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THE DECLINE AND FALL OF WAGE AND PRICE CONTROLS IN BRITAIN (1973-1978)

INTRODUCTION

President Carter's current policy of a "voluntary" system of wage and price controls is by no means the first case of a politician coming to power opposed to the use of controls who later instituted some form of control or guideline over rises in prices or incomes. Voluntary and statutory limits have been used throughout history by governments of all types in the fight against inflation. They are, without doubt, very attractive weapons for a democracy to use. They give the impression to the voting public that the authorities are taking firm, resolute action in dealing with what are apparently the root causes of inflation -- rising costs and business greed. Clearly it is advantageous for any politician seeking reelection to be able to point to laws which he has helped to pass which declare inflation illegal. Even when inflation breaks the law by continuing amid wage and price controls, the politician is in the happy position of being able to blame "maverick" unions and corporations for the situation and to urge the passing of even tougher controls.

There are, of course, many theoretical objections to a policy of wage and price controls -- voluntary or other wise. Many leading economists, for example, contend that controls ignore the basic cause of inflation: that it is not due to the passing on by manufacturers of labor and other cost increases, but is due instead to an expansion in money and credit which exceeds the growth of real output in the economy. These same economists would argue that the ability of companies to grant wage demands and to charge higher prices is possible only because of an overabundance of money (or, at least, that the corporations will only agree to pay higher labor and raw material bills if they believe that the government will create enough new money to enable the public to pay higher final prices). In other words, these so-called monetarist economists contend that wage and price controls put the cart before the horse -- that it is the "inflationary" government policy of printing too much money that brings about higher costs, wages, and prices, and not cost increases that bring about inflation.

The application of controls, if one accepts the monetarist thesis, would thus be like trying to prevent drivers speeding by passing a law that no speedometer should read more than 55 mph.

Not only is there persuasive theoretical evidence from the monetarists which casts grave doubt on the basic assumptions behind wage and price controls, but there is also overwhelming empirical evidence which must lead any reasonable observer to the conclusion that whatever the academic arguments might be, controls just have not worked. History is littered with countless examples of monarchies, dictatorships and democracies which have attempted, without success, to limit inflation by the control of wages and prices. [1]

A STUDY OF BRITAIN

This Briefing will present a summary of the recent history of wage and price controls in Britain. The British case is of particular interest and relevance in view of President Carter's policies. In the first place, controls are by no means a novelty in Britain, and there have not been the philosophical objections to government intervention in the market place that have characterized criticism of controls in America. Hence the British experience may be a useful guide to how controls might work if the American people became persuaded that they were a valuable weapon against inflation.

In the second place, for most of the period examined by this Briefing, there was a socialist government in Britain, a government possessing a very close relationship with organized labor. So if a policy of wage control were to succeed, it is likely that the partnership between government and labor prevalent in Britain would be the best climate for success. Hence the British situation presents the opportunity of studying wage controls under particularly favorable circumstances.

Finally, the wage element in the policy of controls was <u>voluntary</u> under the period of the Labor government (i.e., after spring 1974). No law was passed laying down a maximum rate for wage increases. Instead the government relied on its powers of persuasion and arm-twisting, with the back-up power of limited economic sanctions against companies breaking the guidelines. In

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1. See Robert Schuettinger and Eamonn Butler, <u>Forty Centuries of Wage and Price Controls</u> (Washington, D.C.: The Heritage Foundation, 1979).

this particular regard, the policy bore strong resemblances to the present Carter package.

The notion of a voluntary system of controls is very attractive to those who may believe in the economic case for controls, but are also disturbed by the prospect of bureaucratic meddling with the economy. Yet, as this paper will demonstrate, the British experience of "voluntary" wage controls suggests than non-statutory wage guidelines may be even more damaging, in certain respects, that legally-enforced controls.

PRICE CONTROLS IN BRITAIN SINCE 1972

THE CREATION OF THE PRICE COMMISSION

When Keynesian economics became the cornerstone of government economic policy after the Second World War, the use of prices and incomes policy became central to Treasury thinking on how to deal with post-war inflation. During the later 1960s, under the Labor government of Harold Wilson, the policy achieved an institutionalized basis with the creation of the Prices and Incomes Board. From its inception, however, the Board was heavily criticized by the opposition Conservative party as wasteful, bureaucratic and ineffective, and the party was pledged to sweep away controls when it came to power in 1970.

Within a year of taking office, however, the Conservative government began to have second thoughts on the subject of price controls. Prices were beginning to rise disturbingly, and there were moves from the Confederation of British Industry (the association of major British Companies) for a joint agreement with the unions to limit pay and price increases. By the autumn of 1972 the Conservatives felt compelled to introduce legislation to control prices and incomes.

During the first five months of the policy, November 1972 to March 1973, control took the form of a total freeze on incomes and prices (the so-called Stage 1). Following this period, the second stage of the policy commenced with the creation of the Price Commission.

The policy of price control introduced under the Conservative government had four key characteristics:

1. <u>Separation of Pay from Prices</u>

The Labor government's Prices and Incomes Board, set up in 1963, had dealt with both price and wage increases. The Conservatives, adopting the approach used by President Nixon in his 1971 system of controls, split the function of controlling the two elements.

2. Administration by an Independent Statutory Authority

Control of prices was entrusted to an independent statutory agency (i.e., the Price Commission). Parliament set the procedures for the notification of price increases, etc., but the power of enforcement rested in the hands of the Commission. As the act prescribed:

> The Price Commission shall exercise the powers....in such ways as appear to them appropriate for the purposes of ensuring the provisions of the code are implemented.[2]

3. The Legalistic Nature of the Control

The American Price Commission and the Cost of Living Council, which paralleled the British Price Commission, were subordinate law-making bodies, with the power to lay down directives having the force of law. The Price Commission in Britain, on the other hand, had no such legislative power, and alterations in the price code required the agreement of Parliament. Thus changes were slow and difficult to make, and in consequence the system was less flexible than that in the United States.

4. The "Steady Progression" from Freeze to Decontrol

It was well understood in Britain, as elsewhere, that one of the major problems with a "freeze" is that when it is lifted there will be a price explosion. In the United States, the broad strategy of the Nixon controls was to relax price controls in line with the decline in inflationary pressures. Hence Phase 1 (the "freeze") was followed by Phase 2 (the "strict control"), by Phase 3 ("relaxtion"), and finally by Phase 4 ("out"). The aim of the Counter Inflation Act of 1973 was to set in motion a similar process, with the steps being called "stages." The stages took the following form:

Stage 1	November 1972 - March 1973
Stage 2	April 1973 - October 1973
Stage 3	November 1973 - November 1974
Stage 4	December 1974 - March 1976

The three-year life of the Price Commission, as laid down in the 1973 Counter Inflation Act, came to an end in March 1976. The then Labor government, however, redesigned the functions of the Price Commission in the 1977 Price Commission Act, gave it discretionary powers, and made it a permanent part of the economy.

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2. The Counter-Inflation Act of 1973, section 6.

THE PROCESS OF PRICE CONTROL

The price control instituted in 1973 applied to all products, with the exception of fresh food, and applied to all types and levels of enterprise. In manufacturing sector, there were two elements of control:

a. Allowable Cost Control

Under allowable cost control prices could only be increased to the extent that they could be justified by certain specified ("allowable") costs. In 1973, for instance, only one-half of any increase in wages could be passed on as an allowable cost.

b. Profit Margin Control

Under this aspect of control, the profit margin of the enterprise was not permitted to exceed the level made in the twelve months before April 1973. Thus, if the company had experienced a year of poor profits prior to the control, it would be unable to make up the shortfall.

The basis of enforcement of the controls rested primarily on "pre-notification." The larger companies were required to inform the Commission of intended price increases, and the Commission would investigate them and decide if they complied with the price code. By November 1973, medium-sized companies were also required to notify the Commission of intended rises, and this meant that approximately 1,400 companies became subject to direct controls.

It was assumed that if the leading companies were directly controlled, the engine of inflation would, in effect, be slowed down, and that competition would ensure that the smaller companies would keep their prices down. Nevertheless, companies below the pre-notification level (other than the very smallest companies) were required to keep records, and these were inspected from time to time by the Price Commission.

THE RESULTS OF PRICE CONTROLS

In the words of the chairman of the Price Commission from 1973 to 1977, Sir Arthur Cockfield, the record of the Commission in its first years was "a bitter disappointment."[3]

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3. Sir Arthur Cockfield, The Price Commission and the Price Control, The Three Banks Review (London), March 1978, p.17.

TABLE I

The Retail Price Index and the Expansion in the Supply of Money in the United Kingdom, 1970-1975 (percentage increase)

Year	Retail Price Index	Increase in Money Supply (M3)
1970	6.4	9.5
1971	9.4	12.4
1972	7.1	25.8
1973	9.2	28.7
1974	15.4	12.7
1975	28.4	7.8

Source: Central Statistical Office, Annual Abstract of Statistics (Her Majesty's Stationery Office, London).

Bank of England Quarterly Bulletin (London).

Note: M3 = Notes and currency in circulation + private sector checking and savings accounts + public sector deposits.

The inflation figures for Britain between 1970 and 1975 are presented in Table I. The Retail Price Index covers all items and represents a comparison of prices with those of the previous year.

Although defenders of price controls would contend that there were many factors serving to push up inflation in Britain during the early 1970s (such as the quadrupling of oil prices and the failure of wage controls), the rate of inflation during the years of the Price Commission hardly suggests that the controlling body was a great success. Britain suffered inflation of South American proportions during 1974-1975. In viewing the inflation of the period, however, it is interesting to note the increase in the supply of money during the same years. Between 1971 and 1973, Britain experienced a massive injection of newly-created money as part of the Conservative government's policy of stimulating growth through cheap credit. Monetarist economists have not been slow to point out that this monetary expansion preceded the acceleration in inflation with a time difference in keeping with their theory of inflation. It might also be noticed, in passing, that the money supply slowed down dramatically after the election of the Labor government in 1974 (at which time the International Monetary Fund laid down strict financial guidelines for the granting of standby credit), and that inflation subsequently declined to its present level of approximately 10 percent.

Viewing the period from 1974-1978, Britain's inflation rate can have done little to give comfort of the 500 battling staff of the Price Commission.

TABLE II

Inflation in the Major Industrial Countries
(February 1974-August 1978)

West Germany	20.6 %
United States	39.6
Japan	45.5
Canada	49.1
France	56.8
Britain	96.1
Italy	98.0

Source: House of Commons Official Report (Hansard) (H.M.S.O. London), vol. 960 No. 31 (13 December 1978), col. 693

As Table II shows, Britain had the worst inflation rate for the period of any major industrial country, with the sole exception of Italy. During the same period Britain's industrial production index fell from 110.6 (October 1973) to 109.5 (October 1978), and the average family real income fell from £71.40 per week in 1973-4 to £64.90 in 1977-8 (at June 1978 prices).[4]

THE PRICE COMMISSION: THE CHAIRMAN'S OBSERVATIONS

Disappointment with the record of the Price Commission has been expressed widely in Britain, and some would say that its role has now been relegated to that of a cosmetic, public-relations agency. Some of the most interesting reflections on the work of the Commission, however, come not from its opponents but from its chairman from 1973 to 1977, Sir Arthur Cockfield. Sir Arthur argued in an

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4. House of Commons Official Report (Hansard), vol. 960 (13 December 1978), col. 693.

article last year[5] that price controls should be viewed rather like sending for the fire department when your house is on fire--"that is not the time to say you shouldn't have let grandmother smoke in bed." In other words, he saw controls as an emergency measure, dealing with current inflation, and not as a means of dealing with the cause of that inflation. As Sir Arthur continued, price controls may be necessary in a critical situation:

> But it is equally important not to regard such controls as a "solution": they provide only a breathing space in which basic weaknesses in policy can be put right.

Sir Arthur was also concerned that controls had lasted too long, and that the government had, in practice, used them as an alternative to painful but effective corrective policies:

> Controls of this character cannot last very long. There is a remarkable similarity between price controls and excess profit taxes. Both assume that the then existing patterns of prices, profits, and profit margins must be accepted -- and can and should continue. As a result, those who were doing well continue to do well: those who were doing badly continue to do badly. This ossifies the pattern of the economy: it stultifies progress: it penalizes efficiency and rewards inefficiency. As time goes on, refinements and reliefs have to be introduced to meet the hard cases. The legislation -- or code -- gets longer and longer....In the end the control becomes largely ineffective. So one ends up with more and more complex control which achieves less and less.

At the peak of the inflation, in 1975, Sir Arthur contends that controls may have slowed down price increases by 3-4 percent "but...towards the end the effect was minimal." In 1974, on the other hand, output was falling and the economy was moving into recession:

> As a result the market was increasingly taking control and prices were being held down by market forces and not by the mechnism of price control.[6]

PRICE CONTROLS IN BRITAIN: CONCLUSION

The recent experience of price controls in Britain suggests

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5. Cockfield, The Price Commission. The following quotations are taken from this article.

6. He has argued in an interview with the author that controls may have an important function in reducing the public's expectation of inflation, which may in turn help to reduce inflation by slowing down the rate at which money circulates. But this, of course, presupposes that the public does believe that controls will curb inflation.

certain conclusions which provide important lessons for the United States.

a. Controls assume "cost-push" inflation

The true cause of inflation has been a source of dispute among economists for centuries. Controls can only be justified, however, if one believes that price inflation is a result of labor and other costs being "passed on" in the form of higher output prices to the consumer. But if one subscribes to the school of thought which argues that inflation is due to an expansion in the supply of money that is greater than the increase in goods and services (or loosely, "too much money chasing too few goods"), then the whole notion of price controls is an irrelevance.

This Briefing is not the place to discuss the theoretical arguments or empirical evidence regarding the cause of inflation. But, as Table I and other data show for Britain, there is a remarkable correlation between monetary expansion and inflation which casts grave doubt on the cost-push theory and hence on the use of controls.

b. Price controls do not slow down inflation

Even the strongest advocates of price controls find it difficult to point to clear cases where controls have had any more than a temporary, or local, effect on the trend of inflation. The chairman of the Price Commission may well feel able to make the hypothetical assertion that prices would probably have risen by 3-4 percent more at the peak of Britain's inflation had it not been for the action of the Price Commission. But, even if this could be verified, it ignores the probability that price controls may only even out the peaks and troughs of the trend of inflation. Companies may, in other words, merely postpone price increases during a period of very high inflation when controls are in effect and then introduce even higher prices after the peak has passed (prices sufficiently high to recoup lost revenue), adding to the rate of inflation in the following period.

c. Price controls are damaging to the economy

If price control has any effect, it is to cause dislocation and damage to the economy. If one restrains the price of any individual item during a period of general inflation, production of that good becomes less profitable and shortages develop. If one restrains the prices of all goods and services in the economy there will be misallocation and a general slowdown or recession. As Alfred Kahn would surely testify, holding down price increases is no easy task: but if price controls become more stringent in the U.S., the result will almost certainly be recession. Since price controls were instituted in Britain in 1972, the economy has been in total stagnation, profits have fallen, bankruptices increased, and unemployment has reached record levels.

d. Price controls breed unjustified criticism of the free enterprise system

Some of Alfred Kahn's recent suggestions and criticisms of business demonstrate a particularly disturbing side-effect of controls. When they do fail, the inevitable response of the controlling agency is to blame business for being unpatriotic, unprincipled, greedy, etc., etc. It becomes easy for a bureaucrat to point the finger at individual companies -- particularly when they are large corporations -- and to generate public suspicion. By doing so the government is merely diverting attention from the bankruptcy of its own policy of control. Yet the tactic can be effective and can lead to distrust of business in general. In Britain this has reached the point where a company chairman announcing good profit figures osunds more like an accused man confessing his "crimes" at a Soviet show trial.

e. Price controls inhibit competition and may raise prices

Price controls reduce price flexibility. A company will hesitate to lower prices to compete because it may find it impossible to raise them at a later date if it has miscalculated or conditions require it.

This obstacle to competition serves, in the long run, to push up prices and to reduce efficiency, since companies will tend to err on the side of posting higher prices than they feel are adequate to avoid being hurt by controls. The whole approach of price control also tends to put executives into a "cost-plus" frame of mind, where pricing decisions become a calculation based on costs and "legitimate" profits rather than on an accurate appraisal of the market.

f. Deregulation as an alternative to price controls

It would appear form the evidence of most countries that improvements in competition are much more effective in forcing companies to economize and trim prices than are price controls. This would suggest that the government would be better employed in dismantling the anti-competitive industry regulation it set up in the past rather than creating new regulations regarding prices. It is interesting to note that in the one major industry that has been deregulated recently -- airlines -- there have been dramatic reductions in fares. Alfred Kahn looked a much happier inflation - fighter when he was decontrolling the airline industry than he now does as the nation's top price-controller.

PAY CONTROL IN BRITAIN 1973-1978

INTRODUCTION

The prices freeze of 1972-1973 and the price control under the Price Commission was only one arm of the policy used by recent British governments in an attempt to lower inflation. In the same way that it was believed that the root cause of most price increases lay at the door of the larger private companies -- and so they were chosen by the Price Commission for the most careful scrutiny -- so it was also felt that the main element behind cost increases was labor (other, that is, than that due to imported raw materials, over which no control could be exercised). Thus pay control was considered an essential complementary policy to that of price control.

In an examination of the recent history of pay control in Britain it is necessary to distinguish between two distinct periods, viz. the period of statutory control under the Conservative government of Edward Heath (the controls lasting from November 1972 until the government was defeated in 1974), and the period of so-called voluntary control that followed it. The form of control was quite different in each period, and the lessons to be drawn are also somewhat different.

This Briefing will concentrate on the second -- the voluntary -- period for two reasons. Firstly, the problems associated with statutory controls are fairly well understood in the United States and elsewhere, and the British experience merely confirms the dismal record of other countries. But secondly, the British case of voluntary pay controls has more relevance to the present U.S. situation, and it demonstrates the grave danger to freedom and the principle of equal justice that is involved with a discretionary system. It is also important to show that voluntary controls have not been effective in Britain, despite the decline in inflation and the moderation of wage claims during the last two years -- this "success" was merely the by-product of other factors influencing the economy.

THE PERIOD OF STATUTORY CONTROL: NOVEMBER 1972 - SEPTEMBER 1974

The Mechanism of Control

Pay policy under the Conservative government ran in parallel with price controls. When the prices freeze was instituted in November 1972 it was accompanied by a freeze on pay. In April 1973, when the second stage of price control policy commenced with the creation of the Price Commission, a new pay policy was announced allowing increases in pay of £ 1 per week plus 4 percent (thus favoring the lower paid). This, in turn, was followed by a slight easing of controls in November 1973, when the limit was altered to 7 percent or £ 2.25 per week, whichever was the greater.

The Problems of Control

From its inception, the pay control policy met heavy criticism, both from Conservative advocates of a free economy, who argued that it distorted the economy without curing inflation, and from union leaders, who charged that it penalized the working class and removed the right to bargain freely with employers. The policy generated heated political disputes and worsening industrial disruption by the unions. Certain specific criticisms were commonly voiced:

a. <u>It was easy for certain groups to evade the controls</u>

Much union anger was directed at management personnel, who found it easy to rewrite work specifications to suggest that extra payment was being awarded for additional responsibilities, i.e., bogus promotions were used to pay managers more than the statutory limit while obeying the letter of the law.

b. <u>Businesses suffered shortages of manpower</u>

The pay controls were not (in general) supported by employers, particularly those in expanding industries, since business was denied the right to raise wages as a means of attracting more, or better qualified, workers. This resulted in inefficiency in a large number of firms who were unable to fill key positions in their workforce.

c. <u>Powerful unions were able to evade controls</u>

The most serious problem with the statutory controls was that they provoked a major set-piece clash between the government and the more powerful unions. A trend became clear during 1973: the weaker unions were being forced to toe the line by the government (e.g., groups such as the police and the nurses), while a confrontation with more militant unions was avoided by the use of "special case" loopholes to pay these workers above the specified rate.

Naturally, as it became clear that the policy favored the more powerful unions, public opinion became increasingly alienated from the government's strategy and less powerful workers resented the fact that they seemed to be carrying the whole burden. As a result of such criticisms the Conservative government took a tougher stance in the face of wage demands towards the end of 1973. It was in this climate that the final confrontation developed, between the government and the powerful National Union of Mineworkers.

The dispute was long and bitter. The union picketed power stations all over Britain, causing the government to put the whole nation on a three day working week. Finally the government attempted to break the deadlock by calling a general election on the issue of "Who runs the country?" Unfortunately for the Conservatives, the widespread lack of confidence in statutory controls, and the pledge of the unions to co-operate with a Labor government in a voluntary system of pay controls, ensured the defeat of the Conservative government, and with it the removal of mandatory controls.

THE PERIOD OF VOLUNTARY PAY CONTROLS: SINCE SEPTEMBER 1974

THE "SOCIAL CONTRACT"

The Labor party came to power in February 1974, pledged to end mandatory wage (but not price) controls and, with the "solemn and binding" (but not written!) agreement of the unions, to cooperate in a policy of voluntary wage restraint. This understanding was given the lofty title of the Social Contract.

It was not long before the Social Contract came under strain. The unions claimed that the government was not keeping its side of the bargain because prices were rising at an unacceptable rate. In practice, the Social Contract resulted in a wage explosion. The annual rate of increase in earnings rose to 21 percent by the end of 1974, compared with 13 percent in 1973, and by the end of 1975 the figure was running at nearly 30 percent.[8]

After 1976, the rate of inflation did subside in Britain. By the end of 1976, it was down to 15 percent, and by December 1977, it had falled to 13 percent.[9] Union wage settlements also declined during this period, falling from a peak in 1976 to 14½ percent during 1976 and to 9½ percent by the end of 1977.

It seems most likely that the moderation of wage settlements was more the <u>result</u> of the decline in inflation than the cause of place, 1974-1977 was a period of tight monetary policy, and there has been in Britain (as elsewhere) a much closer correlation between the money supply and inflation than between earingings and inflation. Secondly, it was the policy of most union negotiators at this time to build a "cost of living" element into their demands, and final settlements tended to reflect this. So it is not surprising that earnings should run parallel with the rate of inflation. Furthermore, Britain experienced a rapid increase in unemployment after 1974; indeed, it broke post-war records. It is far more reasonable to conclude that this was a more effective check on wage demands than any wage controls, especially when one notes that during 1976-1977 the increase in earnings was still double the guideline limits.

THE GROWING USE OF SANCTIONS: 1977-1978

THE ROLE OF BUSINESS

Faced with persistantly high inflation, and the apparent failure of the Social Contract to hold down wages, the Labor government changed its policy in mid-1977 by laying down a more rigid general

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7. The "Social Contract" was greeted with a good deal of cynicism by Conservative politicians, who pointed out that there was nothing binding in the agreement. It was described by many as the "Social Con-Trick," and one MP, Dr. Rhodes Boyson, remarked that "it isn't worth the paper it isn't written on."

8. The Economist, various issues.

9. Ibid.

limit (10 percent) and by threatening the use of government economic sanctions against any company which conceded a claim above the limit. Thus the responsibility for enforcing the "voluntary" pay controls was transferred from the unions to business. Companies were expected to support the government's policy by withstanding union claims, even when they were prepared to pay more on purely commercial grounds. If they did not do so, they might be made subject to sanctions. The sanctions available to the government fell into two broad types, and in each case they were used on a discretionary basis.

a. The withdrawal of aid, export guarantees, etc.

Most major companies in Britain receive a number of government grants for particular purposes: assistance and loan gaurantees to promote exports, for example, or aid as an inducement to locate factories in depressed areas. Under the wage control policy, companies were faced with the threat that such aid might be withdrawn if they exceeded the wage guidelines. For many companies this was a very real threat, since a significant proportion of their income came from that source.

b. The withdrawal of government contracts

The possibility of the government sector denying contracts to companies which exceeded the pay guidelines was an even more serious threat. In Britain the government sector affects almost all industries, and there is scarcely any company that is not either directly or indirectly involved with a government contract at either national or local level.

As part of the new policy, all new government contracts included a clause requiring the contractor to abide by the pay guidelines. For those already working on a contract, a "request" was made that a guideline clause be added to the existing contract. In some cases, local councils were even instructed to withhold payment from companies deemed to have broken the guidelines.

Business objected strongly to the use of sanctions -- particularly the withholding of contracts. As the Confederation of British Industry (CBI) pointed out, arbitrary sanctions gave the government tyrannical power over industry:

a. The government had complete discretion to interpret the guidelines and to decide who had broken them.

b. There was no appeal against a government decision.

c. The main contractor could be penalized if one of his subcontractors paid an employee above the guideline figure -- even if that employee had not been working on the contract. Thus the main contractor was put in the position of having to police the main contractor was put in the position of having to police the activities of smaller firms, on pain of losing his contract.[10]

The CBI was so opposed to the sanctions that it even considered organizing a national boycott of government contracts containing guideline clauses. By March 1978, however, an uneasy agreement was reached whereby a contractor would only be held responsible for sub-contractors who supplied more than 5 percent of the value of the main contract. In addition, the government agreed to pay companies in breach of the guidelines for already completed work.

THE BLACKLIST

The government was not in any way apologetic for its use of discretionary power. As Chancellor of the Exchequer Dennis Healey remarked in September 1978:

> I hope we shall not have to use this power. Last year we used it in only a tiny minority of cases. But make no mistake about it, we shall use it if we have to.[11]

The government contended that its position was entirely reasonable. Since the policy was voluntary it did not wish to take an unbending approach to each company, and it would take into account any "special factors" before denying a contract. It could not, it was argued, be expected to assist firms, either by contracts or by financial aid, who were breaking its guidelines.

This position seemed reasonable to many people, but it led inevitably to totally arbitrary and clandestine sanctions against companies. Government actions became clouded in secrecy, and "discretion" developed into the use of thinly-veiled threats in place of clearly defined sanctions. As one industrialist complained, "nothing is being put in writing. Companies are merely being told by telephone."[12]

Those companies which were deemed to have broken the guidelines sufficiently to warrant retaliation were put on a blacklist (no contracts were to be awarded to any on the list). This list was never published. According to the government it "would definitely not be in the best public interest" to do so.[13] The Prime Minister even went so far as to claim, in January 1978, that a blacklist was

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10. Speech by Sir John Methven, Director-General of the CBI, 7 February 1978.

11. Financial Times, 14 September 1978.

12. Daily Telegraph, 23 December 1978.

13. Times, 14 December 1977.

"a figment of the media's imagination to a large extent."[14] Even MPs were denied access, as Conservative Michael Latham complained:

> When I asked for a list (the minister) refused to give me one because "the withholding of public contracts or other discretionary assistance is a matter between the government and the firm concerned."[15]

Some companies were notified in writing that they were on the blacklist; others were not. The proprietor of High Speed Turnings, for example, complained that:

> No one in the company knew it was on the blacklist until a week ago. A chap from one of the papers rang me up and said, "Do you know you are on the government's blacklist?" I said, "What list is that?" ...We certainly had no formal notification and we still have not had.[16]

The secrecy surrounding the policy meant that some firms were put on the list in error. Yet, since the list was informal, they had on recourse to compensation -- even if they ever discovered they were blacklisted! Under British law, a civil servant cannot be sued for a mistake of that kind.

THE BLACKLIST IN ACTION

Exactly how many companies were on the blacklist by 1978 has never been officially disclosed, but estimates of well over 200 major firms were not denied by the Labor government. Some specific cases were made public during 1977, however, and it emerged that sanctions were only being used against those who were not strong enough to confront the government. Whenever a powerful union was involved, or political considerations suggested "discretion," the government chose to avoid sanctions. The following examples of 1977 pay deals illustrate this:

a. MacKie and Company of Belfast, Northern Ireland

This small but very efficient shipbuilding company was denied export credit guarantees because it raised wages above the guidelines in order to expand its workforce. The government took action because it felt that the MacKie deal would influence negotiations at the giant state-owned Harland and Wolff shipyards nearby.

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14. Hansard, vol. 960, col. 747.

15. Daily Telegraph, 9 January 1978.

16. Hansard, vol. 940 (13 February 1978), col. 322.

As an editorial in one London newspaper put it:

> MacKie's is a successful and profitable private business, which has been losing labor because of its observance of wage restraints. Harland and Wolff has been the recipient of untold millions from the long-suffering taxpayer, and yet has managed to retain its place as top of the league for unproductiveness....In a sane industrial system MacKie's labor force would be due for whatever was needed to hold it and expand, while Harland and Wolff might try what a cut in wages would do to shrink its inflated workforce. Instead it is MacKie's which is to be browbeaten.[17]

b. The Miners

The miners had brought down the Conservative government in 1974 over the issue of statutory wage controls. The Labor government had no wish to repeat this, and so a pay deal within the government guideline of 10 percent was supplemented by a "productivity agreement" (a favorite escape clause which was often used by the government to avoid a confrontation). This agreement, which was said to self-financing, involved the payment of bonuses if specified production targets were achieved. It can easily be seen that the agreement was a facade by examining subsequent production figures. Between the first half of 1977-1978 and the first half of 1978, when the agreement was in effect, output per underground worker rose by 1.6 percent, whereas earnings per worker went up by no less than 24 percent.[18]

c. The Ford Motor Company

Ford has for some time been the most successful and profitable automobile company in Britain. The company was quite happy in 1977 to pay above the guideline figure to attract good workers. One of the company's executives made it quite clear early in the pay talks that Ford were "negotiating with the unions, not with the government. We aim for a realistic and responsible settlement."[19] The unions were equally adamant that the guidelines had no place in the discussions. "I cannot be bound," warned Moss Evans of the TGWU, Britain's largest union, "by the government unless there is a statutory requirement to do so."[20]

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17. Daily Telegraph, 23 September 1977.

18. Hansard, vol. 960, col. 781.

19. Daily Telegraph, 6 October 1977.

20. Ibid.

Clearly afraid that there would be major confrontation between it and one of its most important union supporters, the Labor government backed off and a 12 percent settlement was reached. The Chancellor conceded that:

> We regret the Ford settlement; but after consideration it has been decided that there is no discretionary action which would be appropriate in this case.[21]

It might be noted at this point that the government had two available sanctions which it chose not to use. Not only did it purchase a large number of vehicles from Ford, but it was also involved in a £70 million subsidy to the company for the construction of a factory in south Wales.

It was quite evident to the British public by the spring of 1978 that the so-called voluntary wage guidelines meant taking action against the weak and making concessions to the strong. As one typically cynical newspaper editorial put it:

> You can break the 10 percent (guideline) if:
>
> * You are too big to be bullied by the government -- Ford and the miners.
>
> * You are planning to build a factory near the Prime Minister's constituency -- Ford.
>
> * You plan to wrap the whole deal up in a productivity deal -- miners.
>
> * You can give the government a bloody nose -- miners, power workers?
>
> * You have real sympathy from the public -- police? nurses?
>
> * You are a special case -- everyone?[22]

THE COLLAPSE OF SANCTIONS

By the summer of 1978 it was clear to the Labor government that with a general election no more than 18 months away the credibility of the voluntary wage control policy had to be restored. The record of 1977-1978 had not been good. Average incomes had risen by 14 percent, compared with the guideline of 10 percent, and the public had the impression that the more powerful companies and unions were freely able to ignore the pay limits.

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21. Hansard, vol. 940 (1 December 1977), col. 322.

22. Evening Standard (London), 6 October 1977.

Despite the failure of the 10 percent limit, the government announced an even tighter guideline (5 percent) in July 1978.[23] Opposition became more intense, and it was only a matter of time before unions, management and the government would be drawn into a major confrontation. That clash came in the autumn over the annual wage negotiations at the Ford Motor Company. Unlike the previous year, the company sought to obey the guidelines, since it knew that it would be political suicide for the government if it once again avoided taking action. The unions, on the other hand, were adamant that they would not accept non-statutory guidelines. After the inevitable breakdown of talks, 57,000 workers struck the company, and after a nine-week stoppage costing Ford over £400 million in lost production the company reached a pay deal worth 17 percent for the next year.

Ford defended its action to the government by arguing that unofficial strike action over the guidelines was costing the company so much that if a 17 percent deal reduced these stoppages by only half it would more than compensate for the cost of the settlement above 5 percent. The government, however, felt that this time it could not take the escape route and imposed the sanction of a total state boycott of Ford products.

The Ford dispute was instrumental in bringing about the final collapse of the sanctions policy. The company pointed out that as a result of its attempts to obey the guidelines it would have to raise prices to recoup the £400 million strike loss and the estimated £200 million annual loss due to government sanctions. In addition, there was now open rebellion within the Labor party from left-wing and union-sponsored MPs; and these MPs, together with the combined parliamentary opposition, defeated the sanctions policy in the House of Commons in December 1978.

"VOLUNTARY" WAGE CONTROLS - AN OVERVIEW

The attempt by the British government to force companies and unions to abide by "voluntary" guidelines provides important warnings to those who see such a policy as a feasible alternative to

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23. At the time, the Labor government asserted that the halving of the pay limit would reduce inflation considerably, and that its special relationship with the unions would ensure reasonable compliance. Many critics of the government, however, claimed that the tough 5 percent figure was merely a political ploy aimed at a general election in September 1978. In the event, the government did not risk calling an election and so it became saddled with a very low target figure for wages.

statutory wage controls. The British experience shows that to be credible to the public such controls must be non-discriminatory; and yet if they are they become indistinguishable from mandatory controls. In addition, they not only have the same damaging side effects as statutory controls, but also other very disturbing effects:

a. The danger of arbitrary government

Once a government uses "discretion" in enforcing a policy, it is rarely long before the basis of decision becomes heavily influenced by political considerations. In Britain the selection of targets for punishment became shrouded in secrecy. As the Chairman of the CBI pointed out:

> Government has now developed a whole panoply of informal and often secret weapons -- blacklists, contract clauses...and wide discretionary powers under statute -- which it is operating in total secrecy, with no right of appeal, and which it admits will not be used on a uniform basis -- all in support of a too rigid, non-statutory pay policy which has no support from the (unions).[24]

Certain companies were selected for penalities for which there was no explanation or appeal. As one MP commented on the Ford case, the chairman of that company, Sir Terence Beckett:

> was summoned to a... "court" composed of the Secretaries of State for Industry, Prices and Consumer Protection, and Employment. Indeed, he was summoned twice, first to make his defense and secondly to receive his sentence. The members of the court were prosecutors, judges and jury in a trial action for which there was no basis in law. Sir Terence knew and the Secretaries of State knew that they had found him guilty before he went in the first time.[25]

While tough action was taken in cases such as that of Ford, in others the government chose to ignore clear breaches of the guidelines. No sanctions, for example, were taken against the Trade Union Congress (the equivalent of the AFL-CIO), which paid its staff an increase of 20 percent, nor against the Labor party itself, which gave its headquarters staff an increase of 12½ percent.

b. The encouragement of militant unions

Voluntary pay controls depend on the authority of so-called moderate unionism. Labor leaders are requested to pursue pay claims which are lower than those they feel are justified and possible. This is rather like telling a defense attorney that he should not press his client's case too hard because it would be against the public interest if he won it. It is totally against the purpose

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24. Speech by Sir John Methven, 6 December 1978.

25. Reginald Prentice MP, Hansard, vol. 960 col. 738.

and nature of trade unions for them to act in such a manner (as George Meany has explained very bluntly to Mr. Carter).

In Britain the pay guidelines presented an obstacle which the unions took as a challenge, and they provided militant unions with the excuse to provoke crippling strikes. The guideline limits were soon seen as the minumum any union could accept without losing face, and it is clear that in many cases union officials took a much more extreme negotiating position than they might have wished in order to appear strong and so allay criticism within their union.

c. Pay controls can push up industrial costs, rather than lower them

The British experience suggests that pay controls may have led to a rise in industrial costs. In the first place, as explained above, internal political factors forced many unions to push for higher settlements than economic conditions warranted. Secondly, firms which resisted breaches of the guidelines faced strikes and industrial interruption which lowered efficiency and raised unit costs -- and, of course, several of those who eventually capitulated (e.g., Ford), were then faced with the additional cost burden of sanctions. Furthermore, the blacklist policy meant that government contracts no longer went automatically to the lowest bidder, which in turn raised costs in government projects.

d. Wage controls produce a misallocation of labor

The voluntary wage policy produced serious problems for many British firms who were unable to raise pay as a means of attracting, or retaining, key workers. Those who abided by the rules saw their workers attracted away to companies who broke them -- either because the companies were strong enough to risk sanctions, or because powerful unions operated within them. In several cases companies were penalized when they exceeded the pay limits for just a tiny fraction of particularly essential workers. John Lewis and Company, for instance, is a chain store with 25,000 employees and an annual wage bill of £54 million. Yet it was blacklisted when it decided to pay 444 typists and salesmen an extra £6 per week to prevent them leaving to work for competitors. The addition to the wage costs of the company amounted to 0.002 percent of the total.[26]

Such absurdities became everyday events under the guidelines. Most disturbing of all, of course, was the fact that it was companies who kept to the pay limits who lost key workers, and the labor force became distributed on the basis of industrial power instead of market need.

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26. *Ibid.*, col. 749.

e. Voluntary controls are very damaging to business and force companies to become the policing agents of government

A voluntary wage policy involves the government passing the buck to business. Believing that a statutory policy will not be acceptable to the legilsature, the government announces pay guidelines and requires business to enforce them over the opposition of the unions. To encourage companies to take a firm stand the government employs the threat of sanctions -- as in Britain -- or the prospect of public reprimand and consumer boycotts -- as in the case of the U.S. Thus the corporation not only becomes the policing agent of a non-statutory conrol, but it is also required to pay the cost of enforcement.

This unwelcome duty is highly damaging to business. It jeopardizes industrial relations, and it puts the company in the dilemma of having to deal with contradictory threats from the government and the unions: in cases such as Ford's, the company may even suffer damaging blows from each side. As the director of the CBI explained, for companies like Ford, "the use of sanctions can be compared to a court sentencing a householder because his home has been burgled."[27]

When faced with this dilemma, a company must calculate which course of action will be least costly to it: to abide by the guidelines and risk a prolonged strike (and perhaps sanctions if it cannot hold out); or to concede a reasonable pay demand and accept the probabiltiy of sanctions. As the CBI pointed out:

> When considering the matter of sanctions one thing is for sure: all logic must be suspended. There is no rhyme or reason to santions, for if there were, the logical thing would surely be to pay up early and not take a strike. If Ford had done this they would be hundreds of millions of £s better off.[28]

CONCLUSION

The present American system of wage and price controls may be more of an irritation than a threat to business and the rest of the economy. Yet there is a very real danger that just because they are having little effect, pressure will grow for tighter controls with powerful sanctions. If that occurs, the dangerous side-effects noticeable in the British experience will be repeated in the U.S.

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27. Speech by Sir John Methven, 27 November 1978.

28. Ibid., 6 December 1978.

There are already ominous signs within the present system which bear a strong resemblence to developments in Britain:

a. Rejection by organized labor

The AFL-CIO has made it abundantly clear that it opposes voluntary restraint, and wishes to see statutory controls on prices. This places business in the position of having to fight the administration's battles with labor for it.

b. Business the scapegoat for failure

Already business is being singled out as the cause of the government's failure to curb inflation. The AFL-CIO's Operation Pricewatch will only lead to the hounding and pillorying of individual companies and the creation of a feeling that business is to blame.

c. The threat of sanctions

Obeying voluntary guidelines makes no sense for either corporations or unions. Why should a competitive businessman accept lower profits than the market will deliver? How will his shareholders react to lower dividends? How can a union leader justify to his members a lower pay raise than he knows he can win from the company?

The only way the government can make people act against their economic self interest is to threaten them with some sanction. The Carter administration intends to use federal procurement policies to ensure compliance with the guidelines. However, both business and labor unions have, through suits, attacked the legality of such a sanction. It can only be a short time before an additional threat -- veiled or otherwise -- is introduced to encourage compliance with the voluntary controls.

d. The emergence of the "special case"

The Teamsters are the first major example of the administration turning a blind eye to a breach of the pay guidelines. As in similar British cases, the Administration steadfastly claims that the settlement is within the limit if "special" factors are taken into account. No doubt further ingenious loopholes will be found to accommodate other powerful unions which the government does not wish to confront -- while retaining the myth that the guidelines are intact. This is the first step towards a situation where government actions become arbitrary and politically motivated, and where the weak are punished but the strong are not.

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