, particularly regarding non-wage issues. For example, the 1978 strikes in the metalworking, engineering and newspaper industries, largely concerned with issues such as job security in the face of increasing automation, were bitter. Recent wage negotiations have been conducted in a less cooperative and more hostile atmosphere. Some analysts feel that younger trade union members tend to view confrontation, rather than cooperation, as the essence of labor-management relations. Employer dissatisfaction with the Codetermination Act of 1976 and labor's withdrawal from concerted action meetings in 1977 also are evidence of changing attitudes.

Codetermination

Many observers believe that codetermination, or worker participation in management decisionmaking, contributes to greater trust and cooperation between management and labor. Continual exposure to problems and needs of the enterprise provides workers an awareness of the difficulties facing management and the economy. Moreover, steps to solve problems before they become inflamed result in greater efficiency in the long run.

There are basically two worker participation mechanisms in Germany. First, workers are represented on the supervisory board of a company [2] and secondly, at the plant level, works councils are concerned with the daily operation of the firm.[3]

Interest in worker participation began in the mid-1800s in Germany when some workers committees were established on a voluntary basis to deal mainly with social matters. After World War I, works councils were introduced and worker participation became an important goal of the German labor movement. However, all trade unions and works councils were dissolved by the Nazi regime.

After World War II, the trade unions introduced a codetermination plan in which the entire economy would be run jointly by employers and workers at the plant, company, industry, regional and national levels. Although the trade union plan was not adopted, the Codetermination Act of 1951 was a major breakthrough.

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[1] Dornberg, John. Germany Faces a Troubled Decade. Institutional Investor, v. 14, June 1980. p. 174.

[2] German companies have two boards of directors—a supervisory board, which meets infrequently to examine financial statements and broad policy, and a board of executive directors (also called a management board), which meets often and makes the important business decisions. The board of executive directors is elected by the supervisory board.

[3] The term "codetermination" is sometimes used to refer only to worker representatives on supervisory boards and other times also includes works councils. In this paper, codetermination includes both worker representatives on supervisory boards and works councils.

This act, which applied only to the coal, iron and steel industry, included equal representation of workers and shareholders on the supervisory board and provided for a labor director (similar to a personnel director) who would be a full member of the management board and could be appointed or dismissed only by the majority of workers' members on the supervisory board. The Works Council Act of 1952 extended worker representation on supervisory boards to most other corporations above a minimum size but workers elect only one-third of the supervisory board members; shareholders elect the remaining two-thirds.

The issue of whether or not workers should have equal repreesntation on supervisory boards was discussed and disputed over the years. Workers believe that parity is necessary, even though it would mean that workers would share in the responsibilities for decisions. Employers, however, are strongly opposed to parity on the grounds that private property rights would be jeopardized, management's authority would be undermined, and its independence in collective bargaining would be compromised. After much discussion and study of this issue, the Codetermination Act of 1976 was passed, which applies to firms employing more than 2,000 people. The 1951 Act still applies to firms in the iron, steel and coal industries, while the 1952 Act still applies to smaller firms.

Although workers were given equal representation with management on supervisory boards in the 1976 Act, several qualifications give workers less than equal representation in practice. The main qualifications are:

1. A labor director is appointed by a majority of the supervisory board (not majority of the labor representatives on the board, as in the coal, iron and steel industries).
2. The chairman of the supervisory board is chosen by a majority of the shareholders' representatives and casts two votes in the case of a tie.
3. The labor members of the supervisory board include white-collar and managerial workers.

Neither the workers nor employers were fully satisfied with the 1976 Act; workers felt the act did not go far enough while employers felt it went too far. Employer dissatisfaction led to a court challenge by the Federation of German Employers' Associations (BDA) to the constitutionality of the act in 1977. Although the Court ruled in 1979 that the Act was constitutional, trust between workers and employers was adversely affeced by the Court challenge; the trade unions in response to the Court challenge withdrew from the "concerted action" discussions on the national level.

Some employers have taken steps to avoid complying with the 1976 Act. For example, a few companies have attempted to restrict the number of employees to 2,000 or less in order to avoid complying with the codetermination requirements of the 1976 Act.

The highly publicized Mannesmann Company's attempt to change its codetermination status contributed to recent labor-management tensions. Mannesmann, which in the past was primarily a steel company (and consequently under the 1951 Codetermination Act), has diversified away from steel and wanted to merge its steel manufacturing facilities into its pipe division. In early December 1980, management adopted a proposal for a two-step procedure by which the steel facilities would be leased to the pipe division by mid-1981, and the Codetermination Act of 1951 would no longer apply. Trade unions and the Social Democratic Party (which has a large labor constituency) protested. In January 1981, the Federal Cabinet, in a compromise, decided that Mannesmann's codetermination status will continue under the 1951 Act until 1987. Neither employers nor trade unions were satisfied with this compromise.

The Works Constitution Act of 1972 is the current legal basis for works councils. This act provides that works councils shall be elected by employees in all firms with five or more employees, and deal with issues such as conditions of work (hours, remuneration methods), personnel matters (such as dimissals and layoffs) and changes in the organization of the enterprise (such as department closings). In general, wages are determined by collective bargaining between the trade unions and federations of employers at the industry level, but in practice works councils influence remuneration in some cases. Works councils, unlike trade unions, are not permitted to strike to settle differences; instead, "compulsory arbitration" is utilized.

It is important to note that collective bargaining is carried out between trade unions and federations of employers (or employer associations) at the industry level. This means that individual employers deal mainly with works councils at the plant or enterprise level and employer associations deal mainly with the trade unions at the industry level. Although union members are often members of works councils and other interrelationships between the two exist, the basic separation of works councils from collective bargaining contributes to the success of works councils.

The average worker has little direct involvement in his representation on the board of supervisors, but is considerably more involved in the works council. Many analysts believe that the works councils are the most important part of the worker participation mechanism, since they represent the workers in day-to-day operations of firms.

Despite some resistance by employers, most observers believe that the codetermination system has worked well. The anticipation of problems and their early resolution by works councils probably contributed to the high rate of economic growth. Perhaps more important, employees (and indirectly unions) became better informed and more responsible than had codetermination not existed.

Concerted Action

Although the market is the basic allocator of resources in Germany's post war "social market economy," large groups, in particular, government, business and labor, have a significant influence on the way in which economic decisions are made. As a result, there has been a conscious effort to make each of these large groups fully aware of the consequences of their actions on the economy. Concerted action, the term applied to these efforts, was intiated by the Council of Economic Experts for the Examination of Aggregate Economic Demand (CEE) in the mid-1960s. As will be discussed later, labor withdrew from concerted action meetings in 1977, which, to date, have not been resumed.

Established by law in 1963, the CEE is composed of five experts (usually university professors) appointed by the federal government for five-year terms. The CEE is completely independent of the government, and its members cannot be part of any government or legislative body. The CEE is required to analyze the current economic situation and make suggestions regarding the four goals of price stability, high employment, international equilibrium and adequate growth (often referred to as the magic square or magic quadrangle) in an annual report submitted to the government in the autumn of each year.[4]

The CEE suggested the basic concept of concerted action in its 1965–66 Annual Report. The federal government, which agreed with this idea, took steps to put it into effect. The "Act to Promote the Stability and Growth of the Economy," passed in 1967, included a provision that the federal government submit an annual report to the legislature on the German economy. This report must include the government's comment on the CEE report and the government's own projections. Whenever one of the four goals appears to be unobtainable, the government is to provide "benchmarks for orientation" [5] to be used by the "social partners" (business, government and labor) in an attempt to reach all four goals simultaneously. Thus, concerted action was aimed at four broad macroeconomic goals, not only price stability.

More specifically, concerted action has been described by the CEE as follows:

> Representatives of the social groups meet and communicate to each other, and to representatives of policy-making officialdom, reasoned accounts of their expectations about prospective economic developments. This exchange of views proceeds on the basis of benchmarks for orientation by which the Government—taking due account of the limits of what appears at all attainable—states its own targets quantitatively in the framwork of a national-income projection. The benchmarks include estimates of the anticipated development of incomes, but they definitely do not represent guidelines for the behavior of the groups bargaining on the market.[6]

The purpose of concerted action is to provide an opportunity for coordination of private decisions and official policy through an exchange of information. Trade union leaders, representatives of employers and officials of the government (including the Bundesbank and Council of Economic Advisors) as well as members of CEE meet several times a year to discuss the government's economic forecasts and analysis. Attendance at meetings is voluntary, no guidelines for discussion or debate are prepared, no votes are taken, and no votes are taken, and no group is expected to commit itself to any particular economic behavior. Occasionally the government officials have been very explicit regarding the economic consequences of different actions by the social partners. For example, in 1975, the negative relationship between the increase in money wages and the increase in real GNP was made clear in three alternative scenarios presented by the government.

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[4] The CEE may also issue other reports in unusual situations, as it did after the first oil shock and most recently in 1981.

[5] Price, income, employment and other data on the current economic situation, as well as possible and desired future developments.

[6] Schiff, Erie, Incomes Policies Abroad, Part II. Washington, D.C. American Enterprise Institute, 1972. p. 19.

According to one analyst, CEE emphasizes wage restraint as the most important strategy in attaining the four broad targets.[7] The CEE's Annual Reports since 1974 contain numerous statements urging trade unions to exercise wage restraint. The CEE has usually suggested that the annual percentage increase in wages be less than the sum of the anticipated increase in labor productivity plus the expected rise in the cost of living. The 1977 Annual Report of the CEE, however, suggested limiting wage increases to the anticipated increase in labor productivity.

In addition to the CEE, representatives of the five leading economic research institutes in West Germany meet twice a year and issue a report analyzing current economic conditions and projections for the near future. Although these research institutes have no official role in the concerted action process, their views are widely publicized and respected, and thus may influence CEE or government analyses as well as concerted action meetings.

Concerted action was made possible in West Germany by the considerable trust between labor and management and by the existence of a central federation of trade unions (the German Federation of Trade Unions or DGB), and a high degree of organization of employers (represented by the Federation of German Employers' Associations or BDA).

The success of concerted action in promoting wage restraint depends partly on the accuracy of the government's forecasts. If the forecasts are accurate and labor believes that they achieved a fair settlement, they support concerted action in the next round; if the actual inflation rate or productivity gain is above the anticipated rate, labor usually exercises less restraint in wage demands in the next round. This occurred in 1969 and in 1973 when workers based their wage demands on official forecasts which turned out to be underestimated; in the next concerted round, workers' demands were less restrained.

The trade unions withdrew from concerted action in 1977 after the Federation of German Employers' Associations challenged the constitutionality of the 1976 Codetermination Act in court, which the unions considered a breach of trust. Despite plans to reestablish some form of concerted action, recent labor-management relations have been relatively poor (partly resulting from the Mannesmann reorganization dispute discussed earlier), and concerted action meetings have not been resumed. Other contacts between labor and management have, however, continued.

Other Factors

Most wage contracts are signed in the spring, beginning with that of the metalworking trade union, I.G. Metall. In practice, the agreement made by this union, and to a lesser extent the public sector union, sets the pattern for settlements made by other unions. Contracts are renegotiated annually and no cost-of-living clauses are included. An important feature is the "bunching together" of contracts in the

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[7] Roberts, Charles C. Economic Theory and Policy-Making in West Germany: The Role of the Council of Economic Experts. Cambridge Journal of Economics, v. 3. March 1979. p. 86.

spring, when heavy government and public scrutiny is focused on the bargaining process. Increases once a year help to avoid the competition among unions that results from a succession of contract negotiations occurring throughout the year, as in other countries.

Related to, and perhops one explanation for, the cooperative spirit is that trade unions are also owners of businesses in some caess. For example, among the firms owned by the German Federation of Trade Unions is the country's fourth largest bank and its largest construction company.[8]

Since hyperinflations of the early 1920s and the immediate post-World War II period, the Germans have had a well publicized fear of inflation. Not only does this affect their behavior as consumers (for example, they tend to cooperate with anti-inflationary policies of the government by cutting back spending when monetary policy is tightened), but it also contributes to the wage restraint exercised by labor unions.

The year-end announcement by the Deutsche Bundesbank (central bank) regarding the rate of growth of the money supply which it will permit in the subsequent year also may contribute to wage restraint. Wage increases in excess of those estimated by the government may be seen as inflationary in view of the anticipated limits to money supply growth; consequently, money supply growth limits reinforce the need for wage restraint.

Wage Increases in the 1970s

In the German consensual approach, wage negotiations are conducted in the framework of *anticipated* productivity and price increases, not *actual* increases. However, a comparison of wage increases with *actual* productivity and price increases may provide evidence regarding the success of German incomes policies.

As discussed earlier, one of the two formulas for wage restraint suggested by the CEE was that wage increases should not exceed the sum of productivity and price increases. As shown in table 1 below, wage increases were substantially greater than the sum of productivity and price increases only in 1971 and 1974, years of labor unrest and of adjustment to the first oil shock.

By the CEE's second formula, that wage increases should not exceed productivity increases, the evidence is less favorable. Except in 1976, wage increases were greater than productivity increases every year, often by a substantial amount, but this is not surprising in view of the significant inflation even in Germany during the 1970s. This second wage-setting formula is more realistic for a time in which inflation is mild or nonexistent.

Wage increases in the late 1970s were relatively moderate, especially in view of the recent tensions between labor and management. And in 1981 (not shown in the table), wage settlements in the metalworking industry and public sector were about 5 percent, continuing the trend of moderation.

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[8] Hein, John. Revisited—Geormany's "Economic Miracle." Across the Board, v. 17, March 1980. p. 51.

TABLE 1.—PRICES, PRODUCTIVITY AND WAGES IN WEST GERMANY

Year	Annual percent change in—			
	Wages [1]	Productivity [2]	Consumer prices [3]	Productivity plus consumer prices
1971	13.3	3.0	5.2	8.2
1972	9.1	3.9	5.6	9.5
1973	10.3	4.6	7.0	11.6
1974	12.5	2.4	7.0	9.4
1975	8.5	1.7	6.0	7.7
1976	5.9	6.1	4.3	10.4
1977	6.9	3.2	3.7	6.9
1978	5.6	2.4	2.7	5.1
1979	4.8	3.2	4.1	7.3
1980	6.7	1.0	5.5	6.5

[1] Monthly contractual pay rates.
[2] Output per person.
[3] Including food.

Source: Computed by CRS based on data in OECD Economic Survey, Germany. June 1981, p. 75.

Comparing wage increases with price increases, one sees that prices increased less than wages in every year since 1971. This means, of course, that real incomes of workers increased every year, and the consensual approach did not lead to a reduction in real income of workers.

Conclusion

Trust between labor and management, codetermination, concerted action and other factors are interrelated. For example, concerted action could not exist without mutual trust and, at the same time, concerted action meetings contribute to greater trust. Also when relationships in one sphere break down, they tend to break down in other areas. For example, as mentioned earlier, labor unions withdrew from concerted action meetings in response to the court challenge of the 1976 Codetermination Act by the employers. Because of the interrelationships and because some of these institutional devices (especially concerted action) are on an informal basis, it is impossible to estimate the effect of each factor individually on price stability in West Germany.

Furthermore, the informal wage policies discussed in this paper are only one aspect of the economic situation in Germany. It is likely that other economic measures, such as monetary policy and to a lesser extent fiscal policy, play a larger role in the maintenance of price stability than do incomes policies. Attitudes of Germans, such as their considerable fear of inflation resulting from the hyperinflations of the 1920s and post-World War II period, cause them to cooperate with government policies to curb inflation. Institutional factors, such as the close relationship between the banking and industrial sectors and the relatively large proportion of the industrial sector owned by the government, may also be important. At times, such as in 1977–78, appreciation of the Deutsche Mark relative to other currencies contribute to the moderate inflation rate.

Nevertheless, wage restraint by labor unions, concerted action, codetermination and labor-management cooperation probably did contribute to price stability directly as well as indirectly by increasing the effectiveness of other German economic policies.

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