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Inflation, Unemployment, and the Wagner Act: A Critical Reappraisal

Daniel J.B. Mitchell*

The year 1985 marks the 50th anniversary of the Wagner Act. It also marks a time in which the assumptions underlying the American system of union-management relations are being increasingly questioned by academics and practitioners. Because the Wagner Act, as amended by the Taft-Hartley Act, is the legal framework of that system, it too has come under increasing critical scrutiny.

The need to reappraise the economic policies embodied in the Wagner Act is evident for a number of reasons. First, the Wagner Act was a piece of economic legislation, enacted as a direct response to the economic challenge of the times: the Great Depression. Second, the main economic assumption underlying the Wagner Act—that pushing up wages will promote recovery from a depression—is based on questionable theory. Third, whatever merits the Wagner Act's economic theory may have had in 1935, its approach is anachronistic and counter-productive in 1985 due to the post-World War II development of an active, anti-inflationary monetary policy.

Given these conclusions, this paper suggests an alternative to the wage system endorsed by the Wagner Act. It argues that a more flexible approach to wage determination is required to meet the national objectives of low inflation and low unemployment. Specifically, it suggests that a wider use of gain sharing would provide needed flexibility, create incentives to raise or preserve employment levels, and improve the linkage between wage setting and anti-inflation policy.¹ Such a gain sharing approach to wage setting is not in conflict with the Wagner Act's legal framework, but it is not specifically endorsed by it either.

Especially after the Act was amended by Taft-Hartley, a rigid demarcation between labor and management has infused the American industrial relations system. Union participation in managerial matters is not encouraged. This demarcation inhibits desirable change in the wage system, since the widespread use of alternatives such as gain sharing

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1. Gain sharing plans could apply to the sharing of revenues as well as profits. But profit sharing is the most common form of gain sharing.

carries with it the need for a less adversarial approach than is currently the norm.

This paper concludes by suggesting changes in public policy that would improve coordination of macroeconomic policy and the labor relations system which has grown up under the Wagner-Taft-Hartley framework.

I. A HISTORICAL VIEW OF THE WAGNER ACT

Modern industrial relations courses tend to depict the Wagner Act as primarily an effort to promote "industrial democracy" through collective bargaining. The emphasis is on the legal rights of workers created by the legislation. When the Wagner Act is viewed in that way, it seems almost as unfair to ask about the Wagner Act's impact on macroeconomic performance as it would be to ask whether the first amendment's guarantee of freedom of speech has beneficial macroeconomic effects.

To some extent, this vision of the Wagner Act reflects what Freeman and Medoff recently termed "the two faces of unions." In their terminology, unions have a "voice" face involving the ability of the employee to redress workplace problems and a "monopoly" or economic face involving pushing wages above market levels.² There is a natural tendency on the part of those sympathetic to unions to emphasize the friendlier, "noneconomic," voice face.³

A. *Economic Perspectives in the 1930s*

1. *The economic face of the Wagner Act.*

Historically, the Wagner Act also had two faces, which correspond to those proposed by Freeman and Medoff. There was definitely an industrial democracy (voice) motivation in its passage. As Senator Wagner stated in 1937: "The right to bargain collectively is at the bottom of social justice for the worker The denial or observance of this right means the difference between despotism and democracy."⁴ Although the industrial democracy face is emphasized today, the Wagner Act was also a piece of economic legislation. Modern commentators tend to discount the Act's economic face because it seems anachronistic.

2. R. FREEMAN & J. MEDOFF, *WHAT DO UNIONS DO?* 5-11 (1984).

3. Employees who are dissatisfied with workplace conditions have a choice: They can quit ("exit") or attempt to change the policies ("voice" their grievances). Freeman and Medoff emphasize the "voice" mechanisms, such as industrial jurisprudence through grievance and arbitration procedures. Economists have applied the notion of a "voice" in contexts outside the labor market. For example, a dissatisfied consumer might complain to the store manager to resolve a complaint rather than cease to shop at the store. A tenant might complain to the landlord about building maintenance rather than move.

4. H. MILLIS & E. BROWN, *FROM THE WAGNER ACT TO TAFT-HARTLEY* 3 (1950) (quoting address by Sen. Wagner, May 8, 1937).

The macroeconomic motivation behind the Wagner Act is clearly stated in its preamble: "The inequality of bargaining power between employees . . . and employers . . . burdens and affects the flow of commerce, and tends to aggravate recurrent business depressions, by depressing wage rates and the purchasing power of wage earners . . ." ⁵ So central is this economic theme that one searches the preamble in vain to find a corresponding justification based on industrial democracy. The only other justification suggested by the language of the preamble is that the Act will lead to fewer strikes.

Though the statement in the preamble appears clear, it is not conclusive proof that the Wagner Act was originally viewed as an instrument of economic policy. Its inclusion was possibly no more than a means of convincing the Supreme Court that the law involved interstate commerce. The Act's predecessor, the National Industrial Recovery Act of 1933 (NIRA), had been declared unconstitutional only months before the Wagner Act was adopted. ⁶ Perhaps the preamble—with its reference to burdening the flow of commerce—was simply a ploy to convince the Court that Congress had the authority to pass such a law. But while the constitutionality issue may have been a contributing factor to the language, the history of the Wagner Act suggests that the preamble also embodied a then-popular theory of economic depressions.

There were legislative antecedents to the economic theory contained in the Wagner Act. For example, the Norris-LaGuardia Act of 1932 included the observation that "the individual unorganized worker is commonly helpless . . . to obtain acceptable terms and conditions of employment." ⁷ Thus, the idea that wages might be "too" low in the absence of collective bargaining was already in vogue by the early 1930s. And while the authors of the Norris-LaGuardia Act did not explicitly make the connection to the Depression in their declaration of policy, that connection was made only a year later.

The National Industrial Recovery Act was constructed out of a variety of economic interests and theories. As Himmelberg documents, its enactment was partly the result of a push from business interests for a relaxation of the antitrust laws. ⁸ With the advent of the Great Depression, this motivation could be repackaged as the enablement of "business planning" which would lead to recovery and economic stability. Others saw the NIRA as the beginning of national economic planning—i.e., planning by or through government. And still others, for example

5. Wagner Act, ch. 372, § 1, 49 Stat. 449, 449 (1935) (current version at 29 U.S.C. § 151 (1982)).

6. See *Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935).

7. Norris-LaGuardia Act of 1932, ch. 90, § 2, 47 Stat. 70, 70 (codified at 29 U.S.C. § 101 (1982)).

8. See R. HIMMELBERG, *THE ORIGINS OF THE NATIONAL RECOVERY ADMINISTRATION* 110-50 (1976).

Labor Secretary Francis Perkins, saw the NIRA as a device to raise wages and worker purchasing power, thereby increasing economic output.⁹

Because of these mixed motivations, the NIRA's preamble is mainly a promise of promoting "cooperation" to bring about economic recovery. There is, however, specific reference to increasing "the consumption of industrial and agricultural products by increasing purchasing power,"¹⁰ although the statute does not state *whose* purchasing power was to be raised. President Roosevelt, upon signing the bill into law, indicated that while the wage increases promoted by the law would raise production costs, businesses should "give first consideration to the improvement of operating figures . . . to be expected from the rising purchasing power of the public."¹¹ Thus, the intent seemed to be to increase wages relative to prices, thereby raising real wages and purchasing power.

There are—to be sure—ambiguities concerning the economic theories underlying the early New Deal programs. The President's inaugural observation that "the only thing we have to fear is fear itself" reflected a conviction that building confidence was the key to ending the Depression. Presumably, however, business confidence would be buoyed more by an increase in prices relative to wages than by the reverse. Moreover, a consistent theme of price inflation ran through the early New Deal (although "reflation" was the preferred term).

At the most fundamental level, there was the uncontroverted fact that prices had fallen substantially since 1929. From 1929 to 1933, retail prices declined by 27 percent.¹² This observation was apparently used as a justification for raising prices. It was argued that if prices could be raised back to 1929 levels, production would also rise to its 1929 peak. It is not clear whether a distinction was made between alternative means of raising prices. Reflation through NIRA cartel agreements on pricing or through adjusting the dollar value of gold was thought to be as promising as monetary expansion. In the words of Warren and Pearson, whose peculiar theories of gold and prices lay behind the President's gold policies: "Inflation results in unusual business activity. Deflation stops business."¹³

The original version of the Wagner bill, submitted as the "Labor Disputes Act" in March 1934, did not in its preamble relate the proposed law to economic recovery. Like the Norris-LaGuardia Act it merely concentrated on the issue of equalizing "the bargaining power

9. *See id.* at 190-91.

10. National Industrial Recovery Act, ch. 90, § 1, 48 Stat. 195, 195 (1933).

11. BROOKINGS INSTITUTION, THE ABC OF THE NRA 128 (1934).

12. *See* U.S. BUREAU OF LABOR STATISTICS, HANDBOOK OF LABOR STATISTICS, BULLETIN 2217, at 350 (1985).

13. G. WARREN & F. PEARSON, GOLD AND PRICES 428 (1935).

of employers and employees."¹⁴ However, Senator Wagner, in introducing the bill, stated that such balancing was "necessary to insure a wise distribution of wealth . . . , to maintain a full flow of purchasing power, and to prevent recurrent depressions."¹⁵ The NIRA, he indicated, was not having the desired effect of boosting real wages "upon which permanent prosperity must rest."¹⁶ Indeed, he declared, failure to pass the Wagner bill would "jeopardize the whole recovery program."¹⁷

Senator Wagner's wage-purchasing power justification appears to have been widely accepted. It was noted correctly that the upward pressure on wages induced by the NIRA had been offset by corresponding price boosts.¹⁸ The Wagner bill was intended to tilt the bias toward wages more successfully than had the NIRA. Not surprisingly, the wage-purchasing power theory was supported by organized labor; it was (and to some extent remains) a traditional justification of the labor movement for raising wages.¹⁹ To the extent the justification was criticized, the criticisms came from employers.

Employers who gave testimony before Congress on the Wagner bill made various arguments against its passage. They argued that the Act's effort to balance the bargaining power of labor and management falsely presupposed a "fundamental theory of . . . class antagonism"; that since U.S. wages were already higher than those in countries where unions were more prevalent, it was evident that unions could not raise wages further; and that Congress should stimulate investment rather than consumption.²⁰ These protests, however, were of no avail. By February 1935, the full exposition of the wage-purchasing power theory had entered the proposed bill's preamble. The Wagner Act was to be an exercise in improving macroeconomic performance by creating micro-level conditions conducive to raising wages.

2. *External views of the Wagner Act's wage-purchasing power theory.*

Although the Wagner theory did not seem particularly controversial in Congress, the view that pushing up wages would stimulate output and employment was by no means uniformly accepted in the academic

14. 1 NLRB, LEGISLATIVE HISTORY OF THE NATIONAL LABOR RELATIONS ACT 1935, at 1 (1949) [hereinafter cited as WAGNER HEARINGS].

15. *Id.* at 15.

16. *Id.* at 17.

17. *Id.* at 42.

18. *See id.* at 1252 (statement of Sen. Cutting).

19. *See id.* at 98 (statement of William Green, president, AFL). Earlier statements of the AFL position can be found in official publications of the Federation. *See, e.g., Overproduction Myth*, 37 AM. FEDERATIONIST 789 (1930).

20. *See* 1 WAGNER HEARINGS, *supra* note 14, at 515-16, 546-48, 600-01. In contrast to the employer view, the Communist Party, in testimony before the Senate Committee on Labor and Education, denounced the Wagner bill as a capitalist's trick to conceal class conflict. *See* 2 WAGNER HEARINGS, *supra* note 14, at 1967-73.

community. Economist Edward Mason of Harvard wrote of the "crudity of the errors" of NRA administrators who believed in recovery via wage increases.²¹ However, empirically oriented economists—as opposed to theoreticians—were more receptive to the NIRA view. A Brookings study published in 1936, while conceding that contemporary economists were split on the wage theory, cautiously indicated that "expansion of purchasing power among the masses is a primary essential to sustained prosperity." On the other hand, the book argued, boosting real wages would not ensure "*permanent prosperity*."²²

Actually, what strikes the modern reader most is the general absence of economic data in these discussions. It was widely accepted that there had been an increase in profits in the late 1920s and that this had led to a decline in consumption. Information available now (but not necessarily readily obtainable then) indicates that although there was a profit expansion, real consumption also rose steadily during the 1920s.²³ Moreover, from 1929 to 1933, real investment fell absolutely by as much as real consumption even though investment accounted for only 18 percent of real GNP in 1929 while consumption accounted for 68 percent.²⁴ In a world in which unemployment—the key problem facing the country in the 1930s—went largely unmeasured, it is hardly surprising that the debate on the wage-purchasing power theory was largely nonempirical. Debaters were free to indulge their prejudices without fear of contradiction by statistical analyses.

The role that monetary policy might have played in causing or exacerbating the Depression, or in engineering a recovery from it, was largely neglected. Economist Lauchlin Currie, writing in 1934, did blame misguided Federal Reserve policies single-mindedly aimed at limiting "speculation" in the late 1920s.²⁵ His analysis foreshadowed the later conclusions of Friedman and Schwartz in the 1960s and, more recently, of Field in the 1980s.²⁶ But at the time he wrote, Currie was the exception. Classical economists argued that the problem was that wages were too high; labor-oriented economists such as Paul H. Douglas endorsed the wage-purchasing power theory and argued that the Depression had resulted from wages being too low.²⁷ Neither side

21. Mason, *The National Recovery Administration*, 49 Q.J. ECON. 668 (1935).

22. BROOKINGS INSTITUTION, *THE RECOVERY PROBLEM IN THE UNITED STATES* 530 (1936) (emphasis added).

23. See S. KUZNETS, *CAPITAL IN THE AMERICAN ECONOMY: ITS FORMATION AND FINANCING* 487 (1961).

24. See BUREAU OF ECONOMIC ANALYSIS, U.S. DEP'T OF COMMERCE, *THE NATIONAL INCOME & PRODUCT ACCOUNTS OF THE UNITED STATES, 1929-1976: STATISTICAL TABLES* 6 (1981).

25. See Currie, *The Failure of Monetary Policy to Prevent the Depression of 1929-32*, 42 J. POL. ECON. 176 (1934).

26. See M. FRIEDMAN & A. SCHWARTZ, *A MONETARY HISTORY OF THE UNITED STATES: 1867-1960*, at 299-419 (1963); Field, *Asset Exchanges and the Transactions Demand for Money, 1919-29*, 74 AM. ECON. REV. 43 (1984).

27. P. DOUGLAS, *CONTROLLING DEPRESSIONS* 67-77 (1935). Although Douglas, writing in 1935, endorsed the theory that an insufficient share for labor contributed to the Great

looked closely at monetary policy.

B. *Changing Economic Perspectives*

1. *The postwar view.*

When the Taft-Hartley bill—which was to amend the Wagner Act substantially—was being debated after World War II, the issue of changing the Wagner preamble arose. The impetus for Taft-Hartley arose out of the postwar wave of strikes, and the strike issue was therefore much more central to the debate than the economic impact of collective bargaining. Although economic issues were discussed, the tenor of the discussions was very different than in 1934–35.

The original Hartley bill would have banned industry-wide bargaining, partly on the theory that such bargaining was inflationary because it pushed up wage costs. As part of this effort, the Wagner Act's preamble language dealing with wages and business depressions was deleted from Hartley's proposal.²⁸ Wage boosts were seen as undesirable and those favoring banning industry-wide bargaining now had a new Brookings book to support their views.²⁹ However, *opponents* of the bill cited the old Wagner theory. A ban on industry-wide bargaining, they argued, would lead to an inequality of bargaining power disadvantaging labor and possibly to depression.³⁰

Senator Taft was more moderate than Congressman Hartley in the House; the Senate bill retained the basic wage-purchasing power theory of the old Wagner Act and did not ban industry-wide bargaining.³¹ Nonetheless, Taft's motivation in retaining the Wagner Act's language appeared to be based less on macroeconomic models than on a conservative approach of making as few changes as possible. Since the preamble's theory of wages and purchasing power had no legal significance, Taft saw no reason to change the wording. His statements gave no indication whether or not he personally subscribed to the theory.

Despite retention of the wage-purchasing power language, oppo-

Depression, he expressed doubt that wages should be pushed up any further than had been done under the NIRA because firms had not borrowed sufficiently to finance the enlarged wage bill. *Id.* at 225–26.

28. 1 NLRB, LEGISLATIVE HISTORY OF THE LABOR MANAGEMENT RELATIONS ACT, 1947, at 33 (1948) [hereinafter cited as TAFT-HARTLEY HEARINGS].

29. See H. METZ & M. JACOBSTEIN, A NATIONAL LABOR POLICY 61–64 (1947). Representative Adam Clayton Powell, an opponent of the Hartley bill, referred to the Brookings book as “practically the bible” of the bill's proponents. 1 TAFT-HARTLEY HEARINGS, *supra* note 28, at 776.

30. See 1 TAFT-HARTLEY HEARINGS, *supra* note 28, at 355–56, 379.

31. After the bill passed, Congressman Hartley wrote a book on federal labor policy. Senator Taft wrote the introduction. Taft argued that employers formerly had excessive power over their employees but that the Wagner Act and other legislation tipped the balance strongly in the other direction, in favor of labor. He rejected claims by Hartley that the Senate bill—Taft's bill—was watered down in order to obtain votes. See Taft, *Foreword* to F. HARTLEY, OUR NEW NATIONAL LABOR POLICY at xi–xiii (1948).

nents of Taft-Hartley continued in the final stages of the Congressional debate to raise the specter of renewed depression.³² Their arguments, however, prevented neither the bill's initial passage nor the later Congressional override of President Truman's veto.

2. *The reasons behind the change in economic thinking.*

Various reasons can be suggested to explain the shift in Congress away from the view that the Wagner Act was an antidepression measure. First, there was no depression when Taft-Hartley was passed, despite many predictions that one would occur after the end of World War II. The absence of a depression naturally eroded interest in antidepression measures. Second, since inflation was seen as the major problem in the War's aftermath, concern over its abatement took precedence over worries about a new depression. After relative price stability was fostered by elaborate federal wage-price controls, retail prices rose by 8.5 percent in 1946 and by over 14 percent in 1947.³³ Unions, freed from wage restraints, negotiated large, cross-industry pattern settlements and came to be seen as part of the inflation problem.

In addition to changes in the immediate economic background, there were changes occurring in the way macroeconomic policy was conceived. The Wagner Act's economic rationale—that pushing up wages would boost consumption and economic activity—was a pre-Keynesian notion. The essence of postwar Keynesianism was that government, not unions or businesses, had the major role in economic stabilization. Government was to carry out this responsibility through appropriate macroeconomic policies (the Keynesians emphasized fiscal policy), not by manipulating prices or wages directly.

At the time the Wagner Act was passed, Keynes's *General Theory of Employment, Interest, and Money*³⁴ had yet to be published, and Keynesian ideas were just beginning to circulate. Although it is tempting to view New Deal fiscal policies as "Keynesian," the evidence suggests that Roosevelt himself was not much impressed with what he understood of Keynes's theories.³⁵ During World War II, however, Keynesian ideas seeped across the Atlantic and became more prevalent in America. For example, the chairman of the National War Labor Board, George Taylor, argued that the Board's anti-inflation role should not be viewed as limiting worker purchasing power. To the extent that purchasing power needed limitation, he said, that role should be played by fiscal policy—i.e., tax increases.³⁶

32. 1 TAFT-HARTLEY HEARINGS, *supra* note 28, at 1649.

33. U.S. BUREAU OF LABOR STATISTICS, HANDBOOK OF LABOR STATISTICS, BULLETIN 2217 350 (1985).

34. J. KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST, AND MONEY (1936).

35. See I. BERNSTEIN, A HISTORY OF THE AMERICAN WORKER, 1933-1941, at 18 (1970).

36. See 1 U.S. DEPT. OF LABOR, TERMINATION REPORT: NATIONAL WAR LABOR BOARD 181 (n.d.).

After World War II, Keynesian economics had become a well-developed school of thought in the United States. American Keynesians would not have viewed wage cuts as the answer to depression; indeed, they scorned the wage-cutting solution of classical economists. But they also would not have seen wage increases as the answer to depression. To a Keynesian, the Wagner Act's approach to economic stabilization would have seemed antiquated.

Congress was not converted to Keynesianism after the War but it was influenced by the new doctrine. While not willing to commit itself to the Full Employment Act proposed by the Keynesians, Congress did pass the Employment Act of 1946, which established a Council of Economic Advisors in the President's office, provided for the preparation of economic reports by the Council, and created a joint House-Senate committee to analyze economic trends.³⁷ Such measures did not, however, preclude simultaneous support for the wage-purchasing power theory. Indeed, Senator Wagner was one of the supporters of the original Full Employment measure. But Keynesian thinking tended to shift the emphasis away from wages and collective bargaining as tools of macroeconomic policy.

II. ANALYTICAL PROBLEMS WITH THE WAGNER THEORY

A. *Theoretical Shortcomings*

Since the wage-purchasing power theory was never rigorously stated, critiquing it is difficult. A critic can always be accused of missing some subtle point. The reverse criticism can also be made, namely that economic policy in the 1930s was made without a clear-cut model of economic relationships. But even with these difficulties, it is possible to identify several inadequacies in the wage-purchasing power approach.

1. *The wage-purchasing power theory.*

The essence of the wage-purchasing model is simple. Labor's real share of national income can be defined as the nominal wage (W) times the amount of labor input (L) divided by a price index (P). If it is assumed that workers have a positive marginal propensity to consume out of their wage income, then anything which raises labor's real wage share should also raise real consumption. As consumption rises, the output needed to supply that consumption must also rise and, in turn, the amount of labor employed should increase. All elements of the

37. For a report on this legislation, see S. BAILEY, *CONGRESS MAKES A LAW: THE STORY BEHIND THE EMPLOYMENT ACT OF 1946* (1950). Bailey notes that Senator Taft was willing to accept the Senate version of the bill, that did not involve the government in a guarantee of full employment. Given his preference for not charging the federal government with such a responsibility, Taft's willingness to leave the Wagner Act's wage-purchasing power preamble intact may have reflected an underlying preference for leaving economic matters at the micro level. *Id.* at 197-98.

model appear to reinforce the positive employment effect of the wage increase.³⁸

The difficulty with this model is that it omits reference to pricing and production for nonconsumption goods. Note that labor's share is expressed in real terms (WL/P). If P rises due to the increase in labor costs, the positive impact of a nominal wage increase will tend to be offset. Furthermore, if increasing labor's share in national income squeezes the nonwage (profit) share, there could be negative effects on investment. An adequate model of the wage-purchasing power theory must account for these pricing and investment relationships. Such a model is substantially more complicated than the simple view represented in the Wagner Act's preamble.

Whether an augmented model which took account of pricing and investment relations would produce a positive employment impact following a nominal wage boost is unclear. Unconstrained by other considerations, such a model might well suggest that wage boosts would be offset by price boosts on the basis of a simple markup theory of pricing. Indeed, under the NIRA during the years 1933-35, wages and prices rose at parallel rates, leaving the real wage unchanged. This lack of growth in real wages coincided with a lack of productivity improvement. From 1935 to 1940, after passage of the Wagner Act and before World War II began to affect output, real wages rose at about two percent per annum, roughly paralleling the growth of productivity. In short, pricing during the post-1933 period seemed to be based on a markup over unit labor costs. Real wages rose when productivity rose and failed to rise when productivity was flat.³⁹

Given this markup behavior, it is difficult to put much faith in a wage-led recovery story. Indeed, about half the real wage increase after 1935 occurred from 1935 to 1937, a period which ended in recession. Of course, these observations do not prove that the wage boosts did not have a net positive effect. One might argue that without union pressure, real wages might not have "captured" the productivity improvement and consumption might therefore have been depressed, causing the economy to slip backward even after 1937. These conclusions, however, do not leap out from the data.

Perhaps a greater cause for skepticism is the omission—even in the augmented model—of a financial monetary sector. If wage boosts lead to price boosts—even price boosts that are insufficient to prevent real wage growth—the real value of the money supply would decrease.

38. The tendency of the model to reinforce the initial wage effect on employment does not necessarily imply that any wage increase will set off an unending employment expansion. The model has a self-limiting multiplier action under reasonable assumptions.

39. Real wage increases are calculated from the national income accounts by deflating wages and salaries per full-time employee equivalent for the overall economy by the personal consumption deflator. Productivity is calculated from the ratio of real GNP to total full-time equivalent employment.

Such a development could lead to an increase in real interest rates and a decrease in investment and—through multiplier effects—to reductions in other forms of economic activity. Again, it cannot be stated with absolute assurance that a wage increase must lead to decreased output and employment, even with a monetary effect included. Nevertheless, adding a monetary constraint does suggest that unless the monetary authorities accommodate the resulting inflation, real output and employment are likely to be retarded.

The outcome of a sudden boost in wages can be analyzed using a contemporary multiple equation econometric model. As is always the case, the results of such an experiment do not necessarily provide an accurate prediction of what would happen in the real world. Such models have built-in assumptions which may or may not be valid. Nevertheless, use of such a model will at least illustrate the modern consensus view of economists concerning the results of a sudden burst of wage push inflation.

One such model is the DRI annual scenario model, which contains 191 equations focusing on the national income accounts and other commonly forecasted variables, such as unemployment and inflation. The model was used to simulate the effects of a 10 percent increase in wage push in 1985.⁴⁰ Since, in the model, wage increases feed into prices and back into wages, the immediate effect was an increase in wages by a little more than 11 percent above what would otherwise have been predicted. Inflation—as measured by the GNP deflator—rose by about six and one-half percentage points. Real consumption expenditures rose slightly but overall real GNP declined by about 0.7 percent in the first year. This drop was due to a decrease in real investment triggered by falling real profits and rising interest rates. Finally, unemployment tended to rise, partly due to the employment drop and partly because the model assumes that higher real wages attract a greater supply of job seekers.

As noted, the above simulation does not disprove the Wagner Act's wage-purchasing power theory. Indeed, although most economic indicators in the model continue to deteriorate after the initial shock, some do not.⁴¹ However, even given the limitations in the model, the

40. Professor Larry J. Kimbell of the U.C.L.A. Business Forecasting Project was kind enough to make the described simulation for me. The simulation was made on the assumption of an unchanged monetary policy defined as the growth in the level of nonborrowed reserves in Federal Reserve member banks. A 10% increase in wage push was simulated as an addition to the constant term for 1985 only in the wage-change equation so that, given initial conditions, wages would rise 10 percentage points more than otherwise. Since initial conditions are changed by the wage boost, the actual jump in wage inflation is above 10 percentage points.

41. For example, according to the model, real GNP is 2.7% below the level otherwise forecasted after two years. But the inflation effect tends to taper off: The GNP deflator increases after two years by less than three percentage points above its otherwise forecasted value. The employment effect is the most ambiguous because the model assumes a significant deterioration in productivity performance due to the induced recession. Employment is

Wagner Act's economic assumptions can no longer be accepted uncritically. The most dramatic effect is a burst of inflation from the cost-push pressures of the initial wage shock. Such a result would undoubtedly goad the monetary authorities into taking restrictive—i.e., demand-depressing—measures. With the greater willingness in 1985 as opposed to 1935 to use macroeconomic policy, especially monetary policy, in pursuit of economic objectives, the view that wage boosts are inevitably beneficial can no longer be the assumption underlying national labor relations policy.

2. *Wages and monetary policy.*

In the modern world, the monetary authority, such as the Federal Reserve in the United States, cannot be viewed as merely a passive reactor to wage trends. Monetary policy is actively used to regulate economic activity and, even more extensively, to restrain inflation. One can debate the wisdom or effectiveness with which such policies are pursued, but the fact that they *are* pursued is undeniable. Thus, a full model of the impact of wage increases on economic activity must take account of the responses of monetary policy to wage inflation.

The importance of monetary policy is particularly well illustrated by events of the period between the late 1970s and the early 1980s. During the late 1970s, price and wage inflation accelerated as the economy expanded after the severe recession of the mid-1970s. This acceleration was exacerbated by political turmoil in Iran, the fall of the Shah, and the resultant OPEC oil price increases which rattled the U.S. economy in 1979 and 1980.

During the expansion of the late 1970s, discussion in the Federal Reserve's Open Market Committee—the committee which sets monetary policy—began to focus on wage developments. The minutes of a Committee meeting in August 1977 record the concern “that businesses did not appear to be pressing as actively as they might to hold labor costs down, fearing the impact of strikes and assuming that inflation would continue.”⁴² In February 1978, minutes of the Committee indicate that some members believed that wage increases were abnormally large, given underlying economic conditions.⁴³ By April of that year, the Committee expressed fears that the wage settlement in the coal industry—following a well-publicized strike—could cause accelerating wage inflation if it “were viewed as a pattern-setter.”⁴⁴ And at its

slightly below otherwise forecasted levels the first year, slightly above in the second year, and slightly below in the third year. Real consumption falls below otherwise forecasted levels after the first year.

42. *Record of Policy Actions of the Federal Open Market Committee: Meeting Held on August 16, 1977*, 63 FED. RESERVE BULL. 915 (1977) (official Committee Minutes) [hereinafter cited as *Minutes*].

43. *Minutes: Meeting Held on February 28, 1978*, 64 FED. RESERVE BULL. 296 (1978).

44. *Minutes: Meeting Held on April 18, 1978*, 64 FED. RESERVE BULL. 470 (1978).

July 1978 meeting, the Committee looked ahead to the 1979 bargaining round with trepidation, fearing that "strong pressures for large increases in wages would tend to spread throughout the economy."⁴⁵

During the late 1970s, the Federal Reserve also began to articulate an inflation expectations theory which was then circulating among many policy oriented economists. According to this theory, a period of prolonged inflation causes expectations of further inflation. These expectations reinforce inflation because they lead to programmed increases in wages and prices designed to "keep up" with price and cost trends. Examples of such expectation-generated increases can be found in the case of long-term contracts, the most prominent of which occur in the collective bargaining sector where agreements typically run two to three years. Closely linked to the expectations theory was the proposition that the U.S. economy was prone to the establishment of a self-perpetuating wage-price spiral.

The expectations theory was stated repeatedly by members of the Federal Reserve Board of Governors in the late 1970s and early 1980s. Member Henry Wallich and Chairman Paul Volcker were especially vocal concerning the expectations approach. Thus, in February 1979, before the Senate Committee on Banking, Housing and Urban Affairs, Henry Wallich stated that "rapid acceleration in costs, being transmitted to prices, often leads to further acceleration of costs, including wage demands. Throughout the 1970s this cycle of wage and price increases has been curtailed only briefly by downturns in activity, only to worsen again when the economy heated up."⁴⁶ A few months later, Paul Volcker, appearing before the House of Representatives Committee on the Budget declared that "over the years, labor and product markets have developed an increasing sensitivity to inflation. Expectations about inflation are an important factor in wage bargaining, in price setting for many goods and services, and certainly in interest rates."⁴⁷

Beginning in 1979, monetary policy turned increasingly restrictionist for anti-inflation reasons. As the economy slowed and slipped into recession, the Federal Reserve watched the labor market for signs that inflationary expectations were being lowered.⁴⁸ Despite the economic

45. *Minutes: Meeting Held on July 18, 1978*, 64 FED. RESERVE BULL. 749 (1978).

46. *Statements to Congress*, 65 FED. RESERVE BULL. 133-34 (1979) (statement of Henry C. Wallich before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, Feb. 8, 1979).

47. *Statements to Congress*, 65 FED. RESERVE BULL. 740 (1979) (statement of Paul A. Volcker before the Committee on the Budget, U.S. House of Representatives, Sept. 5, 1979).

48. In July 1980 Paul Volcker announced:

We are now in the process of seeing the inflation rate . . . drop to or even below what can be thought of as the underlying or core rate of inflation of 9 to 10 percent. That core rate is roughly determined by trends in wages and productivity. We can take some satisfaction in the observed drop of inflation and in the dampening of inflationary expectations. . . . [W]e now need to make progress in improving productivity or reducing underlying cost and wage trends

slump, the Federal Reserve Board wanted to be sure that it had cracked the wage-price spiral. Until it was clear that substantial progress had been made, the Federal Reserve was unwilling to let an ongoing recovery take place.⁴⁹

As concession bargaining in the union sector became more obvious, the Federal Reserve adopted a cautious optimism concerning its anti-inflation efforts.⁵⁰ It did, however, recognize that continued vigilance⁵¹ and steadfastness⁵² were necessary, and that total success would not be achieved until greater price stability was combined with prosperity over an extended period.⁵³

It is clear that the Federal Reserve had embarked on a new course after 1979 which made wage push, or even wage catch up, a hazardous practice for collective bargainers. There was some dispute among economists as to whether an announced change in monetary policy toward a strict anti-inflation stance would itself contribute to reduced in-

Statements to Congress, 66 FED. RESERVE BULL. 639 (1980) (statement of Paul A. Volcker before the Budget Committee, U.S. Senate, July 24, 1980).

49. "The deeply entrenched underlying rate of inflation is sustained by the interaction of labor costs, productivity, and prices. So far, only small and inconclusive signs of a moderation in wage pressures have appeared." *Statements to Congress*, 67 FED. RESERVE BULL. 614 (1981) (statement of Paul A. Volcker before the Committee on Banking, Finance, and Urban Affairs, U.S. House of Representatives, July 21, 1981); "[S]ustaining [anti-inflation] progress will need to be reflected in moderation in the growth in *nominal* wages. The general indexes of worker compensation still show relatively little improvement Major tests of the changing climate still lie ahead; 1982 is a particularly important year for wage bargaining." *Statements to Congress*, 68 FED. RESERVE BULL. 89 (1982) (statement of Paul A. Volcker before the Joint Economic Committee of the U.S. Congress, Jan. 26, 1982).

50. "What seems to me . . . important for the longer run is that the trend of underlying costs and nominal wages has begun to move lower, and that trend should be sustainable as the economy recovers upward momentum." *Statements to Congress*, 68 FED. RESERVE BULL. 488 (1982) (statement of Paul A. Volcker before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, July 20, 1982). "The upward trend of nominal wages and salaries slowed noticeably last year, with average wages rising about 6 percent Longer-term union agreements negotiated in earlier, more inflationary years are expiring, tending to further moderate the wage trend." *Statements to Congress*, 69 FED. RESERVE BULL. 168 (1983) (statement of Paul A. Volcker before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Feb. 16, 1983).

51. "Yes, we have broken the inflationary momentum—but continuing vigilance . . . will be essential As part of this disinflationary process, growth in worker compensation in *nominal* terms has declined to the area of 6 to 7 percent" *Statements to Congress*, 68 FED. RESERVE BULL. 748 (1982) (statement of Paul A. Volcker before the Joint Economic Committee of the U.S. Congress, Nov. 24, 1982) (some emphasis omitted).

52. "Bargaining practices and attitudes—built up during a period of accelerating inflation—change only slowly, but surely success will fundamentally be dependent upon a sense that the financial environment will remain conducive to progress against inflation." *Statements to Congress*, 69 FED. RESERVE BULL. 77 (1983) (statement of Paul A. Volcker before the Joint Economic Committee of the U.S. Congress, Jan. 27, 1983).

53. "The pressures of recession, deregulation of some important industries, and import competition have all contributed to a greater sense of discipline and realism in pricing and wage bargaining. But we cannot . . . claim success against inflation until we can combine greater price stability with prosperity over an extended period." *Statements to Congress*, 70 FED. RESERVE BULL. 206 (1984) (statement of Paul A. Volcker before the Committee on the Budget, U.S. Senate, Feb. 29, 1984).

flationary pressure.⁵⁴ Some thought that use of incomes policy—e.g., wage-price guidelines, social accords, and similar devices—could supplement an anti-inflationary monetary policy and make the disinflation adjustment less painful. In the end, however, brute force—two back-to-back recessions in the early 1980s—was the main vehicle of adjustment. The cost was high—unemployment reached levels in excess of 10 percent in 1982. But inflation ultimately dropped substantially.

There is a lesson to be learned from the painful disinflation of the early 1980s. It is that a wage-oriented role for unions as envisioned in the Wagner Act risks putting organized labor on a collision course with monetary policy. Given the strong public sentiment against permitting inflation to go unchecked, it is labor which suffers from such a collision.

B. *Implications for Unions*

1. *The narrow scope of bargaining.*

According to the Wagner Act, unions are supposed to bargain over “wages, hours, or other working conditions.”⁵⁵ The first two items directly affect a firm’s costs since an increase in the per hour wage or a reduction in hours with no change in pay will raise the effective wage. “Working conditions” is a vaguer phrase; almost anything remotely related to the workplace affects working conditions. But the authors of the original Wagner Act probably did not have an expansive definition in mind.

In particular, some of the novel consultative and participative arrangements which have developed in recent years, and which have macroeconomic relevance, were probably not contemplated. The authors of the Wagner Act, especially Senator Wagner himself, were anxious to do away with the employer dominated “company unions” which had proliferated under the NIRA. Employers painted these representation plans as progressive practices, but Senator Wagner viewed them as sham organizations.⁵⁶ The message was quite clear: Unions should concentrate on improving pay and closely related conditions; such improvements would contribute to economic recovery. Other areas—such as those with which company unions allegedly dealt—were of little interest in 1935.

Evidence from the period suggests that Senator Wagner and his col-

54. See, e.g., Fellner, *Monetary and Fiscal Policy in a Disinflationary Process: Justified and Unjustified Misgivings about Budget Deficits*, in *ESSAYS IN CONTEMPORARY ECONOMIC PROBLEMS: DISINFLATION* 55–86 (W. Fellner ed. 1984).

55. Wagner Act, ch. 372, § 1, 49 Stat. 449, 449 (1935) (current version at 29 U.S.C. § 151 (1982)). The act defines labor organizations as existing to deal with “grievances, labor disputes, wages, rates of pay, hours of employment, or conditions of work.” *Id.* § 2(9) (current version at 29 U.S.C. § 152(5) (1982)). Labor disputes are defined as involving controversies over “terms or conditions of employment.” *Id.* (current version at 29 U.S.C. § 152(9) (1982)).

56. See 1 WAGNER HEARINGS, *supra* note 14, at 22–26.

leagues had good reason to be skeptical about then-existing company unions and representation plans.⁵⁷ By banning such arrangements, however, they moved the U.S. along a path different from that of countries in which employer-sponsored consultation mechanisms are required by law.⁵⁸ Since wage-centered unionism was to be the centerpiece of American labor relations policy, topics other than narrow workplace issues were implicitly taken off the table.

At the time, this position was also characteristic of those employers who found themselves forced to deal with unions. To the extent that unions sought to widen the scope of bargaining, management was likely to resist. This attitude became especially apparent during World War II. Leaders in certain CIO unions saw the war effort, and the resulting emphasis on output and cooperation, as a chance to widen the scope of bargaining to include more traditional management prerogatives. Plans were put forward for joint production committees amidst rhetoric emphasizing the common interests of labor and management.⁵⁹ But management saw these proposals as potential intrusions into areas which had formerly been considered off-limits for labor. Management feared that wartime concessions might lead to postwar loss of control of the enterprise.

In defense of its conservative stance, management could point to the Wagner Act's seemingly narrow definition of the scope of bargaining. But the vagueness of the Wagner Act with regard to the scope of bargaining was a problem. In the view of the management community, changes were needed to prevent the NLRB and the courts from widening that scope. Ultimately, the debate focused on defining who was a "supervisor."

In an adversarial, wage-bargaining relationship, top management must be able to rely on its lieutenants. Thus, the NLRB's inconsistency on the issue of whether foremen could unionize infuriated the management community. Management viewed foremen as their front line and unionization of foremen was seen as encouraging traitorous behavior. In response to the concerns of management, Taft-Hartley carefully defined "supervisory employee" in order to keep foremen out of bargaining units.⁶⁰

The original Hartley bill would have further narrowed the scope of

57. The Bureau of Labor Statistics undertook a major survey of company unions in 1935. Of those for which a start-up date could be determined, about two-thirds were established during the NIRA period, suggesting that their creation was an expedient to ward off outside unions. See BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, CHARACTERISTICS OF COMPANY UNIONS, 1935, at 54 (1937).

58. The "works counsels" found in some European countries are examples of such consultation mechanisms.

59. See Jacoby, *Union-Management Cooperation: An Historical Perspective*, in HUMAN RESOURCE PRODUCTIVITY IN THE 1980s, at 206-11 (E. Flamholtz ed. 1982).

60. For a discussion of the foreman issue, see B. TAYLOR & F. WITNEY, LABOR RELATIONS LAW 350-59 (4th ed. 1983).

bargaining, omitting even modern health and welfare benefits.⁶¹ Although Congress ultimately rejected Hartley's position, the management community largely succeeded in keeping the postwar scope of bargaining—as actually practiced—focused on concerns about the immediate physical workplace.

With hindsight, it is easy to criticize the management position. But it must be recalled that even with regard to traditional workplace issues, unions in the 1940s were not always models of reasonable behavior. The rush of workers into unions in the 1930s and 1940s meant that unions were often represented by inexperienced bargainers. Various political factions strove for control of the new unions, adding to the potential for friction between labor and management. Finally, the wave of strikes following World War II galvanized the management community into asserting its authority over the workplace.⁶² As seen from the vantage point of management, what was needed was both legislative action and a firm posture in labor negotiations.⁶³

Why didn't labor recognize the damage it was doing to its long-range interests during the strike wave of 1946? Consider that in that year, Congress passed the Case Act, a forerunner of Taft-Hartley, which failed to become law only because of a presidential veto. Perhaps the reason for labor's failure to see future consequences lies in the decentralized structure of American unions. This structure always makes it difficult for the labor movement to confront global issues. No single union is large enough to "internalize" the effects of its behavior on the movement as a whole. Prior to the AFL-CIO merger, the existence of two rival federations simply exacerbated the dilemma. Whether this

61. See HARTLEY, *supra* note 31, at 167.

62. For a general study of the position of the management community, see H. HARRIS, *THE RIGHT TO MANAGE: INDUSTRIAL RELATIONS POLICIES OF AMERICAN BUSINESS IN THE 1940S* (1982). Harris notes the reaction at General Electric (GE), which considered itself a model of good labor relations, to a bitter strike in 1946. GE had recognized the United Electrical Workers in the 1930s at a time when other employers were strenuously resisting the new unions. After the strike, GE embarked on a new course of labor relations and bargaining, ultimately known as "Boulwarism." Lemuel Boulware, GE's new Vice President for Employee and Community Relations, viewed his assignment as correcting "the ridiculous situation where—despite the best of intentions and the best practices known—the company was distrusted and disapproved of by employees . . ." L. BOULWARE, *THE TRUTH ABOUT BOULWARISM* 3 (1969). Boulware's policy of trying to convince employees that GE would do right by them—with or without their unions—led to two decades of industrial relations strife and litigation.

63. Management texts of the period stress the appropriateness of the separation of management and union interests. See, e.g., S. DUNN, *MANAGEMENT RIGHTS IN LABOR RELATIONS* (1946). Dunn notes that "collective bargaining is a vital part of managerial responsibility and is not intended to infringe upon managerial rights or functions. Employers, while complying with their legal duty to bargain collectively, should also take the leadership in collective bargaining. Employers should know their rights and be firm . . ." *Id.* at 77. At a 1945 labor-management conference called by the President, union and management representatives were unable to agree on a common statement regarding management rights. See DIVISION OF LABOR STANDARDS, U.S. DEP'T OF LABOR, *THE PRESIDENT'S NATIONAL LABOR-MANAGEMENT CONFERENCE* 56-62 (1946).

lack of cohesiveness fully explains labor's behavior, or whether some leaders were just shortsighted, remains an open question.

Historians can be left to wrestle with that issue, but the crucial fact is that wage-oriented unionism—endorsed by the original Wagner Act—was solidified by Taft-Hartley and by the management reaction to labor unrest. Participation by unions outside the traditional areas of workplace concerns was not encouraged. Unions were not to involve themselves in managerial decisions or worry about the firm's economic condition. The narrow scope of bargaining that arose in the 1940s hinders innovative approaches to wage setting. In particular, the concept of gain sharing—discussed in Section III below—remains difficult for unions and managements to accept, since it inevitably raises issues of wider union participation in management.

2. *Postwar trends.*

The passage of Taft-Hartley and the management policy of containment coincided with the end of the growth in the unionization rate—that is, in the proportion of the workforce that was unionized. After the Korean War, the unionization rate declined, gradually during the 1960s, more rapidly in the late 1970s, and drastically during the early 1980s. Drawing causal relations is always risky, but some common themes run through these phases.⁶⁴

As already noted, the postwar strike wave in 1946 was a major factor in the passage of Taft-Hartley. Wage pressures seemed to spur management into response. The period after the Korean War was characterized by a widening of the union/nonunion wage differential and breakthroughs in certain benefit areas, notably supplemental unemployment benefit plans.⁶⁵ By the end of the 1950s, Congress had passed another piece of union-opposed legislation: the Landrum-Griffin Act. Also in the late 1950s, an upward trend developed in both the

64. The Bureau of Labor Statistics (BLS) has varied its data collection procedure with regard to union membership and representation. According to BLS estimates based on membership surveys, union members accounted for 34–36% of nonagricultural payroll employment immediately after World War II. Thereafter, the ratio fell somewhat, but it rose again to roughly the post-World War II level immediately after the Korean War. By 1970, calculated on the same basis, the ratio had declined to about 27%. During the 1960s, however, certain employee associations—mainly in the public sector—had adopted union-like bargaining functions. Including those organizations raises the 1970 figure to 30%. By 1980, however, the figure had declined to about 25%. Since 1980, the BLS has relied on the Current Population Survey for estimates of unionization. In 1980, the CPS data indicated that about 26% of wage and salary workers were represented by unions (including non-members in bargaining units). By 1984, that estimate had declined to just under 22%. See BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, HANDBOOK OF LABOR STATISTICS 412 (Bulletin 2070) (1980); BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, press release USDL 81-435, Sept. 3, 1981 (as corrected by USDL 81-446, Sept. 18, 1981); BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, EARNINGS AND OTHER CHARACTERISTICS OF ORGANIZED WORKERS (May 1980) (Bulletin 2105) (1981); Flaim, *New Data on Union Members and their Earnings*, in 32 EMPLOYMENT AND EARNINGS, 208–11 (Jan. 1985).

65. See D. MITCHELL, UNIONS, WAGES, AND INFLATION 45–47 (1980).

number of successful suits for employer unfair labor practices and the number of workers ordered reinstated by the NLRB.⁶⁶ As in the 1940s, developments in the workplace and in bargaining seemed to trigger a management reaction.

The upward trend in employer unfair labor practices actions and worker reinstatement orders accelerated around 1970. This acceleration followed a period in the late 1960s in which strike activity increased noticeably, contract rejections seemingly became more common, and the union/nonunion wage differential again widened.⁶⁷ As before, workplace problems and bargaining developments seemed to have wider implications than the immediate settlements they produced. Managerial attitudes toughened: Nonunion firms became more resistant to unionization efforts while union organized firms sought ways to avoid unionization at new locations.

This process repeated in the 1970s. Union/nonunion wage differentials widened,⁶⁸ supporting management impressions that avoiding unionization was economically prudent. Management pressure defeated an attempt in 1978 by organized labor to counter management's union-avoidance tactics by amending the Wagner-Taft-Hartley framework. Substantial declines in union membership followed in the early 1980s—declines much larger than can be explained by hard times in the older "smokestack" industries.⁶⁹

In short, unions found themselves in a "Catch-22" situation. Management's primary goal in the 1940s was to keep unions focused on wages and related workplace issues and away from matters management considered its own prerogative. Unions acquiesced and concentrated on wage and benefit issues. The more successfully they did so, the more they galvanized management resistance and fostered their own decline. Short run success meant long-term failure.

III. THE MACROECONOMIC DILEMMA AND THE GAIN SHARING SOLUTION

If the postwar channeling of labor's attention into wage-centered issues was not healthy in the long term for unions as institutions, what impact did it have on the economy as a whole? This question is often posed as, "Are unions inflationary—do they push up wages and cause

66. For a chart of these trends, see R. FREEMAN & J. MEDOFF, *supra* note 2, at 232.

67. See D. MITCHELL, *supra* note 65, at 48–53.

68. On union/nonunion wage trends in the late 1970s, see Mitchell, *Collective Bargaining and Wage Determination in the 1970s*, in PROCEEDINGS OF THE THIRTY-THIRD ANNUAL MEETINGS 135–42 (B. Dennis ed. 1981).

69. Using data on workers covered by major private union agreements (agreements covering 1,000 or more workers) over the period 1979–1984, I estimated that only about one-fourth of the decrease of about two million represented workers could be explained by industry-level trends in the employment of production workers. See Mitchell, *Shifting Norms in Wage Determination*, in BROOKINGS PAPERS ON ECONOMIC ACTIVITY (1985)(forthcoming).

prices to rise?" But interesting as that question sounds, it diverts attention from the true dilemma of macroeconomic policy.

Since union members have always represented a minority of the workforce, it is evident that they cannot be the sole source of inflation. In fact, most wage decisions are made in nonunion settings. Thus, even if inflation is attributed to wage developments—a questionable proposition in most periods—the blame must be placed largely on non-union employers.

The main periods of postwar inflation are the late 1940s, the late 1960s, and the mid-to-late 1970s. It is difficult to put the blame for inflation on wages in these periods. In the late 1940s, the key factor was pent-up demand, promoted by monetary expansion and military spending during World War II, and only temporarily contained by wartime wage-price controls. Inflation in the late 1960s was also driven by monetary and fiscal expansion, this time resulting from the Vietnam War and development of social programs under the Great Society. Finally, the 1970s saw two OPEC oil price shocks, dollar devaluation, and stimulation from macroeconomic policy. Different economists will weigh these factors differently and will prefer to tell the story in accord with their prior theoretical beliefs. But the basic message—that wages, union or otherwise, were not the basic causes of these inflationary periods—is not widely debated.

The important question, however, is not whether unions cause inflation but whether the interaction of the wage determination system (of which unions are an important part) with anti-inflation macroeconomic policy makes it difficult to halt inflation. The continuation of inflation, not its initial cause, is the key issue.

There is a problem in the interaction between monetary policy and wage determination; wage setting practices make inflation restraint an unnecessarily painful process. But unions *could* play a role in improving macroeconomic performance. Such a role would lead unions away from the wage-centered system imbedded in the Wagner-Taft-Hartley framework, a system whose long term characteristics have already been seen to contribute to the institutional crisis now facing the labor movement.

A. *The Current Wage System.*

Wage setting today consists primarily of establishing a *nominal* wage rate (a wage expressed in dollar terms) based on a period of time (an hour, a week, a month, or a year), or, in some cases, based on a certain amount of work accomplished (a "piece" rate). In the union sector, this nominal wage is often partially protected against inflation through a cost of living adjustment clause (COLA clause) and by periodic wage adjustments over the contract's life. In the nonunion sector, COLA clauses are quite rare. Wage decisions, however, are made as fre-

quently as management desires (often annually) and so can reflect inflation if management wishes.

The current wage system would not seem foreign to Senator Wagner, were he alive. He probably would be impressed by COLA clauses and long term contracts in the union sector; these features were known, but much less common, in the 1930s.⁷⁰ And he undoubtedly would be surprised by the expansion of fringe benefits. However, he would be quite at home with one basic element: the fact that a wage is chosen, either unilaterally by management or through collective bargaining, and remains in place for some time. During that period, management assesses business conditions and determines how many workers to hire at that wage. In other words, the primary short run response to changes in economic conditions is made by management through layoffs and new hiring.

It is this mode of response which is at the root of the modern macroeconomic dilemma. Since the end of World War II, economic downturns typically have been deliberately "engineered" to restrain inflation. However, the main impact of an engineered demand restriction, a "tight" monetary policy for instance, is primarily a decrease in production and employment and only secondarily a decrease in inflation. Wages are set by a variety of factors—such as the need to keep up with other employers or to catch up with past inflation—but they are not closely linked with demand conditions facing the employer. If demand is depressed for a sufficiently long period—as the experience of the early 1980s demonstrated—inflationary pressures will eventually subside, but only after a considerable price has been paid in terms of lost output and unemployment.⁷¹

The wage system's basic outline was already present when the Wagner Act was passed.⁷² However, the NIRA codes, the Wagner Act, and other legislation of the period reinforced the notion of fixing the wage—or pushing it up—even in the face of adverse economic circumstances. Statistical evidence shows that wage flexibility diminished after

70. For discussion of the history of contractual devices, see Jacoby & Mitchell, *Development of Contractual Features of the Union-Management Relationship*, 33 *LAB. L.J.* 512 (1982).

71. Okun estimated that raising the unemployment rate by one percentage point for a year would not produce more than a 0.5% reduction in the inflation rate. Although precise estimates will vary depending on the period considered, this estimate is still within the range of current thinking. See Okun, *Efficient Disinflationary Policies*, 68 *AM. ECON. REV.* 348 (1978).

72. The Wagner Act ratified and helped solidify trends that were already apparent in 1935. But just as the legal system surrounding labor relations ratified one set of arrangements, it can now be modified to favor an alternative system. There are signs today of increased interest in gain sharing on the part of both labor and management. This article suggests that steps should be taken to amplify this new interest. Workers' preferences for stable income flows have undoubtedly contributed to the existing wage system in which labor costs are varied primarily by layoffs and hiring rather than by flexible compensation arrangements. But the evidence of the post-World War II period shows that tax incentives can move wage setters to install a wide variety of compensation plans. For example, employer-provided fringe benefits and the recent surge in employee stock ownership plans (ESOPs) owe much to tax incentives.

the 1930s.⁷³ And there seems to have been a decided disinterest during the postwar period in setting wages according to the employer's "ability to pay" as an alternative to the contemporary wage system.

Using ability-to-pay as a determinant of employee compensation is not directly in conflict with the Wagner Act, but neither is it supported by the Act's underlying economic model. Before the 1920s, the use of ability-to-pay as a wage criterion seemed to have been more acceptable than it was after the 1930s. In describing criteria that might be used in wage disputes by arbitrators, Herbert Feis argued in 1924: "[I]f on the one hand, the particular industry concerned is in a much poorer condition than most others, caution should be used in increasing wages; while if its condition is better than most others, more than ordinary advances may be undertaken."⁷⁴

After World War II, however, this view faded. For example, in 1947 the noted Harvard economist, Sumner Slichter severely criticized the use of ability-to-pay as a wage criterion, arguing that it would amount to "subsidizing inefficiency" since less profitable employers would pay less.⁷⁵ Bernstein's 1954 study of criteria used by arbitrators in the postwar period suggested that the "financial condition" of the employer was likely to be given little weight except when that condition was extremely grave and a substantial employment reduction would otherwise have resulted.⁷⁶

There is a certain logic to this view in the collective bargaining context. Union contracts typically give great weight to seniority. When layoffs occur, only the junior employees are affected, unless the economic situation is especially severe. Since unions are political institutions, it is not surprising that the more senior workers—the "median voters" in the union's political process—are the key determinants of wage and layoff policies.⁷⁷ In periods of relatively minor economic fluctuations, the median voter will see no reason to permit his or her wage to fluctuate merely to cushion junior employees. Thus, the wage concessions of the early 1980s occurred only when mass layoffs, plant closings, and bankruptcies threatened the median voter in certain industries.⁷⁸ Since unions after World War II became pace setters for

73. See Mitchell, *Wage Flexibility: Then and Now*, 24 *INDUS. REL.* 266 (1985).

74. H. FEIS, *PRINCIPLES OF WAGE SETTLEMENT* 189 (1924).

75. S. SLICHTER, *BASIC CRITERIA USED IN WAGE NEGOTIATIONS* 27 (1947).

76. I. BERNSTEIN, *ARBITRATION OF WAGES* 77-90 (1954). See also J. BACKMAN, *ECONOMIC DATA UTILIZED IN WAGE ARBITRATION* 39-43 (1952).

77. Median voter models depict the union as a democratic decisionmaker with the key constituent being the "median" voter, who provides the majority on any issue. If workers are ranked by seniority, the median voter is a member with a middle range of seniority. More realistically, since senior members play a disproportionate role in decisionmaking in any organization, the union is biased toward the interests of senior members. This tendency is apparent in layoff and promotion features of union contracts and in the tilt of union-negotiated fringe benefits toward those benefits of special value to senior employees. See R. FREEMAN & J. MEDOFF, *supra* note 2, at 122-35.

78. See Mitchell, *Recent Union Contract Concessions*, 1 *BROOKINGS PAPERS ON ECONOMIC AC-*

wage and employment practices—even in nonunion firms—it is not surprising to find the postwar period characterized by a general decrease in wage responsiveness to demand—that is, by a lesser emphasis on ability to pay.⁷⁹ And since the Wagner Act promoted modern collective bargaining, the postwar rejection of wage responsiveness to demand is an indirect legacy of the Wagner legislation.

B. *The Macroeconomics of Gain Sharing*

Despite general postwar disinterest in anything but the standard wage system, some employers have long used alternative pay systems. In particular, profit sharing has a lengthy history going back to the mid-nineteenth century.⁸⁰ Under profit sharing schemes, ability to pay is automatically reflected in labor compensation through fluctuations in the profit-sharing bonus. Labor compensation (wage plus bonus) is thereby made responsive to the firm's economic condition.

In some countries, notably Japan, variable bonus payments are a substantially larger part of total compensation than they are in the U.S.⁸¹ The Japanese example is particularly interesting since that country has exhibited both a lower and a more stable rate of unemployment than has the U.S.⁸² Demand restrictions in Japan reduce inflation more efficiently and less painfully than does the U.S. wage system.

It is difficult to estimate precisely how many U.S. workers participate in true profit sharing plans. Many firms have retirement programs which they term "profit sharing" in order to escape the regulatory rigors of conventional pension plans while simultaneously claiming pension-like tax benefits. Nevertheless, a 1983 survey conducted by the Bureau of Labor Statistics found that roughly one-fourth of the employees of medium-to-large firms had plans described as profit sharing.⁸³ However, the exclusion of smaller firms meant that many private

TIVITY 165-201 (1982); Flanagan, *Wage Concessions and Long-Term Union Wage Flexibility*, 1 BROOKINGS PAPERS ON ECONOMIC ACTIVITY 183-216 (1982).

79. Researchers have found, for example, that seniority is important in nonunion personnel decisions, although less so than in the union sector. Thus, one would expect that nonunion wages would be insensitive to demand, but would show somewhat more sensitivity than union wages, a result which has generally been confirmed. On union and nonunion use of seniority, see Abraham & Medoff, *Length of Service in Union and Nonunion Work Groups*, 38 INDUS. & LAB. REL. REV. 87 (1984).

80. For some early historical references, see NAT'L INDUS. CONFERENCE BD., PROFIT SHARING 3-7 (1934).

81. In 1978, bonus payments amounted to about one-fifth of total compensation of Japanese production workers in manufacturing. See BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, BULLETIN No. 2175, HANDBOOK OF LABOR STATISTICS 438 (1983).

82. The U.S. Department of Labor recently released a study comparing Japanese and U.S. labor market adjustments. Greater wage flexibility and the bonus system were cited as factors enabling Japanese firms to provide more stable employment for their workers. See BUREAU OF INT'L LABOR AFFAIRS, U.S. DEP'T OF LABOR, UNITED STATES-JAPAN COMPARATIVE STUDY OF EMPLOYMENT ADJUSTMENT (1985).

83. BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, BULLETIN No. 2213, EMPLOYEE BENEFITS IN MEDIUM AND LARGE FIRMS, 1983, 60-61 (1984).

wage and salary workers were omitted from the survey. There are no data indicating the proportion of small firms which have profit sharing plans, but it is likely that it is substantially below one-fourth. Whatever the exact figure in these categories, true profit sharing remains an uncommon form of compensation in the American workplace.

Profit sharing is often justified as a means of improving employee morale and productivity. These effects may possibly occur. If they were certain to occur, profit sharing obviously would be more widespread than it is. Unfortunately, profit sharing has also been used as part of a campaign by nonunion employers to keep from organizing their workforces. This history has led to union antipathy toward the profit sharing alternative.⁸⁴ Until quite recently, the macroeconomic side of profit sharing (and other forms of gain sharing) has been neglected.

In the modern world, job seekers often spend considerable time searching for new employment.⁸⁵ Typically, the financial burden of this search is borne largely by the job seeker. Of course, a laid-off worker will often be eligible for unemployment benefits. Other family members may also bring in some income. Nevertheless, the unemployed worker's income is reduced during the job search, which is often long and frustrating.

There are some exceptions to the rule that the unemployed worker does the searching. Door-to-door sales personnel, for example, are often actively sought by employers. In May 1985 the *Los Angeles Times* reported that the item the Fuller Brush Company was most eager to sell was a job with Fuller Brush as a sales representative.⁸⁶ Sales firms such as Fuller Brush behave differently from most other companies for a variety of reasons. Door-to-door sales personnel are paid on a commission basis. They receive a share of the sales they generate and their employer collects the remainder. Thus, it always pays for the employer to add more sales personnel, since the percentage going to the employer is sufficient to cover the costs of purchasing the item being sold. More employees mean more sales and, therefore, more profits. It is the form of the compensation system, the share contract, which produces this result. With a fixed time-based wage, additional sales personnel would also bring in more sales, but because of diminishing marginal returns, the employer would want to hire a limited number of salespersons.⁸⁷

84. See Mitchell, *Wage Flexibility in the United States: Lessons from the Past*, 75 AM. ECON. REV. 36-40 (1985).

85. The median spell of unemployment in 1983 was over 13 weeks. Married-couple families in which some family member experienced unemployment had median annual incomes 25% below those families with no unemployment. For families with one wage earner, the gap was 40%. See Sehgal, *Work Experience in 1983 Reflects the Effects of the Recovery*, MONTHLY LAB. REV., Dec. 1984, at 18, 23.

86. See Fuller, *Fuller Brush Man Still Knocking*, L.A. Times, May 13, 1985, § 4, at 1, col. 2.

87. See M. WEITZMAN, *THE SHARE ECONOMY: CONQUERING STAGFLATION* (1984).

In general, a compensation system based on sharing—of profits, revenues, or sales—gives the employer an incentive to hire larger numbers of employees. Martin Weitzman describes an economy of firms operating on a gain sharing compensation system as one composed of labor-seeking “vacuum cleaners” which would suck up unemployed workers and keep the economy at full employment.⁸⁸ The difficulty lies in making the *transition* from the current wage system to one with more gain sharing.

For the Weitzman approach to operate effectively, most major employers would have to shift toward a gain sharing form of compensation. Fuller Brush cannot be expected to solve the nation’s economic problems by itself! As a single firm operating within a larger wage system, the people it hires end up working at lower and lower effective wages. But if a *majority* of firms operated in a gain sharing mode, competition among them for labor would help keep wages from declining. Unions can play a role in determining the terms of the sharing arrangement.

Even at the level of an individual firm, however, there is a connection between wage responsiveness to demand (through gain sharing or otherwise) and job security. A firm’s payroll equals its average wage (W) multiplied by the amount of labor employed (L). A firm which finds it necessary to reduce its payroll by five percent, for example, will be indifferent between a five percent reduction in L (the layoff approach) or a five percent reduction in W .⁸⁹ In the early 1980s, unions found themselves confronted with such trade-offs, and some adopted profit sharing as a way of adding more flexibility to W in exchange for less variability in L .

The interplay between wage-setting and monetary policy is fairly clear. When the Federal Reserve puts on the monetary brakes, it slows wage and price inflation. The faster the reduction in wage inflation, the shorter the recessions need to be. Making wages more responsive to demand conditions by encouraging gain sharing would aid macroeconomic policy, reduce the need for deliberately engineered unemployment, and—as the Japanese experience suggests—stabilize the economy. While Senator Wagner and his colleagues believed that wage responsiveness to demand aggravated economic fluctuations, macroeconomic policy has made the reverse true. *More gain sharing would reduce the intensity of the business cycle and keep the economy closer to full employment.*

88. See Weitzman, *Some Macroeconomic Implications of Alternative Compensation Systems*, 93 *ECON. J.* 763, 777 (1983).

89. This approach is discussed more fully in Mitchell, *The Changing American Workplace*, 1 *LAB. LAW.* 301, 314–18 (1985).

C. *The Gain Sharing Solution in the 1980s*

1. *A Changing Climate.*

The economic downturn which began in 1979 placed great strains on the collective bargaining sector. Concession bargaining became prominent in many key industries, especially those hit hardest by recession, dollar appreciation, foreign competition, and deregulation. Between 1979 and 1985, nearly 50 percent of private-sector union workers covered by major contracts received a wage cut or freeze. Concession bargaining started to spread outside of its initial sphere of distressed employers and into other sectors.⁹⁰

As the concession movement spread, it spurred interest in new approaches to wage determination. COLA clauses were generally retained in union contracts but were often limited by caps, corridors, diversions, and other restrictive devices. Bargainers were less likely to permit external inflation to dictate compensation adjustments, particularly where—as was often the case in the 1970s—the inflation might reflect forces unrelated to the economic circumstances of the bargaining unit.

Firms became less willing to guarantee periodic wage increases. Beginning in 1983, a growing proportion of contract settlements featured fixed, lump-sum bonus payments instead of annual improvement factors. Where competitive wage pressures were intense, bargainers increasingly adopted “two-tier” wage plans, permitting lower wage rates for newly hired workers.⁹¹

Finally, the use of profit sharing was, for the first time, given serious consideration in the union sector and was adopted in some prominent agreements.⁹² Various assurances regarding job security often accompanied these profit sharing plans. The link between job security and profit sharing was a logical development.

A paradoxical mixture of conflict and cooperation accompanied these developments in wage determination. Some managers—encouraged by changes in the economic and political setting—took an especially hard line with their unions, in some cases breaking strikes and hiring nonunion replacements for their workforces.⁹³ Others, particularly in situations where a hard line approach was unlikely to be successful, emphasized cooperation and participation. A variety of “quality of worklife” initiatives flowered.

Within the union movement itself, a previously unknown degree of

90. The empirical material underlying this section is developed in Mitchell, *supra* note 69.

91. *Id.*

92. Most prominent were the profit sharing plans adopted at General Motors and Ford in 1982.

93. An often cited example was Continental Airlines, which abrogated its labor agreements in a bankruptcy proceeding and rehired a nonunion workforce in 1983.

introspection and self-criticism developed. The AFL-CIO, whose leaders had become increasingly disenchanted with the Wagner-Taft-Hartley legal framework, began to search for alternative roles for unions.⁹⁴ Thus, on the fiftieth anniversary of the Wagner Act, there is a receptiveness to change in many areas.

Periods of receptiveness to change do not occur frequently. When they do, it is often in response to some trauma. Psychological research indicates that even when change comes in such circumstances, it can easily be reversed unless reinforced and supported.⁹⁵ At present, despite the discussion of change in industrial relations circles, and despite some examples of change as a result of concession bargaining, public policy makers have given these matters little serious review. The Wagner-Taft-Hartley framework, and the wage setting practices which arose under that framework, have not been reviewed seriously by Congress and the President since 1947. Changes after 1947 have involved only tinkering and embellishment. Even in the public sector, where substantial unionization developed well after 1947, legislatures have been content to model their legal regulatory systems on the NLRB and its private sector corollaries.

This lack of imagination and attention would be understandable if all had gone smoothly. But all has not gone smoothly. The experience of the early 1980s suggests that the collision of wage setting and anti-inflation monetary policy is undesirable from a macroeconomic perspective. Public policy should seek to foster a greater degree of gain sharing in wage setting.

2. *Effectuating the gain sharing economy.*

To the extent that public policy has attempted to influence wage setting behavior in the post-World War II period, it has done so primarily by the use of formal wage controls or guidelines. Although less extensive, the controls of the Korean War period can be viewed as an offshoot of the World War II program. It was not until the Kennedy Administration in the early 1960s that policymakers began to experiment with direct intervention in wage setting as an ongoing instrument

94. AFL-CIO President Lane Kirkland first publicly hinted at disenchantment with the basic labor law regulatory system in early 1983. See Kirkland, *Scofflaw Firms Rewarded with Hefty U.S. Contracts*, AFL-CIO News, May 7, 1983, at 7. This sentiment was made still more explicit in a newspaper interview in mid-1984. See Trost & Aparcar, *AFL-CIO Chief Calls Labor Law a 'Dead Letter'*, Wall St. J., Aug. 16, 1984, at 8, col. 1. Finally, in early 1985, the AFL-CIO circulated an official report advocating departures from the traditional NLRB form of worker representation. AFL-CIO, *THE CHANGING SITUATION OF WORKERS AND THEIR UNIONS* (1985). This report was heavily influenced by a study conducted by James Medoff. See Medoff, *Study for AFL-CIO on Public's Image of Unions* by Economist James L. Medoff of Harvard University, DAILY LAB. REP., Dec. 24, 1984, at D1.

95. See W. SARGANT, *BATTLE FOR THE MIND: A PHYSIOLOGY OF CONVERSION AND BRAIN-WASHING* (1959) (describing the need for reinforcement after political or religious conversions to prevent new-found beliefs from eroding).

of economic policy.⁹⁶

Although the Nixon Administration initially eschewed the use of "voluntary" guidelines of the Kennedy-Johnson model, it eventually launched a full-scale program of mandatory wage-price controls.⁹⁷ After that program ended in early 1974, there was a hiatus in direct intervention. But the Carter Administration reinstated the guidelines approach, this time threatening noncomplying firms with revocation of their federal purchasing contracts.⁹⁸

The best that can be said for these programs is that given contemporary wage-setting institutions they may, under ideal circumstances, have some influence on expectations of inflation and notions of what the "normal" rate of wage adjustment should be. The difficulty is that circumstances are often not ideal, making programs of direct intervention extremely prone to demolition by external forces such as foreign oil price increases.

Frustration over the high costs of inflation restraint through traditional monetary policy, and over the inability of direct intervention programs to improve economic performance in the 1960s and 1970s, has led to the search for alternatives. Some economists have proposed that multiyear union contracts should be banned, arguing that wage settlements under one-year agreements would be more responsive to demand conditions.⁹⁹ But even if this hypothesis were correct, there would be severe opposition to any such proposal—especially from the management community—because one-year contracts increase the risk of strikes.

Other economists have proposed using taxes and subsidies to "bribe" wage setters into conforming their behavior to anti-inflation standards. Such "tax-based incomes policies" (TIPs) are easy to formulate in the abstract, but extremely hard to design in practice because of the complexity of incorporating all the institutional features of wage setting into the Internal Revenue Code. A Carter Administration TIP proposal—which would have provided tax credits for complying workers contingent on price inflation—was ultimately rejected by Congress because of its complexity and uncertain cost.¹⁰⁰

96. For a history and evaluation of the Kennedy-Johnson guideposts program, see J. SHEAHAN, *THE WAGE-PRICE GUIDEPOSTS* (1967).

97. On the Nixon program, see A. WEBER & D. MITCHELL, *THE PAY BOARD'S PROGRESS: WAGE CONTROLS IN PHASE II* (1978); OFFICE OF ECONOMIC STABILIZATION, U.S. DEP'T OF THE TREASURY, 1 *HISTORICAL WORKING PAPERS ON THE ECONOMIC STABILIZATION PROGRAM: AUGUST 15, 1971 TO APRIL 30, 1974*, at 325-426 (1974).

98. Little has been written on the Carter program. A critical summary appears in U.S. GEN. ACCOUNTING OFFICE, *THE VOLUNTARY PAY AND PRICE STANDARDS HAVE HAD NO DISCERNIBLE EFFECT ON INFLATION (PAD-81-02)* (1980).

99. The proposals for mandatory short-duration contracts are discussed in Jacoby & Mitchell, *Employer Preferences for Long-Term Union Contracts*, 5 J. LAB. RESEARCH 215 (1984).

100. For a discussion of the Carter Administration's TIP plan, see Mitchell, *The Rise and Fall of Real Wage Insurance*, 19 INDUS. REL. 64 (1980). See generally CURING CHRONIC INFLATION (A. Okun & G. Perry eds. 1978).

The lesson of these efforts is that fundamental institutional reform is needed, not some quick-fix gimmick. The positive trends already in evidence need to be reinforced. Since there is growing interest in gain sharing, efforts should be channeled toward developing and implementing effective and comprehensive gain sharing programs.

It should be evident that gain sharing in the unionized sector must inevitably involve a higher degree of labor-management cooperation than has been the norm. If, for example, an important component of worker pay is to be derived from profit sharing, it is inevitable that unions will become concerned with access to the accounts from which profit estimates are derived. Thus, gain sharing and information sharing are linked. Indeed, the thought of having to share information has historically inhibited management interest in profit sharing.¹⁰¹

The likelihood is that if profit sharing becomes an important source of compensation, union interest will spread beyond mere information and toward the management decision-making process itself. While the overall business cycle is an important determinant of aggregate profitability, the fate of each firm's profits is also critically dependent on the quality of its management decisions. Workers dependent upon profit sharing will want to be represented in those decisions. The sharp demarcation between labor and management that is part of the Wagner-Taft-Hartley framework will be challenged in a gain sharing economy.

Even where no form of gain sharing exists, unions and employers have been showing increased interest in quality of worklife initiatives, typically involving some degree of worker participation in management decisions. The further such experiments develop, the more logical it will become for those who contribute in making decisions to share in the fruits—sweet or bitter—of those decisions.¹⁰² Simply by building on these tendencies, public policy can tilt wage setting toward a gain sharing approach.

Tax credits for appropriate gain sharing plans are the most obvious way to promote needed reform. Even in a period of concern about fed-

101. In the late 1930s, hearings on profit sharing were held in Congress. There was some support at the time for promoting profit sharing as a way of reducing industrial disputes. But management spokespersons, notably Alfred Sloan of General Motors, expressed fear that profit sharing would lead to management sharing. Proponents of profit sharing tried to allay such fears by promising that profit sharing could be operated without encroachment on management. See *Survey of Experiences in Profit Sharing and Possibilities of Incentive Taxation: Hearings Before the Subcomm. on Finance of the United States Senate, 75th Cong., 3d Sess. 9-10, 475 (1938)*. However, some labor representatives, such as William Green of the AFL and John L. Lewis of the CIO, were not particularly enthusiastic about profit sharing, hinting that it would indeed involve sharing of management. *Id.* at 106-07, 189-90.

102. Conversely, gain sharing would, in the long run, bring about demands for worker and union participation in management. Unions would bargain over shares and would inevitably develop interests in areas currently outside the Wagner Act's mandatory subjects of bargaining. Union interests have already been widening in the 1980s. A further shift toward gain sharing would be no more revolutionary than the shift toward collective bargaining in the 1930s and 1940s.

eral budget deficits, considerable incentives could be provided simply by directing current tax expenditures on profit sharing toward those plans that are actually contingent on profits. Plans which are termed "profit sharing" but have no precise profit-based formulas should not be rewarded, as they currently are, by favorable tax treatment. Similarly, the tax provisions that heavily promote Employee Stock Ownership Plans (ESOPs) need to be reexamined and better targeted to promote true gain sharing. Except in the few cases of complete worker ownership, many ESOPs simply spread stock around without changing wage responsiveness to demand or internal employment incentives. They frequently are little more than tax-advantaged schemes to obtain financing.

Even with appropriate tax incentives in place, however, there is still the intangible, but extremely important, element of the "climate" for basic reform of wage-setting institutions. Perhaps the place to start to improve this climate would be to delete the second paragraph of the Wagner Act's preamble¹⁰³ and substitute the following language:

Equalization of bargaining power between employees and employers is the objective of this Act. Such bargaining can promote the flow of commerce at a high employment level and reduce inflationary pressures by developing gain sharing payment plans whereby employee compensation reflects to a significant extent the economic circumstances of the employer. The development of gain sharing will be fostered by increased sharing of information and decisionmaking by employers with their employees and labor organizations.

IV. CONCLUSION

American wage setting arrangements evolved over a long period of time. But the 1930s were a critical period in this evolution. Passage of the Wagner Act and related legislation put an official seal of approval on a system of wage rigidity. A dubious theory of wage-purchasing power—embedded in the Act—suggested that the appropriate response for wage setters in depression and recession was to push wage rates up, or at least prevent them from falling.

After World War II, the advent of active, anti-inflation monetary policy made the wage-purchasing power approach completely obsolete. Wage insensitivity to demand put collective bargainers on a collision course with the Federal Reserve, an outcome which has adversely affected the labor movement. Yet the focus of the union movement on wages and benefits in the postwar period was encouraged by the 1947 Taft-Hartley Act through its emphasis on management rights.

103. The text of this preamble, quoted at note 5 *supra*, bears repeating here: "The inequality of bargaining power between employees . . . and employers . . . burdens and affects the flow of commerce, and tends to aggravate recurrent business depressions, by depressing wage rates and the purchasing power of wage earners . . ." Wagner Act, ch. 372, § 1, 49 Stat. 449 (1935) (current version at 29 U.S.C. § 151 (1982)).

Adoption of gain sharing plans, such as profit sharing, would reintroduce needed flexibility in wage setting and improve macroeconomic performance. At the same time, it would inevitably expand union interest and concern into previously held management prerogatives. While the amended Wagner Act does not forbid such a development, it also does not encourage it. Hence, it is suggested that—along with needed tax incentives for gain sharing—the preamble of the Wagner Act should be amended explicitly to endorse gain sharing. Gain sharing should become an important part of U.S. labor relations policy.