

# HOW TO INDUCE LABOR UNIONS TO FOLLOW GUIDELINES

by Bruno Frey\*

## I. INTRODUCTION

The experience of countries embarking on an incomes policy shows without doubt that the main obstacle to its implementation lies in the political problems created. It is above all the trade union movement which opposes an incomes policy, mainly because it (rightly) feels that once "guidelines" have been established, its functions would become largely redundant. Once an incomes policy is launched, wage earners expect automatic wage increases equal to the guidelines which are widely publicized by government and the press. There would be little need for a union under these circumstances as employers are likely to accept a wage increase equal to the guideline as "justified" and for competitive reasons are forced to pay it. As no organization is ready to give up its power voluntarily (and the union movement is least likely to do so) it is an act of self-preservation of union leaders to oppose any attempt to introduce an incomes policy.

There is another, deeper, reason why labor unions tend to oppose an incomes policy: wage increases equal to the "guideline", i.e. equal to the overall productivity increase in the whole economy do not alter the wage share. The historically given income distribution between wages and profits is held constant but there is no reason at all for unions to accept it as "just". In fact, one of the main purposes of the union movement is and has been to *increase* the wage share.

This second reason has often been advanced as a major argument against the whole idea of an incomes policy. The following analysis shows that this is mistaken; it is on the contrary argued that *only through an incomes policy the wage share of the economy can be increased*. It is, however, not sufficient that an incomes policy of the orthodox kind is established (that would leave distribution constant) but it also needs positive action from the side of trade unions in the form of a *savings policy*. Such a policy gives to the trade unions a new field of activity even when income increases are regulated, keeps prices stable and besides a more favourable income distribution also remedies the even more unequal distribution of wealth. Under such a scheme the wage earners take part in the formation of wealth. Once the advantages are recognized, the proposed scheme should induce trade unions to cooperate to an incomes policy voluntarily. It is important to note that the following analysis does not presume that trade unions act in any way against their interests, because this would be utterly unrealistic. It is on the contrary assumed that they behave perfectly selfish, i.e. they are only concerned with their own well-being.

## II. UNION SIZE, WAGE CLAIMS AND SAVINGS

### *Income Distribution and Nominal Wages*

Taking income distribution as a measure, it must be concluded that the vast increase of labor union activity since its formation has been singularly unsuccessful in raising the share of wages in national income. Although there are statistics showing an increase in the wage share in some countries, it is nevertheless generally accepted that it has been relatively stable in the long run. In any case there is no definite trend observable which could reasonably be attributed to trade union activity.

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The reason for this failure does not lie in an incapability of trade unions to raise nominal wages. They have on the contrary been so successful that entrepreneurs by and large have begun to understand that it is too costly to oppose such wage demands — as they have learnt by experience that the increased wages would be spent again so that the rise in unit labor costs could easily be counterbalanced by price increases, leaving the mark-up ratio and the profit share constant.

Kaldor's simple model of income distribution illustrates this circular-flow impact: according to his theory the income distribution between wages and profits is independent of nominal wages<sup>(1)</sup>. The Kaldor model also shows that there is only one way by which wage earners can increase their share in income, namely by increasing their *savings ratio*.

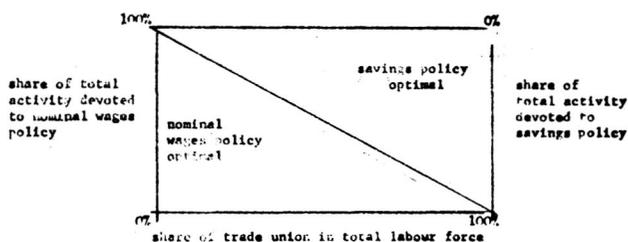
### *Disaggregation: The Influence of Union Size*

It would be wrong to conclude from this that the claim of labor unions for higher nominal wages is irrational! (where it is assumed that the attainment of a maximum *real* wage is the objective). The above conclusion of the independence of distribution of nominal wages is only true for the labor force as a *whole*, but not for a single union. It can be shown<sup>(2)</sup> that the *optimal combination between nominal wage claims and an increase in savings depends crucially on the size of a trade union*.

A *small union* whose membership comprises only an insignificant share of the total labor force *rationaly* claims nominal wage increases (beyond productivity increases), because it receives all the benefits of such an action (i.e. the higher nominal wages) while the costs of nominal wage claims is shared by *all* consumers and wage earners. When the output prices of a small industry rises due to the wage claims of workers in the industry, the *total price level* of the economy (which determines *real* wages) is only slightly affected, and more specifically the increases of the total price level is determined by the weight of this industry's output in total output. The costs of nominal wage claims in the form of a higher price level in the economy can be considered as a "public good," because it must be shared by *all* wage earners. A small trade union can hence increase its real wage (in the short run) at the expense of the rest of the labour force.

A *big union* whose membership consists of a large share of all wage earners in the economy does not act rationally if it only claims nominal wage increases leading to price rises, because the costs of such actions fall largely upon the members of the same union in the form of higher consumer prices: the real wage increases only slightly. In the extreme there is the case of a single union organizing the entire labor force: it would be irrational if it devoted its energy to pressing for wage rises beyond productivity increases of the economy because the entire costs caused fall on the members. We are back at the Kaldor model.

The bigger a trade union therefore, the greater should be the proportion of its activities devoted to the increase of the savings ratio of its members (this union policy will shortly be called "*savings policy*"); the smaller a union, the more stress it should rationally put on claiming higher wages (simply called "*nominal wage policy*"). It can *roughly* be said that a union having X% of the total labor force as its members should devote X% of its total activity to savings policy and (100-X)% to nominal wages policy<sup>(3)</sup>.



This result runs against the “feeling” of many trade unionists and observers who argue that bigger unions *should* ask higher wage increases because they are more liable to be successful. It is, however, exactly their success which through the circular-flow effect is self-defeating.

### *The Possibilities of Savings Policy*

This analysis must be revised when large unions do not act independently of each other. It can safely be assumed that a single small union is in the short run not influenced by what the many other small unions do, but seeks independently to maximize its real income. When there are few big unions, however, there is likely to be (oligopolistic) interaction between them. It can no longer be assumed that large unions devote the greater share of their activity to increasing the savings ratio of their members, because the short run gain of such action — the (relative) fall in the price level — is a “public good” in the sense that it is shared by all. The theory of public goods (BAUMOL, OLSON<sup>(4)</sup>) has shown that under such circumstances nobody would be ready to offer this “good” though each one would be better off. None of the big unions would increase their savings ratio because the others would not only enjoy this lower price level without contributing to its cause, but they would be inclined to ask for higher nominal wages as the constancy of the price level is secured by this other union. A coalition between the big unions would be inherently unstable as each union is tempted to break out. It seems highly unlikely that a voluntary savings policy (and therefore a higher wage share) will become important under present circumstances at a large scale<sup>(5)</sup>: for *small unions* it is more rational to increase their real wages at the cost of other unions through a nominal wages policy, while *large unions* are not prepared to a savings policy because it would make nominal wage policy *more* attractive to non-collaborating unions.

### *Breaking up of Unions and Inflation*

The analysis shows that the proposal of breaking up trade unions into smaller units (as e.g. proposed by FELLNER and LUTZ) would not lead to lower nominal wage increases but on the contrary to higher wage increases. According to our argument it would be preferable to have only one union in the economy which (if it acts rationally) would be induced by self-interest not to ask for wage increases leading to price increases, because these price increases would leave the real income of the union members unchanged. A small union does not have to take into account such price rise repercussions and therefore rationally conducts an aggressive nominal wage policy.

### *Pressure for Voluntary Wage Restraints in a Democracy*

In most countries it is customary that the government tries to “talk down wage increases” by appealing to “public interests” or to “self-restriction for democracy’s sake.” Heavy pressure is at times put upon trade union leaders. Such actions are generally approved by wide circles as performing a useful function in a democracy. It should be pointed out, however, that such statements violate other democratic values of which one of the most important is that subgroups of the society (of which trade unions are certainly crucial) should

be organized democratically. It can fairly be assumed that union members are principally concerned with their own well-being, i.e. they want to maximize their real wage. They elect their leaders not to work for the common interests of the society but to defend their particular interests as well as possible. Putting pressure on union officials to restrict their wage claims means in such circumstances that the government expects the elected representatives to disregard the opinion and interests of union members. "Talking down" wage demands has thus dangerous implications for democratically elected union leaders which should be borne in mind.

### III. POLICIES FOR STABLE PRICES

#### A. *Orthodox Incomes Policy*

Incomes policy practically abolishes free wage bargaining. *Small unions* for which a nominal wage policy is rational, are no longer allowed to follow their advantage. Guidelines set by government constitute in practice not only a maximum wage increase but also a minimum increase below which no group of workers will be satisfied. Hence an incomes policy not only restricts wage rises but is also likely to bring an expansionary force into sectors in which thus far wage rises were exceptionally moderate. When the guidelines are accepted by workers, producers and government as the "normal" amount of wage increases, wage negotiations can no longer be considered as an important area of bargaining. Negotiations with respect to production practices, employee training, sanitation etc. are of no comparable importance, especially as most items are regulated by law<sup>(6)</sup>.

The situation for *few large* unions is somewhat different. The freezing of *relative* wages between various occupations that goes with (the strict variant of) incomes policy, gives to large unions (for which a nominal wage policy is largely self-defeating) the possibility to start a savings policy. Only when each of these large unions can be confident that no other union will be able to take undue advantage of price stability through higher nominal wage claims, it will devote its activity to the promotion of a savings policy. It is little recognized that an incomes policy is not only a means to secure price stability but more important a *necessary prerequisite for a change in income distribution between labor and capital*. It would be too optimistic to assume that the fixing of relative wages through an incomes policy would be a sufficient condition for the adoption of a savings policy by a significant share of trade unions. For this the idea is too unfamiliar and new to unionists, especially to those grown up in the Marxian tradition.

An incomes policy of the type expounded above will be met with much resistance by unionists. The trade union movement as a whole (as organized in trade unions conferences) may view it as an assault on the right of free bargaining (which cannot be disputed). Depending on the political bias of the government trying to introduce an incomes policy a trade union conference may formally approve it in resolutions. However, as it clearly runs against the interest of unions, especially of small unions it cannot be expected to be followed voluntarily in practice. A legal enforcement of an incomes policy would necessarily impose considerable costs upon the society.

Even if, on the other hand, it would be assumed that labor unions would voluntarily follow the guidelines, costs would arise which should not be neglected. At present much of the old conflict between "labor" and "capital" is disguised because both parties have learnt that it is much easier to shift the costs of this conflict to another group, namely onto the consumers in the form of price increases. The incomes policy prohibits both "labor" and "capital" infringing on the guidelines and thus the conflict of interest between the two is sharply brought out. A firm making high profits due to above-average productivity increases can no longer grant higher wage increases to continue good relationships with its own employees, but is forced to lower prices, i.e. to pass the benefit on to an unidentified body of consumers.

## B. *Compulsory Savings as an Alternative*

There seems to be an appealing way out of the difficulties associated with an incomes policy — namely

- (a) The government sets out a guideline according to labor productivity increases,
- (b) Bargaining between employees and unions stays *completely free* but the excess of nominal wages above guidelines *must be saved*.

This proposal is appealing because it leaves completely untouched the social value of free bargaining and hence evades the costs of ensuring that wage bargains do not violate the guideline. Moreover it would change the income distribution in favour of workers through the increase of workers' savings ratios.

Such a compulsory savings policy has shortcomings, too:

- (i) After a period of adjustment entrepreneurs would realize that it is no longer favourable for them to grant readily nominal wage increases as prices can no longer be increased correspondingly because demand does not rise proportionately. They would therefore take a much firmer stand against wage claims. The increase in workers' savings ratio would hence be smaller than it appears from present statistics of the excess of wage over productivity increases.
- (ii) While large trade unions restrict themselves under present conditions knowing that wage increases are largely self-defeating because of the price rises caused, this is no longer true under a regime of compulsory savings: There are no longer repercussions of nominal wage claims on the price level. Large unions would therefore try to maximize wage increases, i.e. *wage claims would be even higher than under present conditions*.

If producers yield to the increased nominal wage policy especially of large unions, this would lead either

- (a) to an increase in prices due to rising unit labor cost *and* to falling (or less rapidly increasing) real output, because demand stays constant,  
or
- (b) to such a pronounced fall in the mark up ratios that private investment and growth is likely to fall.

Both effects are clearly undesirable. If producers choose instead to stay firm against these increased wage claims, industrial conflict would be more pronounced: More working days would be lost through strikes and there would be a general decline of cooperation.

- (iii) It would be even more likely than under present conditions that strong unions would gain large wage increases at the expense of little organized groups of workers.

It is thus a value judgment as to whether an incomes policy with its advantages and disadvantages it is preferred to a compulsory savings policy. If free bargaining, an increased wage share and minimum government interference are valued highly, the latter seems more attractive; if a "just" distribution of relative wages and a greater likelihood of price stability are valued highly and strong government interference is not considered to be a high cost, the former seems to be more desirable.

### C. *Incomes Policy and Savings Policy Combined*

It is possible to combine the advantages of an incomes policy and of a savings policy: An incomes policy should be established primarily in order to stabilize the internal distribution of the wage sum and thus to provide the *necessary prerequisite* for a *voluntary savings* policy by unions. At the same time it is necessary to give *positive incentives* to trade unions to adopt this new policy. Such incentives may be

- (i) stimulation of workers' savings by tax reductions or direct subsidies<sup>(7)</sup>,
- (ii) granting of wage increases in excess of productivity increases if this excess is saved, thus making trade unions accustomed to this new policy. These excesses above the guideline should be controlled in order not to reduce the profit share too rapidly, as this would probably lead to a decrease in investment.

These positive incentives are indispensable in order to compensate labor unions for the factual loss of the free bargaining. The resistance of union officials to incomes policy comes largely from the feeling that unions would become superfluous if maximum wage increases are prescribed by government and if each worker expects this maximum to be his normal wage increase. It must be demonstrated to trade unionists that with the adoption of a savings policy a wide new field is opened. If workers' savings are accumulated within, and administered by, unions (which is the most likely institutional arrangement), unions would hold within relatively short time a great proportion of the total wealth in the economy. The prospect of this power should be an effective additional incentive to union leaders to undertake a savings policy, once the nominal wages policy is precluded.

A combination of incomes policy and savings policy gives to the government increased flexibility. In special cases it is possible to grant to a group of workers income increases beyond the guideline, without endangering price stability as *all* wage increases over the guideline *must* be saved.

On the whole it seems likely that the increased costs on society arising from the administration of a combined incomes and savings policy is more than counterbalanced by the great *benefits* to the society arising from a voluntary new labour union policy.

## IV CONCLUSIONS

The analysis shows that the problems of price stability and income distribution cannot be separated from each other, mainly for political reasons. Without an incomes policy (which corresponds to the present situation in most countries) there is neither price stability nor a more favourable distribution of income or wealth for wage earners. There is, however, a continuous threat of deflation, not because of any inherent instability of the inflationary growth process but because the government has to use restrictive measures to keep the balance of payments under control. An orthodox incomes policy seeks only to deal with the problem of rising prices but by equating the guidelines for wage increases to the economy's average increase in labor productivity it in fact also keeps the distribution of incomes constant. As trade unions have no reason to accept the historically given distribution as "just" and as moreover an incomes policy makes their essential bargaining function largely redundant, they are opposed to such a regulation of incomes. A wage policy that lacks the voluntary cooperation of unions is doomed to failure.

It is one of the purposes of this paper to show that the frequent attacks against incomes policy on the ground that it keeps the distribution of incomes at an arbitrary level is mistaken: only a stabilization of the *internal* distribution of the wage sum through an incomes policy makes a distributional change feasible. The proposed combinations of an incomes policy with a savings policy not only gives trade unions a new function but it is also the only way to change the distribution of incomes and of wealth in favor of wage earners. Such a policy would have revolutionary consequences without disrupting the established social and economic order.

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1. Nicholas Kaldor, *Alternative Theories of Distribution*. *Review of Economic Studies* 23 (1955/56).
  2. This is done in my article "Lohnpolitik und Sparpolitik als optimale Gewerkschaftsstrategien" (*Wage Policy and Savings Policy in the Optimal Trade Union Policy*). *Jahrbuch für Sozialwissenschaft* 17 (1966).
  3. In the *long run* the savings policy becomes for all unions more favorable because they do not only have a benefit through the (relatively) lower price level, but also through the returns of accumulated savings. Wages policy on the other hand becomes less successful in the long run because an increase of nominal wages of one group induces wage increases by other groups.
  4. William J. Baumol, *Welfare Economics and the Theory of the State*, 2nd ed. London, 1965. Mancur Olson, Jr., *The Logic of Collective Action, Public Goods and the Theory of Groups*. Cambridge (Mass.) 1965.
  5. It may be pointed out, however, that in the Federal Republic of Germany one union under the leadership of Georg Leber actually put a savings policy into practice. I. G. Bau-Steine-Erden, *Vermögensbildung in Arbeiterhand*. Frankfurt 1965.
  6. For a contrary opinion cf. e.g. Sidney Weintraub, *National Wage Policy*, In: *Some Aspects of Wage Theory and Policy*. Philadelphia and New York 1963, p. 210-212.
  7. This is e.g. done on a fairly large scale in the Federal Republic of Germany. The relevant laws are: "Promotion of Accumulation by Employees" (July 12, 1961); "Capital Accumulation through Collective Agreement" (May 5, 1965).