AN EVALUATION OF THE GUARANTEED ANNUAL WAGE
IN ITS ROLE AS AN ECONOMIC STABILIZER

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CHAPTER I

INTRODUCTION

Some of the factors involved in the extremes of business fluctuations are among the greatest of the threats to the capitalistic structure. Such extreme fluctuations may at times seem to precipitate almost a complete collapse of the American economic structure. The major problem of economics in recent years has been the study of the business cycle, with emphasis on the means of controlling or stabilizing it.

I. THE PROBLEM

In recognizing the danger of the vicissitudes of business activity, it is necessary to consider any plan or program which could help alleviate this threat. At the present time, an additional economic institution is being developed—the guaranteed annual wage—which will have its effects on business fluctuations. The purpose of this study is to consider guaranteed annual wage plans, to evaluate their possible effects on economic stability, and to consider policies to offset any possible destabilizing effects.

Guaranteed annual wage plans have increased in importance in recent years. While a few attempts to establish guaranteed annual wage plans were made prior to the 1930's, most were unable to survive the great depression. However, they have become more numerous since
that time. Generally, these plans have varied greatly in details and the extent of the guarantee, since they were established on a firm rather than industry basis. A particular plan, then, was designed to cover or to insure the security of only a small portion of the total labor force; it would not have too much effect on the economy as a whole. Even the total of the workers covered under all of the plans has not been a large enough share of the total labor force to affect the economy to any great extent.

However, to the extent that in the future such plans are extended to a larger share of the labor force, their impact upon the economy will be increased. This will be especially true when they are established on an industry-wide basis. To the extent that purchasing power, prices, investment, and other economic factors are affected, these plans will tend to have a greater bearing on the major problem of the economic system—the extremes of the business cycle. The guaranteed annual wage, therefore, represents a factor which must be studied carefully to determine its stabilizing or destabilizing effects upon the economy. Methods of overcoming any destabilizing effects must be considered in the anticipation of a general acceptance of the guaranteed annual wage throughout the economy.

II. PLAN OF STUDY

In order to study the effects of the guaranteed annual wage on business fluctuations, a discussion of both is necessary. A brief
description of a generalized business cycle is given in the following section so as to indicate its basic characteristics. The section following this describes some of the limitations in a study of this type. The second chapter deals with the definition, nature, and history of the guaranteed annual wage plans.

Chapter three is concerned with the study of the guaranteed annual wage in relation to the business cycle. For the purposes of this study, the business cycle is divided into the expansion and the contraction phases. After determining the general pattern of past fluctuations, it is possible to consider the effect that a guaranteed annual wage would have on these phases. Effects resulting from the guaranteed annual wage which would contribute to economic stability are considered; the destabilizing effects are also analyzed. Policies of the government which could tend to offset some of the destabilizing effects of the guaranteed annual wage are considered.

The final chapter is devoted to conclusions with respect to the desirability of the guaranteed annual wage.

III. DESCRIPTION OF A GENERALIZED CYCLE

In order to facilitate the problem of relating the guaranteed annual wage to business fluctuations, it is well to describe the general pattern of a business cycle. All business cycles are not the same in detail, yet there are enough similar characteristics as to develop a general pattern.
Assuming at the start, that the economy is in general equilibrium or that national income has been relatively constant, there will be shifts and changes within the economy, but for a time these may tend to offset each other so that total business activity may remain relatively constant. However, there are various factors which may cause a change of business activity in either direction. It is impossible, of course, to assume that the economy is in complete equilibrium in that there will be factors prevailing from the previous change in business activity which will tend to influence another change. Assuming that the level of business activity has been somewhat low, various self-correcting factors will be at work which may tend to bring about a revival. Included in the endogenous influences are the liquidation of inventories, the improved liquidity of firms and banks, a decline in bankruptcies, an improvement in confidence, an increase in stock prices, a continuing amount of consumption, and better possibilities of long-term investment. There may be exogenous forces which could tend to influence a revival. Included among these would be an increase in government spending for armament or public-works, inventions or discoveries, large additions to the gold supply, or other factors essentially non-economic in nature.

Any one or a combination of these factors may act in such a manner as to stimulate a greater amount of production. Confidence tends to be restored and brings about an increased amount of investment,
employment, production, and consumption. The amount of long-term investment is expanded. The increased amount of spending sets the multiplier effect into motion. Wholesale prices tend to rise faster than labor, insurance, rent, and tax costs; as a result, the possibilities of profit are very good. The increased incomes of individuals in the form of higher wages and the increased incentive for investment bring about greater inflationary pressures. Inventories and credit expansion are increased to high levels. The rise is accompanied by an expansion in bank deposits. An increase in the velocity or supply of money is necessary to allow for greater spending. With a relatively small stimulus, business activity grows in a cumulative fashion until the whole economic system reaches a high level of activity.

Eventually, conditions arise which bring an end to the expanding phase of the cycle. As it becomes more difficult to expand production, the increased amount of spending brings about higher prices. Production costs catch up with prices and business profits start to decline. Banks find that their reserve position has become tight and new loans become more costly and difficult to get. Consumers tend to save more as incomes increase; a point will be reached where more money is held out of the income stream. Firms may fear a possible business turn and reduce new orders in order to shorten their inventory position. Some companies and industries may suddenly find that, relative to the current demand, they have overinvested.

When a decline has set in, it tends to spread rapidly through
the economy. An increased desire for liquidity results in the reduction of inventories; new orders are held to a minimum. Banks may be unwilling or unable to extend credit at this time. There will be a reduction in the output of goods and services and a fall in the average price level. The multiplying effect, which had worked to build the economy up to a high level of activity, now works to rapidly reduce the amount of business activity. Unemployment, which has been very low, starts to increase. With a decrease in income to labor, consumption also tends to decline. An attempt to pay off loans is made; new loans are not made. As pessimistic attitudes prevail throughout the economy, production and consumption drop to extremely low levels, and unemployment reaches high levels.

The length and severity of the decline and depression depend upon various factors. As a decline deepens and continues, self-correcting influences are set up which will eventually help bring about a revival. With continued consumption, existing inventories are used up and thus require additional production. Disposable personal income and consumption are held to higher levels than what otherwise might exist through the action of unemployment compensation, farm-price supports, and lower tax payments. As businesses find their assets in a very liquid condition, they become more optimistic and willing to invest. Because of high reserves, the banking system may make credit available at low rates and thus find more borrowers.
Opportunities for long-term investment are especially important in bringing about a revival. The government may attempt to increase total spending by increasing public investment and stimulating private investment and consumption. With these various influences, business activity is increased and the cycle is ready to repeat itself.¹

Among the important factors leading to extreme stages of the expansion phase is the heavy amount of spending in the form of consumption and investment; in the contraction phase, it is the greatly reduced amount of such spending. Any method which will aid in equalizing this spending over the period of the cycle would aid in achieving greater economic stability. This has been one of the goals of the government in its monetary and fiscal policy during the past thirty years.

IV. LIMITATIONS

The complexity and unpredictability of the subject should be stressed at the outset and especially prior to making any assumptions. In the words of a well-known authority:

For well over a century business cycles have run an unceasing round. They have persisted through vast economic and social changes; they have withstood countless experiments in industry, agriculture, banking, industrial relations, and public policy. . . . Men who wish to serve

democracy faithfully must recognize that the roots of business cycles go deep in our economic organization. . . .

Recognition of the limitations that are present in the social studies is also necessary:

In any economic situation, then, there are always so many known and unknown influences which may have to be banished to the realm of 'other things being equal' in order to get on with the analysis, and yet which probably will not remain equal. . . .

It must also be recognized that there are no past experiences with the annual wage plans comprehensive enough to influence the business cycle to any discernible degree. There are no data as to how a comprehensive plan is or was able to affect the economy in any way.

Actually, various other countries have had some experience under guaranteed annual wage plans. Italy, for example, has a state-imposed guaranteed annual wage law. In Spain and India, it is difficult to lay off workers after they have been hired. Employers in various Latin-American countries are also legally compelled to provide such security for workers once they have hired them. However, a study of effects in other countries would not be particularly

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relevant to this discussion. To assume that the results of a guaranteed annual wage in other countries would be the same as those in the United States is not realistic. With varying political and economic institutions and different cultures, it is not logical to conclude that effects would be identical or even similar in nature. This study is therefore confined to the United States.

While it is true that there are limitations on a study of this nature, it is also true that after determining some of the characteristics of the cycle, it is possible to indicate how a guaranteed annual wage would affect economic stability.
CHAPTER II

NATURE AND HISTORY OF THE GUARANTEED ANNUAL WAGE

Before proceeding with the major problem of the study, it is necessary to consider the nature of the guaranteed annual wage. An understanding of the subject matter facilitates the problem of relating it to business conditions. This chapter is thus devoted to a brief discussion of the guaranteed annual wage. Since this is only a preliminary to the major problem, it has been kept limited in scope. The first section discusses a definition of the subject; successive sections deal with the history, the nature, and the immediate purpose of the plans.

I. DEFINITION

Much of the disagreement over guaranteed annual wages is a result of different interpretations of terms. The ideal, as envisioned by the worker, is a minimum undoubtedly far above that which an employer would care to set up. Various plans have appeared under different names and may or may not represent a guaranteed annual wage. Some may be set up as a guarantee of wages, but for a shorter period of time, as twenty-six weeks. Some companies may insist that their plan is not considered to be a guaranteed annual wage, but in effect, could probably be thought of as such. The Procter and Gamble Company, for example, insists its plan guarantees annual employment
rather than wages. The reason for this is that a specific wage is not guaranteed. Thus, the company is able, in guaranteeing employment only, to shift employees about as it sees fit. A worker may thus be employed at a lower rate than previously.

For purposes of this study, the guaranteed annual wage is defined as being a guarantee or assurance of a substantial income to a relatively large share of the workers for a minimum period of time, normally, a year.

By a strict definition of the term, a guaranteed annual wage would assure full pay for a full year for all workers. Actually, this would not be practical, or almost impossible to put into effect. Most new workers, for example, are on probation when first starting to work for a company. During this period, the employer has greater freedom to fire the workers who show a lack of desired ability. Immediate coverage of such workers with an annual wage plan would prove extremely unfair to the employer. For practical purposes, then, a guaranteed annual wage plan would provide a guarantee of adequate pay for nearly all workers regardless of layoffs and plant shutdowns made necessary by business setbacks or seasonal variations.

Recent negotiations in various industries have developed the idea of "supplemental unemployment benefit" plans. Employers under these plans have guaranteed payments to workers, which, when added to

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unemployment compensation benefits as provided through the government, would insure a substantial income for the workers. These schemes, however, have been so limited in nature that they can hardly be considered a guaranteed annual wage.

Guaranteed annual wage plans with limited value to the worker would also have little influence on the stability of the economy. Therefore, for purposes of this study, it has been necessary to conceive the plans as being relatively extreme in nature.

II. HISTORY

The concept of an annual wage for production workers is not new. During the Industrial Revolution and at the time of the introduction of manufacturing concerns in the United States, many workers were paid on an annual basis. It was about the time of the Civil War that more workers began to be employed on a day-to-day basis. Since that time, employees have generally been paid on an hourly or piece-rate basis, receiving no compensation from the employer while not working. The attainment of maximum economies in production seemed to justify payment to workers only when they were engaged in production.

One of the first formal guaranteed wage agreements dates back to 1894. This agreement between the National Wallpaper Association and the union, committed the employers to provide eleven months' work in the year. It continued in one form or another until 1930.  

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In the early part of the Twentieth Century there were a few conscious attempts to provide security for workers. One study indicates that at least fifteen guaranteed annual wage plans were introduced prior to 1921.

One of the first plans to guarantee workers a minimum of employment appeared in 1921. At this time, the Cleveland local of the International Ladies' Garment Workers' Union entered into an agreement with the garment manufacturers of that city to provide the workers with a minimum of forty weeks employment per year. However, this plan was discontinued during the depression of the 1930's.

One of the first successful plans was initiated by the management of the Procter and Gamble Company of Cincinnati, Ohio. It was introduced in 1923, and by modification and correction of errors, managed to survive the depression and is still in effect.

Numerous plans to guarantee wages were originated during the prosperous period of the 1920's. With the depression, however, most of these plans had to be discontinued. Still others had to be modified so much that they were virtually ineffective.


Two other successful pioneers in the field were the George A. Hormel and Company and the Nunn-Bush Shoe Company. The Hormel meat-packing company of Austin, Minnesota, experimented with a plan of this type in 1931, when one department was put on a straight-time basis. It was found to be successful and was expanded to include other departments in 1933.\(^1\)

The plan of the Nunn-Bush Shoe Company of Milwaukee, Wisconsin, was inaugurated in 1935. The majority of workers have received fifty-two paychecks per year. This plan differs from most others in that the annual pay of the workers is dependent upon the sales record of the company. Labor's share has been based on an agreed per cent of the value added to raw material costs. In other words, the working force receives a certain per cent of the amount of sales less the cost of materials. With some modification, it has continued in effect.\(^2\)

Another company originating a plan was Spiegel, Inc., of Chicago. This plan has remained in effect since 1939. Employees may have to work overtime during peak seasons and less than forty hours in slack seasons, but fifty-two paychecks per year are guaranteed.\(^3\)


\(^3\) Chernick and Hellickson, *op. cit.*, p. 52.
The Social Security Act was passed in 1935 to provide a minimum of security for workers. Through this act the Federal Government has, in effect, compelled the states to enact unemployment compensation legislation. The systems as set up by the different states have varied considerably. All state laws, however, have provided for experience rating. Through this method, the individual employer's tax towards the plan is related to the benefits paid to his workers. Besides providing for payments to unemployed, there is some incentive for employers to stabilize production and employment in order to secure a lower tax rate. That is, the employer is required to pay unemployment premiums roughly on the basis of the unemployment growing out of his operations. Some companies have felt that their tax contributions for unemployment insurance fulfilled any obligation which they might have to guarantee wages or employment. Some companies, therefore, discontinued guaranteed wage plans; others felt they no longer had any responsibility to set up a plan of this type.

The Fair Labor Standards Act of 1938 recognized and approved the existence of annual wage plans. Under Section 7 (b) (2), employers who had signed a union agreement guaranteeing employment on an annual basis were given a degree of relief from the requirement of time and a half for work in excess of forty hours per week.

There were, during this period, various other attempts to set up guaranteed annual wage plans. However, only a few were successful. By 1940, the Bureau of Labor Statistics found that wage guarantee plans...
were present in only fourteen of the seven thousand agreements on file, and covered only about five thousand workers. Other writers, however, have arrived at different figures, largely due to different concepts as to what constitutes a guaranteed annual wage.

Actually, it was not until after the beginning of World War II that the guaranteed annual wage received a great deal of consideration. In 1944, the United Steel Workers of America requested a guarantee of employment on an annual basis throughout the industry. This plan, which would have covered about four hundred thousand workers, was not approved by the War Labor Board. One of the results of this demand was a recommendation by the War Labor Board for further investigation of the subject. A study was authorized by President Franklin D. Roosevelt in March of 1945. This study, generally referred to as the Latimer Report, was made public in 1947, but was very guarded in its recommendations. It tended to discourage the type of guaranteed annual wage that unions had hoped for, but did suggest that investigation be made of plans in which employers would supplement unemployment compensation payments.

In 1945, the Bureau of Labor Statistics indicated that 42,500 of the workers covered by union agreements were covered by some form of guaranteed wages or employment. About .53 per cent of the workers

1 Chernick and Hellickson, op. cit., p. 51.

covered by union agreements were thus covered. Another source indicates that by January of 1946 approximately two hundred guaranteed wage plans covering some sixty-one thousand workers were in operation in the United States. 1

In 1955, the United Automobile Workers attempted to get an annual wage agreement from the major automobile companies. What they did get was a compromise which was not a true guaranteed annual wage. In addition to the fact that it covered only twenty-six weeks, there were various other limitations. Most writers have thus considered these contracts to be "supplemental unemployment benefit" plans. While they cannot be considered guaranteed annual wage plans, they do embody some of the principles and provide the starting point for a guaranteed wage in future bargaining. The objective of the plan proposed by officials of the United Automobile Workers was to "enable workers to maintain the same living standards when laid off as they enjoyed while working." 2 Union pressures may force management to provide a more adequate guarantee in future negotiations. Emphasis has been placed on the fact that these plans are not to be considered guaranteed annual wage plans. They have been set up in such a manner and are so limited that they cannot be regarded as such. The automobile


2 UAW-CIO Education Department, Questions and Answers About the UAW-CIO Guaranteed Employment Plan (Detroit: UAW-CIO, n.d.), p. 24.
companies have only a limited liability and labor costs remain variable. All workers are not covered; those who are, receive only limited coverage. There is some reason to believe that union pressures in the future will bring agreements which will approach a guaranteed annual wage.

Opponents of the guaranteed annual wage feel that the current five cents per man-hour limitation on the liability of the company will increase in future negotiations. They point out a similar limitation in the United Mine Workers' Welfare Fund, which was to receive a royalty limited to five cents for each ton of coal mined. At the present time, the royalty is forty cents for each ton in bituminous mines and fifty cents in anthracite mines. The funds, however, are still not adequate to provide the benefits promised. Those opposing the plan agreed upon with the United Automobile Workers feel the current five cents per man-hour limitation will undoubtedly increase in a similar manner.

As of November, 1955, about 665,000 employees were covered in the agreements with the three big automobile companies—Ford, General Motors, and Chrysler.¹ A similar agreement was made with the American Motors Corporation in September of 1955.² Bargaining with large companies frequently sets the pattern to be followed by smaller companies. It is quite conceivable that any concessions


² Ibid., p. 5.
granted by major companies will eventually be granted by smaller ones.

Agreements in the pattern of the plan agreed upon by the Ford Motor Company have already spread to various steel and aluminum companies. The glass industry, and shipping lines along the Atlantic Coast have also been granted similar contracts. Two of the country's biggest can-making companies, the American Can Company and the Continental Can Company, initiated a wage plan similar to Ford's, except that workers are guaranteed benefits up to a maximum of fifty-two, rather than twenty-six weeks.¹

The guaranteed annual wage has thus increased in importance in recent years. Actually, relatively few workers are currently covered by a true guaranteed annual wage. However, a fairly large share of the labor force is covered by plans which do embody some of the principles involved in a guaranteed annual wage. Union pressures in future bargaining may increase the acceptance of the guaranteed annual wage or some modification of it.

III. NATURE AND IMMEDIATE PURPOSE

The purpose of the guaranteed annual wage plans is to assure employees of an income for a minimum period of time. It is reasoned that greater security for the workers would, in turn, expand the profits of the employer. Three of the successful plans were set up

¹Ibid., pp. 5-6.
largely through the initiative of management. The three men especially responsible, William C. Procter, Henry L. Hunn, and Jay C. Hormel, each in their respective companies, were greatly concerned over the lack of security provided for their employees. They recognized the fear of the workers of being laid off with a loss of income for substantial periods. These pioneers were able to envisage a method whereby they could reduce this fear, and yet make it pay off in terms of profits for the company. Though acknowledging increased costs in some directions, they felt this could be offset by the increased productivity of a satisfied, secure labor force. A lower turnover rate and increased interest on the part of workers was thought to increase productivity to the extent that it would offset most of the costs of providing more stable production.

The first of these plans, then, attempted to provide security only for the workers covered in the particular plan. There was no conscious attempt to provide stability throughout the economy as a whole. Because of the limited coverage, the initiators could have no such broad objective in mind. Some of these initiators have felt that if plans similar to these were made more extensive, they would have an impact upon the entire economy. Still others have refused to commit themselves on possible results or effects.

In a really effective guaranteed annual wage plan, a company is, in effect, setting up a more rigid labor cost. Normally, labor costs are variable; that is, they depend on the amount of production. When labor costs become more rigid, as they would under a guaranteed
annual wage plan, they become as other fixed costs and must be met regardless of the amount of production. Under a less rigid wage plan these labor costs could remain variable, yet, at the same time, would indicate that complete coverage of future unemployment would not be made.

The basic problem in setting up some of the earliest programs, and the one which was the most costly, was the necessity of stabilizing production to a greater extent. A labor force could be used efficiently and to the advantage of lower costs in guaranteeing wages, only if regularized production was possible. This has been difficult, if not impossible, in seasonal industries. At any rate, it was necessary to level off production as much as possible before attempting a plan of this nature. In some instances, new marketing techniques had to be employed. Wholesalers and retailers were encouraged to make purchases in accordance with desired production schedules. Additional costs were incurred in providing adequate storage space and in tying up working capital in inventory. Perishables and those goods which were subject to style changes represented the greatest problem because of declining value with lengthened storage. Providing raw materials for year-round production also produced similar problems and costs. All of these costs had to be weighed against the value of attaining workers' satisfaction through a guaranteed wage or employment. Some costs were eliminated or reduced with constant employment and production. A smaller number of new employees would have to be hired and trained and
there could be a fuller utilization of existing plant capacity.  

The problem of holding down the fixed cost involved in a guaranteed wage plan has been reduced somewhat in having the plan cover only a limited number of workers in the company. Limited coverage permits a portion of the workers to be hired or laid off in accordance with the amount of production in instances where it was virtually impossible to regularize production to a great extent. Generally, the method employed has been to cover only such employees as have been with the company for a certain length of time. Virtually all companies have the requirement that new workers must be employed for a minimum length of time before they are covered. This time period has varied from a few months to two or three years.

In many instances, where unions have bargained for a guaranteed annual wage, management has offered plans that are so limited that they can scarcely be considered guaranteed annual wage plans. In addition to limiting the number of workers covered under the current contract, they generally have had the right to reduce the number covered in following contracts. In some instances, they have also retained the right to terminate the plan at any time. The limitation which allows the company to modify or terminate a plan has generally distinguished the management plan from the union plan. Most

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labor leaders have felt that a plan offered unilaterally by management could be withdrawn at any time. A plan of this character could thus be terminated at the time it was really needed most. It is obvious, then, that it would have no more value than a purely voluntary attempt to stabilize production. Seniority practices already give a great share of workers far more security than a one-year guarantee.

In most contracts, payments to unemployed begin only after the employee has been out of work for a certain period of time, normally a week. The majority of plans provide payments to the worker of only a percentage of normal pay.

In order to visualize the nature of a particular plan, the Procter and Gamble plan may be selected as one to be considered in some detail. The company contends that its plan is not a guarantee of wages, but of employment. In effect, the covered workers are guaranteed forty-eight weeks of wages at the rate of pay of any particular job in which the company places the worker. In other words, because of the necessity of shifting employees to different jobs to insure employment, the wage rate that a worker has received in the past is not assured. The worker must accept the pay rate of the new job.

Because the company has attempted to stabilize production and employment, a higher morale among its employees has been achieved. Workers have felt more secure in the realization that a conscious attempt has been made to maintain employment. There is some evidence
of this in the labor turnover data. According to company officials:

The total labor turnover figure (including voluntary separation, layoffs, retirement, deaths) at the Company's largest factory dropped sharply from 133.7% per year in 1923 to 56.1% in 1924 as the Guarantee became effective. Turnover has been generally downward since. . . . Since July, 1948. . . . turnover at the Ivorydale Plant averaged 1.0% monthly as against a national average of about 4%.

The Procter and Gamble Company is in a fairly stable industry, however. Because the products are consumer goods for which there is a relatively constant demand, the company is not affected by seasonal and cyclical fluctuations to the degree that many other firms are. Very little of the company's products are produced to a specific order. This, in addition to the fact that fats can be stored from three to six months and soap from six months to a year, allows production to be stabilized to a degree not obtainable by most manufacturing firms.

The Procter and Gamble plan, however, does have limitations in that it does not eliminate all of the insecurity felt by the workers. First of all, workers must have been with the company for a minimum of two years before they are eligible for the protection provided by the plan. Due to this provision, an estimated 15 per cent of the workers are not covered. Secondly, the company retains the right to limit the guarantee to a maximum of 75 per cent of the established work week of covered employees. Finally, the company has the right to modify, withdraw, or terminate the plan at any time.

Because of these limitations, the plan is somewhat weak in accomplishing its purposes. Generally, the workers first laid off in any company are those hired last. The plan, therefore, does not protect these workers who will be affected first in the event of a layoff.

The right of the company to modify or terminate the plan gives little protection to the workers in a depression, a time when protection may be most needed. In 1933 workers in three of their plants were guaranteed only 75 per cent of the established work week. Security is thus only assured to the degree that the worker realizes that the company is making a conscious attempt to secure employment stability. The workers who normally have most to fear, those with less than two years' employment, and the period which all workers fear most—a depression—may thus not be covered.

Some of the more recent attempts at getting guaranteed annual wages have resulted in plans which pay the worker only a part of normal pay. These are designed to tie in with unemployment compensation as paid through the government. Generally, such plans have come to be considered "supplemental unemployment benefit" plans. The amount paid directly by the company plus the amount of unemployment compensation received through the government, total an amount which would provide the worker with a substantial income, though normally less than a full wage. The agreement reached with the Ford Motor Company was one of the first of this type. Various other companies have reached similar agreements.

1 Ibid., pp. 5-12.
There has been some controversy over the legality of paying unemployment compensation at the same time a worker is receiving payments from a company. In Ohio, for example, the question went to a popular referendum of the people in November of 1955, at which time the idea was rejected. In some states, the supplementation plans have been approved by executive action or by rulings by the state attorney generals. Included in the states which have approved supplementation plans are California, Connecticut, Delaware, Florida, Massachusetts, Michigan, New Jersey, New York, and Pennsylvania. The Iowa attorney general's office has also approved the collection of benefits under guaranteed annual wage plans with full state jobless benefits at the same time.2

The Ford Motor Company was one of the first to grant its workers a supplemental unemployment benefit plan. This agreement with the United Automobile Workers was signed on June 8, 1955, but did not go into effect until June 1, 1956. The basic idea of the plan is that the company should contribute to a fund from which payments may be added to the state unemployment compensation received by unemployed workers in order to contribute to a higher level of subsistence to those workers.

The Ford Motor Company's financial obligation is limited to five cents for each hour an employee receives pay from the company.

1"Time Clock," Time, LXVII (March 5, 1956), p. 100.
2Des Moines Register, July 14, 1956, p. 1.
This contribution is required until the fund reaches a maximum amount and also whenever the fund falls below this level. This maximum funding figure was set at fifty-five million dollars in June of 1955, but it will vary in proportion to increases or decreases in the number of hourly-rated employees. The total sum toward which the company will make its contributions will be affected by the number of people covered in the plan and the amounts actually paid in benefits, within the five cents per man-hour limitation.

Workers must be with the company for at least one year before they are eligible to receive benefits from the fund. Unemployment must be from temporary layoffs or a reduction in the work-force. The plan is somewhat complicated in nature; basically, however, it provides for benefits which, when added to state unemployment compensation, will equal 65 per cent of the employee's straight time for a forty-hour week after taxes, for the first four weeks; for the following twenty-two weeks, 60 per cent of pay after taxes is maintained. The maximum possible duration of benefits is thus twenty-six weeks; however, the actual duration of payments will depend on the relative amount of money in the fund and the length of the employee's service with the company. The maximum amount from the fund is twenty-five dollars per week to any one employee.\(^1\)

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Before the plan could go into effect, the requirement was made that the company's contribution to the fund must be recognized as currently deductible expenses for federal income-tax purposes. The requirement was also made that states in which two-thirds of the company's hourly employees covered under the plan are employed must rule that the payment of supplemental unemployment benefits for a week shall not reduce or eliminate the state unemployment benefits payable for the same week. This requirement has been satisfied. In states not approving this integration, employees forego unemployment compensation every third or fourth week, at which time they receive a relatively higher amount in payments from the fund.¹

Generally, employees must have received unemployment compensation in order to be eligible to claim benefits from the fund. In this manner, there is some pressure put on unemployed workers to seek other work. That is, state unemployment compensation is generally not paid, unless the worker is unable to find other suitable work.

Technological unemployment has always been feared by a large share of workers. The possibility of being replaced by machines has caused workers to feel more insecure. In recent years, the concept has been referred to as "automation." While most economists have felt that automation would not reduce job opportunities to any great extent, there is the possibility that it would tend to cause displacement of workers. The guaranteed annual wage has been proposed

as a method of aiding in this problem. As reported by Nat Weinberg, Research Director of the UAW-CIO:

It is definitely not our purpose, through the guaranteed wage or any other device, to reduce the rate of technological improvement. We believe, in fact, that as the guaranteed wage and various economic measures we advocate bring stability and steady growth the average rate of technological advance will be accelerated. Regulation of the timing of the introduction of specific innovations is quite different from slowing down the rate of the introduction of innovations in general.¹

In relatively recent years only, since the demand for a guaranteed annual wage has increased, have proponents advanced the idea that it would aid in economic stability. Generally, they would not claim it to be a "cure-all" for depressions, but feel that it would act as sort of a "prop" or a corrective factor in curtailing declines. Thus, in addition to providing greater security to the labor force, a guaranteed annual wage would aid in adding greater stability to the economy. In this connection, Mr. Weinberg says:

We have leaned over backwards to make clear that we do not consider the guaranteed annual wage a panacea. We do believe that it can make an important contribution to economic stability both directly, through its effects on consumer purchasing power, and indirectly, through the incentive it provides for management to devote more energy and ingenuity to stabilization both company-wide and economy-wide.²


Economic stability would thus be increased through the maintenance of purchasing power in the hands of the labor force. Production stability would also be encouraged by management in order to reduce the cost of paying labor while not actually working.

Guaranteed annual wages have thus been proposed as a method of insuring workers' security, aiding in the problem of automation, and finally, promoting greater stability throughout the economy. The last of these—the impact on economic stability—will be discussed in following chapters.
CHAPTER III

THE GUARANTEED ANNUAL WAGE AS A STABILIZER

The nature of guaranteed annual wage plans and the business cycle having been described, it is possible to analyze the economic impact of the guaranteed annual wage in detail. This chapter will deal with both its stabilizing and destabilizing effects in the expansion and contraction phases of the cycle.

I. EXPANSION PHASE

The expansion phase of the cycle is characterized by increasing amounts of spending in the form of both consumption and investment. Employment and production increase as a general feeling of confidence prevails throughout the economy. If the expansion continues to the point that the attainment of a higher rate of production and employment becomes more difficult because of full employment, inflation becomes a greater possibility. That is, if a higher amount of spending continues as it becomes more difficult to increase production, prices tend to rise more rapidly. The problem at this point is to reduce total spending to the degree that inflation does not become a reality. In order to promote stability, the peak of the cycle must be leveled off, so to speak, by reducing inflationary pressures.

When a guaranteed annual wage is set up, wage costs tend to
become more rigid. Labor costs are generally variable; they increase or decrease as the total volume of production increases or decreases. Under a guaranteed annual wage, decreasing production will not decrease wage costs to the same degree, because at least a part of this wage cost continues. Yet, it is probably not correct to consider wage costs as being fixed under this type of wage plan, since they can be reduced to a certain degree. Under a guaranteed annual wage, labor costs could probably be best described as being "less variable" or "rigid."

The degree of rigidity of wage costs depends upon various factors, especially the comprehensiveness or adequacy of the guarantees. If coverage is limited to workers who have been with companies for a relatively long period of time, costs can remain variable because of the possibility of laying off uncovered workers and thus reducing the labor cost. Obviously, a guarantee of this type would have limited value, as workers last hired are in greater need of such coverage in that they are normally the first to be laid off. Also, since most wage guarantees pay the unemployed an amount less than normal pay, labor costs could be reduced somewhat through a work-force reduction. The rigidity would also depend somewhat on the current level of unemployment throughout the economy. That is, if employees were able to find other jobs quite easily after being laid off from work from a particular company, the responsibility for maintaining an income

to these laid-off workers would be of a very limited scope. Since
there is the possibility, however, that laid-off workers may be unable
to find other employment, labor costs are not as variable as they
would be without the guarantee.

Effective guaranteed annual wage plans, then, do introduce
wage costs which tend to become more rigid. The rigid nature of such
costs could act as an incentive to production and employment stabiliza-
tion, especially in seasonal industries. The need to fully utilize
labor to increase profits would be an inducement to provide employ-
ment and production throughout the year. Many seasonal industries
would have a great deal of difficulty doing this. However, many
companies which had previously believed stabilization was impossible
would make a greater effort to do so in order to fully utilize labor
costs. There are numerous possibilities in this direction, for
example, introducing new lines of production in which the peak season
would coincide with the slack season of the original lines, selling
products at lower prices during the slack season, supplying wholesalers
with products in accordance with a constant amount of production, using
storage facilities, and various other methods. However, for certain
industries, raw materials are available and there is consumer demand
only during certain seasons; stabilization would be very difficult
in these instances. Complete stabilization of production, however,
would not necessarily be costless. In achieving a stable amount of
production, there would be increased costs in the direction of storage
and the tie-up of capital in inventories of raw materials and finished goods.¹

By virtue of its rigid costs alone, a guaranteed annual wage could tend to effect a more stable amount of production and employment. Businesses would be required to plan more in advance of production, and employment could be stabilized to a greater extent. In cyclical industries, it could tend to hold down production and investment at the peak of prosperity. Investment, especially in inventories, could be held down at the peaks of the cycle. During periods of low business activity, production would be continued at a higher level in the attempt to fully utilize labor. Production in cyclical industries would also be stabilized as a result of a more constant demand which would be influenced by the income effect of a guaranteed annual wage.²

For most companies, setting up a fund during prosperous periods for use in the event of a decline would be desirable. Direct contributions to these funds could be stabilizing in that money may be withdrawn from the income stream during times when inflationary tendencies existed. This contribution could be absorbed in various ways. If as a current reduction in wages, the effect would be deflationary in that consumption expenditures may be reduced. If workers


were to forego a wage increase which would come about through increased productivity to allow for contributions, the effect would be neutral because spending for consumption would not be decreased, nor would it be increased. If the cost were passed on to consumers in the form of higher prices, purchasing power to society would be reduced; this would tend to be anti-inflationary. If companies were to decrease expansion and investment and other expenses to contribute to the fund, the effect would be deflationary in that investment and consumption expenditures would be reduced. If the contributions to the fund came as an increase in operating expenses to companies and profits and dividends were reduced, the effect would be deflationary.

It is quite likely that in most instances, the greatest share of these contributions would not come as a reduction of income to companies, but would be absorbed by increased productivity of workers or higher prices to consumers. In all instances, the contribution to the fund would either be deflationary, or else neutral and therefore not contributing to inflation. To the extent that a part of the contributions were deflationary, the effect would be stabilizing.

A guaranteed annual wage is similar in many ways to unemployment compensation. It could be thought of as an extension of this program. Unemployment compensation is an automatic stabilizer in that it tends to be effective in promoting stability, not by conscious action of officials, but by virtue of events leading to a drop in payrolls and an increase in unemployment. It tends to increase costs
in expansion phases; during contraction, it decreases costs and purchasing power is increased. When a worker loses his job, his employer's contributions stop and unemployment compensation can be collected. Contributions would thus be greater in periods of increasing employment and result in an accumulation of funds which might otherwise be spent; payments for unemployment compensation will be greater with increasing unemployment and result in increased purchasing power to the labor force. Unfortunately, however, the stabilizing effect is somewhat weakened by the use of "merit-rating" for employers. This is the situation in some states where a reserve fund is kept for each employer and benefits to workers whose unemployment is attributed to him are charged against this account. In periods of increasing employment, this account grows large, so contributions are reduced, and the stabilizing effect weakened. In periods of increasing unemployment, the size of this account is reduced so the employer must again contribute at a higher rate at a time when contributions should be reduced.1

A guaranteed annual wage could be thought of in many ways as expanded unemployment compensation. That is, purchasing power is stored up in good times for use in poorer times; the net effect may be contra-cyclical. To the extent that such funds are withheld from

the income stream during the expansion phase of the cycle, inflationary pressures are reduced.¹

Because of a current need for capital, there is the possibility that some companies may not desire to set up a fund for future use. The companies must then meet such expenses as they arise. In these instances there would be no reduction in inflationary pressures, in that purchasing power is not held back. Deflationary pressures would actually exist when the economy is in a contraction phase.

In most companies, though, setting up a fund to meet the possibility of a future liability would be desirable. There would be anti-inflationary effects through the use of a guaranteed annual wage to the extent that some funds would be removed from the income stream. The effect, though, may be somewhat weakened by limiting the maximum size of the funds. That is, during prosperous periods, these funds could be increased to the maximum required because there would be relatively small amounts of payments from it. After the maximum had been reached, funds would no longer be held back from the income stream. Companies may thus be in a position again to increase investment, raise wages, or increase spending in other ways.

To achieve the maximum contra-cyclical effect, payments to the fund would have to be made during good times and payments made from it

only during poorer times. This would be quite difficult, however, in that it is not easy to anticipate the length and severity of any future declines. However, in an expanding phase of the cycle, inflationary tendencies would be reduced to the extent that this amount of purchasing power is held back.

These funds could have a great deal of effect on the economy because of their possible size. For example, when the supplemental benefit plans were set up by the Ford Motor Company, General Motors Corporation, and the Chrysler Corporation, the maximum amount of money that was expected to be held in the funds was eventually to reach approximately four hundred dollars per worker. \(^1\) Other companies agreeing to establish some plan to insure workers' security may not set aside this much. However, there is some indication that, if the guaranteed annual wages become more wide-spread, the amount set aside for these funds could become quite important.

In order to determine the final stabilization effect of the guaranteed annual wage, however, it is necessary to consider the manner in which these funds are held. There would be no anti-inflationary effect unless these amounts are actually withheld from the income stream or transferred to less active accounts. The basic difficulty is that most companies would desire to invest the funds

\(^1\) Region 1-A, United Automobile Workers, Facts About the Supplemental Unemployment Benefit Plan (Detroit: United Automobile Workers, n.d.), p. 2.
in some manner in order to receive a return on them. There are various ways in which these accumulated funds could be held or invested. They could be placed in deposits with banks; they could be invested in short- or long-term obligations of the government, or in stocks and bonds of other corporations. In order to determine the ultimate effect on stability, it is necessary to follow through each of these cases.

In the first instance, part of these funds accumulated under a guaranteed annual wage could be placed in commercial banks as demand deposits. This would tend to reduce purchasing power in that demand deposits would be increased and thus require higher bank reserves. With more bank reserves tied up in this manner, the banks would be restricted in their credit expansion in other directions. These deposits would become less active during high levels of business activity. As larger amounts were transferred from active to inactive accounts, the ultimate effect would be somewhat deflationary. A similar situation might result if the guaranteed annual wage funds were held with savings banks. However, this might not be true, since savings banks would probably loan these funds to others.

The funds could be invested in short-term obligations of the government; this type of security is quite liquid, would satisfy the safety requirement, and therefore would be quite suitable for this purpose. If purchased from commercial banks, the banks would be in
a better position to finance inventory accumulations, consumer credit, and other types of credit, which could aid in intensifying the expansion phase. This, however, would reduce banks' secondary reserves and might require the holding of higher primary reserves. That is, since short-term government obligations are excellent secondary reserves, a reduction of the holdings of these by banks might call for higher primary reserves.

If these bonds were purchased from individuals, the ultimate effect would depend on the use made of the funds held by the individual. If for investment or consumption, it would not be anti-inflationary; if the uses were more inactive, as increasing idle balances, anti-inflationary effects would result.

If, however, bonds were purchased from the Federal Reserve System, the effect would be a narrowing of the credit base, which would act to put a damper on inflationary pressures. That is, when companies present checks in payment for the bonds, they would be drawing on, or reducing member-bank reserves held by the Federal Reserve Banks. Member-bank reserves would thus be reduced by an equivalent amount.¹

The funds could also be invested in long-term government bonds. During a relatively prosperous period, the government would probably not increase the national debt in that taxes would be high enough to cover expenses. During a period such as this, when

business activity was relatively high, the government would be attempting to effect a budget surplus, which would be created through heavier taxation rather than issuing new securities. The supply of these obligations would then be limited. If funds were invested in government obligations, purchase would be made on the open market. The effect would be a greater demand for these securities, but the supply would be relatively limited. Assuming that new ones were not issued and the old ones not made available by the Federal Reserve Banks, the price would tend to increase. The effective interest rate would be lowered. As a greater amount of funds is put into government obligations, the interest rate is driven down and a greater amount of funds for investment is available throughout the economy. In effect, with a lower rate structure and availability of funds, possibilities of expansion could become even greater. Actually, the effect would be destabilizing rather than stabilizing in this phase of the cycle. That is, a higher rate structure and a tighter money policy would be desirable in order to reduce inflationary tendencies. If, however, the Federal Reserve Banks were to make their holdings of long-term government bonds available, or purchase was made directly from the Federal Reserve Banks, through the Open Market Committee, the effect would be to reduce member-bank reserves by an equivalent amount. If excess reserves were not held, this could cause a multiple contraction of credit.\(^1\) Banks would thus be in an

\(^1\)Whittlesey, *op. cit.*, pp. 254-267.
unfavorable position to loan, since the purchase of government bonds for the funds would decrease bank reserves. Market rates would also be held up somewhat and investment might be curtailed. Open market operations could be quite effective at this time in that the desire to purchase bonds for the guaranteed annual wage funds would coincide with a desire to sell bonds by the Open Market Committee in attempting to enforce a tighter money policy.

Unless the Federal Reserve Board took such action, the ultimate effect would be inflationary, in that the interest rate would be driven down and more funds would be available for expansion. The interest rate on government securities does not necessarily set the general rate structure, but does tend to influence it in that funds which would otherwise be normally absorbed by government obligations would now, if government yields were low, flow into other channels of investment. Investment would be stimulated through the release of funds formerly invested in government securities. Actually, the rate of interest is not the only factor to be considered in determining the amount of investment. Under prosperous conditions the rate of interest may not be too important as borrowers desire more credit as the prospect of income is good. Lenders are also more willing to lend as the risk is smaller and liquidity needs are lower.\footnote{Robert A. Gordon, \textit{Business Fluctuations} (New York: Harper \& Brothers, 1952), pp. 270-282.} A lower rate structure, however, would make income prospects even greater and would

be inflationary. This would, then, have to be counteracted by appropriate monetary actions, as through the sale of government obligations by Reserve Banks.

If long-term government bonds were purchased for the fund directly from commercial banks, excess bank reserves would be increased. If banks were to expand credit, inflationary effects would result. These bonds for the fund might also be purchased from insurance companies. The effect would probably not be anti-inflationary in that the insurance companies would reinvest in other securities.

The funds could also be held in the form of newly-created government securities. Normally, in a situation of potential inflation, the government would resort to higher taxation in order to obtain a budget surplus and borrowing would be held to a minimum. Borrowing by the government is not in itself inflationary. In fact, because it reduces the cash balances of individuals and businesses, it tends to have a deflationary effect. To the degree that the sale of government securities absorbs funds that otherwise would have been spent on consumption or investment goods, it reduces inflationary pressures. The inflationary tendency usually associated with government borrowing is in the following step in the process—that of spending the funds. With a high level of business activity and a probable budget surplus, the funds accumulated would undoubtedly be used to refund a part of the national debt. However, when used in

\[1\] Whittlesey, op. cit., pp. 492-497.
this way, the anti-inflationary pressures achieved by withdrawing money from the income stream would be offset somewhat, if not entirely by debt repayment. That is, funds taken away from one group of spenders would be returned to other potential spenders in repaying the debt. If bonds held by individuals or corporations were retired, the effect would not be anti-inflationary in that spending for consumption or investment could be increased. In retiring bank-held obligations, excess bank reserves would be created. If the banks did tend to expand credit, the effect would be inflationary in that spending for consumption or investment would be increased.

The funds established for the guaranteed annual wage could also be used to purchase bonds and stocks of other corporations. The purchase of old bonds and stocks would be somewhat inflationary in that the effective interest rate would be lowered and the market price of stocks increased. If the purchase of new bonds and stocks of other corporations was made, the effect would be inflationary in that more money would be poured into the investment stream. The presence of these large reserve funds in the economy would make equity and debt financing easier for companies and there would be less restraint on investment. However, very little if any funds would be used to purchase stock, because of difficulty in disposing of them when cash would be needed most. Purchase of bonds would be more suitable because less risk would be involved.

With a greater supply of funds for investment, the rate
structure would be held down somewhat and with a continued use of these funds for expansion, it would seem that such uses could eventually have an inflationary effect on the economy. In order to be anti-inflationary and stabilizing, there would have to be a removal of money from the income stream.

Assuming, however, that purchasing power is held back during the expansion phase of the cycle, proper taxation policies in regard to the guaranteed annual wage could also prove beneficial or stabilizing. That is, the direct costs of the guaranteed annual wage should be treated as a cost or reduction from gross income of the company at the time actual payments are made to unemployed, as opposed to a deduction from gross income when payments to the funds are made. This would be contra-cyclical in that total corporate and business tax payments would be higher during the expanding phase and lower during the contracting phase of the cycle. Any tax which tends to result in a budget surplus for the government in prosperous times and a deficit in poorer times is contra-cyclical. This, however, is not the case in the supplemental unemployment benefit plan of the Ford Motor Company. That is, the plans will not go into effect unless the company's contributions to the fund are currently deductible expenses for federal income tax purposes. ¹

to increase the propensity to consume. As many persons save for future emergencies, anything which would reduce this need could affect the propensity to consume. If this were the case, inflationary pressures might be increased somewhat. Actually, a one-year guarantee of wages may not reduce the desire to save for future emergencies to any great extent. Especially during periods of increasing income, consumption does not tend to increase as rapidly as income. For short periods of time, most persons tend to maintain a standard of living to which they have become accustomed.

The destabilizing effects of a guaranteed annual wage would come about largely through the investment of funds held for reserves. In order to offset this, counter-balancing monetary and fiscal policy would have to be used. These policies should be devised to prevent purchasing power, held back in one place, from being simply transferred or increased at another. At the same time, however, it would be necessary to assure that the effect would not be one of removing too much purchasing power and private investment opportunities. During the early stages of the upswing, it would be especially important to allow for adequate expansion.

In briefly summarizing this section, first of all, a guaranteed annual wage could contribute to production and employment stability by virtue of its rigid costs. In attempting to fully utilize labor in order to maximize profits, production could be somewhat stabilized.
Production stability would also be promoted by a more constant effective demand as influenced by the guaranteed annual wage.

Because it would be desirable to set up a fund in order to insure adequate provision for future unemployment, consideration of the fund must be made in determining possible stabilizing or destabilizing effects. It is therefore necessary to consider both the source and the disposition of the funds. With respect to the sources of the funds, a deflationary and stabilizing effect would result if the contributions were absorbed by a reduction of current wages, an increase in prices, or a reduction of the companies' dividends, investment, or other expenses. However, if the contributions were absorbed by workers foregoing a wage increase or by a decrease of the companies' retained profits, a neutral effect would result. In none of these instances, however, would there be any destabilizing effects.

In the actual composition or disposition of the funds during the expansion phase, there could be possible inflationary or destabilizing effects. This would occur when the funds were used to purchase new stocks and bonds of corporations, and short- or long-term government bonds held by banks. This would also be true if new government securities were purchased and used to refund bank-held obligations if the banks chose to expand credit. If the funds were used to purchase old stocks and bonds of corporations or old government bonds in the market, the interest rate structure would be driven
down, resulting in inflationary pressures.

The effect of the disposition of the funds could be extremely deflationary and stabilizing, however, if used to purchase short- or long-term government bonds from the Federal Reserve Banks through the Open Market Committee. A slightly deflationary effect would result if the funds were held as bank deposits. A neutral effect would result if the purchase of bonds were made from individuals, or new government bonds were purchased and used to refund debt held by individuals.

At all times the Federal Reserve System must be ready to institute monetary policies to guarantee the stabilizing effects of the fund.

II. CONTRACTION PHASE

The contraction phase of the business cycle is characterized by a decreasing amount of spending for consumption and investment. As the decline sets in, cumulative forces act to bring about a lower level of business activity. Unemployment increases, incomes and consumption decrease, and bring about a lower level of production, which contributes further to greater unemployment. The problem at this time is to stimulate production, consumption, and investment. In the past, during periods of decline, through the government's actions public investment has been increased and private investment
has been stimulated in various ways. In general there has been an attempt to increase the total amount of spending throughout the economy.  

A guaranteed annual wage by virtue of its rigid costs alone may tend to stimulate production. That is, because the labor cost must be paid anyway, an attempt to fully utilize this cost may result in a continued amount of production. The stimulation of continued production would also come about through the realization that a steady income to the labor force would contribute to a continued demand for consumer goods.

One method of influencing an increase in the amount of business activity is to stimulate demand or to add to the amount of purchasing power. Assuming that companies have undertaken a guaranteed annual wage but have not set aside any funds specifically for this purpose, an increase in purchasing power at this time must come from "new money" obtained through bank credit or otherwise idle funds. If the payments come from other active uses, thus constituting a mere transfer of active funds from one use to another, they will not add to aggregate spending and will make no contribution to recovery. If, for example, payments to unemployed were met by reducing other expenditures such as the replacement of inventories, cutting down on repairs and additions, or reducing investment, purchasing power is reduced in one place in order to be increased in another.  

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If, however, the payments to unemployed were at the expense of dividends, there could be a contribution to recovery in that purchasing power would be continued to wage-earners, who, it is believed, have a higher propensity to consume than the groups who receive the greatest share of dividends. In other words, purchasing power is transferred from those who tend to save to those who are certain to spend.

However, if adequate provision has been made for periods of decline well ahead of time through the accumulation of funds, a greater contribution to stability could be made. That is, the payments to the unemployed could be continued without a reduction of expenses in other directions. Other investment could be maintained at this time, such as renovation and expansion, because there would not be such a current drain on working funds. To be most effective, the source of any funds to be used with increasing unemployment must be accumulations held over from prosperity, since it would be more difficult for corporations to add to disbursements during a decline.

A contribution to recovery could thus be made in providing an income to the labor force. Since most of the labor force is in the lower income brackets which normally spend a high per cent of income on consumption, a higher rate of spending would be assured. Since most people tend to maintain a standard of living to which they have been accustomed, an assurance of an income would contribute to continued consumption expenditures. The guarantee of a continued
income to workers could have a desirable psychological effect. With the fear of loss of income due to unemployment reduced, workers might well maintain a high level of spending, and thus contribute to effective demand. If unemployment continues to increase, the rise in benefit payments would partly offset the decline in incomes. The effect of a steady income will assure a continued consumer demand which will in turn contribute to production and investment.

This was one of the methods employed by the government in the 1930's to promote economic recovery. In initiating various public-works programs during the depression, money was poured into the economy in an attempt to influence economic activity. At times, payments were made when there was no real constructive production. Besides aiding in providing subsistence, it also tended to increase the flow of money into the income stream. Production was indirectly stimulated in this manner, through the increase in effective demand. A similar effect is achieved through the farm-support program in that the government makes large payments to farmers when agricultural prices or income are falling.¹

A guaranteed annual wage is similar to unemployment compensation in this respect. Besides providing subsistence for workers as unemployment increases, a potential demand is created. Insofar as income and therefore consumption is maintained, a real contribution to recovery is made.

Because of the fact that extreme inflationary conditions may be avoided through the impact of the guaranteed annual wage and such government policies as those of the 1930's, declines would probably not be so severe. That is, if prices are held down, over-investment in new lines held back, and inventories kept relatively low, the ensuing decline may be less severe.

If funds have been established for use at this time, a real contribution to recovery could be made. However, if contributions to the fund had to be continued at this time, a destabilizing effect could result. Normally, of course, disbursements would greatly exceed contributions. If relatively large amounts of contributions were made, though, the source of funds would at this time be destabilizing if they were at the expense of employed workers, or a reduction of investment, expansion, and other spendings by producers.

Assuming though, that adequate funds had been built up, this effect would not be too important. It is, however, necessary to consider the disposition or composition of these funds. If the reserve funds had been held in government obligations which had reached maturity, they could easily be converted into cash and thus be in a form for prompt payment. However, the government would have to obtain funds with which to repay these; if done by increased taxation, the net effect would be neutral in that purchasing power would be reduced throughout the economy in the form of higher taxes. However, if the government were to obtain the funds by borrowing from the banks, the
money supply would be expanded. At the same time, however, additional bank reserves would be tied up and would thus prevent banks from making loans to private concerns. The Federal Reserve Board would then be required to free additional bank reserves, by lowering the reserve requirement or open market purchases.

It could be possible, though, that these funds were composed of government or corporate bonds which had not yet reached maturity. At this time, there would be a need to convert the holdings into cash; so, large amounts would have to be placed on the market. With a large supply and a smaller demand due to an increased desire for liquidity, the price for these securities would have to be low and this would mean a high effective interest rate. A high rate structure at this time would provide a deterrent to investment and be a strong destabilising influence. Proper action by the Federal Reserve Board would again be required to provide adequate funds at non-restrictive rates.

With respect to the government securities, however, if the Open Market Committee were to purchase a large share of these, the effect would be inflationary and stabilizing in that bank reserves would be increased and thus allow for greater credit expansion. In effect, the need to sell the government securities by the companies to meet payments to unemployed would be matched by action of the Open Market Committee to purchase the bonds to increase member-bank reserves.
and allow for adequate credit expansion. In addition, with a sufficient demand to meet the available supply of bonds at this time, the effective interest rate would not be increased. This would be somewhat inflationary and stabilizing in that investment would be stimulated.

The sale of the bonds from the fund directly to commercial banks would be deflationary and destabilizing in that the banks would be restricted in their credit expansion. If the bonds were sold to insurance companies, an inflationary effect would result if payments came from idle funds. However, it would not contribute to recovery in instances where the insurance companies reduced the purchases of other assets to buy the bonds.

On the condition that the funds had been held as bank deposits, these deposits would now become more active and be somewhat inflationary. However, as funds would go to labor, a large share would not be redeposited. Net deposits might be decreased, at least for a time, which would be deflationary. However, this might be offset by increased circulation outside the banking system.

At this time, an appropriate taxation policy in regard to the guaranteed annual wage would be beneficial in achieving stability. That is, if the companies' contributions had not been deducted from gross income in arriving at taxable income, the actual payments to the unemployed could now be deducted. The reduction of taxes would increase the government deficit. Anything which contributes to a government deficit during declining periods contributes to economic stability.
In briefly summarizing this section, then, the contraction phase of the business cycle is characterized by decreased spending for consumption and investment. If "new money" or otherwise idle funds are injected into the income stream, a contribution to recovery can be made. If a guaranteed annual wage had been employed, but no funds had been set up, or contributions to the funds required, the effect would be neutral if other expenses were reduced.

Assuming, though, that reserve funds have been built up, in order to meet payments, they must be liquidated at this time. When funds are held in corporate or government obligations, the placing of large sums of these on the market would tend to develop a higher rate structure and be a deterrent to investment. If the Open Market Committee purchased large amounts of the government obligations, the effect would be inflationary and stabilizing in that, in creating a demand for debt certificates, the interest rate would not be increased. Also, the purchase of bonds by the Committee increases member-bank reserves by an equivalent amount. Insofar as the banks would be able to expand credit, investment would be encouraged. In instances where funds were withdrawn from bank deposits, the effect would be somewhat destabilizing if net demand deposits were reduced.

Production may also be continued at this time in an attempt to fully utilize labor, and also because a continued income to labor would assure a potential demand for goods.
III. POLICY MEASURES

Some of the possible destabilizing effects which would result in the general acceptance of a guaranteed annual wage would come about through the composition of reserve funds. Some methods of holding or investing the funds may tend to increase inflationary pressures during the expansion phase; during the decline, they may add to deflationary pressures. These methods, however, when tied in with appropriate monetary action by the Federal Reserve Board, could be counter-cyclical.

By the nature of guaranteed annual wage plans, the accumulation of funds would be begun during early stages of recovery. If a maximum is set on the amount of funds, this maximum may be reached before inflation becomes a real threat. The contra-cyclical effect during the expansion phase might thus be somewhat weakened in that the limiting effect of reduced purchasing power would be removed too soon, unless provisions were made that contributions would not be made until a high level of employment had been reached. While there may be no net additions to the fund during the early stages of recovery, some contributions to the fund by the company would be required, and would have to be offset by a greater expansion of credit by the banking system.

For most companies, reserve funds would be necessary in the anticipation of a future decline in unemployment. As the total amount held in these reserve funds grows, the effect upon the economy
is increased. In order to be contra-cyclical, purchasing power must be removed from the economy during expansion phases, for use during periods of contraction. In cases where this does not happen, because of the composition of the funds, monetary and treasury officials would be required to take offsetting action. Through open market operations, changing reserve requirements, and other methods of affecting the money supply, officials could take action to establish the necessary monetary policy.

The accepted method for the composition of these reserve funds for the guaranteed annual wage would undoubtedly be bank deposits or government obligations, since both would satisfy the requirement of safety and liquidity. For stabilization purposes, funds composed of government obligations would be especially desirable. The need to purchase bonds for the fund in an expansion period might require the selling of bonds by the Federal Reserve System in order that excess bank reserves would not become too great and interest rates fall too rapidly, if the bonds were purchased from banks. The purchase of bonds from the government would also tend to be inflationary in that the funds would be used in some manner by the government and thus be returned to the income stream.

During a decline, the need to sell bonds from the funds would be matched by bond purchases by the Open Market Committee to allow for greater credit expansion by the banks. The Open Market Committee would have to take the initiative in these instances,
which would actually mean creating a demand for government bonds. At the same time, a favorable interest rate structure could be effected. The Federal Reserve Board, then, could exercise a greater control over the monetary situation through this method. In conjunction with the open market operations, the Board of Governors could contribute further to the development of favorable credit conditions by changes in reserve requirements and the discount rate.  

The direct deposit of funds in banks would tend to be somewhat stabilizing during the expansion phase in that inactive deposits would be increased. In a decline, these deposits would become more active. However, since payments from the fund would go to labor, net deposits might be decreased, at least for a time. Banks would thus be required to allow for more credit expansion to aid in promoting recovery. Again, a Federal Reserve policy may be needed to allow for and stimulate greater credit expansion.

Purchase of new or old bonds and stocks of other corporations would tend to accentuate both the expansion and contraction phase of the cycle. This method of holding the funds would not be too desirable from the point of safety and liquidity. However, this would be more true of stocks than high-grade bonds. If these methods were used to any great extent, the Federal Reserve Board would have to employ counter-acting measures. This would be through

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open market operations, changing reserve requirements, and discount policy. Through these methods, the Federal Reserve Board is able to effect the reserves of member banks. In effecting the reserves of member banks, the Reserve Board is able to influence bank credit.

Through the use of its various tools, the Federal Reserve Board could influence the monetary situation. Policies would, of course, have to be in conjunction with those of the Treasury. There have at times been disagreements between the Treasury and Federal Reserve officials. However, the achievement of greater economic stability has been the desire of both.

In summary, then, the composition of funds held for the guaranteed annual wage could be destabilizing, but these effects could be offset by appropriate action of the Federal Reserve Board. The easiest method in accomplishing economic stability would be in creating a demand and supply of government bonds by the Open Market Committee. Government bonds would be a suitable method of holding the funds and could fit in with desirable actions by the Reserve Board. Other methods of holding the funds would have to be counteracted by appropriate monetary action.
At the present time, a relatively small share of the labor force is covered by true guaranteed annual wage plans. However, there is some indication that a much larger share of the labor force will be covered either by a guaranteed annual wage or some modification of it in the future. The supplemental unemployment benefit plans which were granted by the major automobile companies embody some of the principles of a guaranteed annual wage. These plans have already spread to various other industries.

As a method of aiding in providing economic stability, the guaranteed annual wage does offer a great deal. It tends to contribute directly to both consumption and employment stability. Consumption stability will be promoted by providing an income to a part of the group which is almost completely dependent on wages for subsistence. Employment and production stability will be affected directly by giving employers more incentive to stabilize production. In attempting to maximize profits, employers will be more concerned with a fuller utilization of workers. Production would also be stabilized indirectly in that a more constant potential demand would be influenced by a continued income to labor.

The guaranteed annual wage can also produce a desirable
social effect by providing subsistence for unemployed workers who are unable to find other jobs immediately. As is true of many other social reforms, it has been viciously attacked by employer groups. Nonetheless, the guaranteed annual wage or similar agreements will probably be accepted by more companies without the undesirable results that have been predicted.

At the same time, however, it is essential that Treasury and Federal Reserve officials be prepared to offset any possible destabilizing effects which may result from the composition of the reserve funds set up for the guaranteed annual wage. The accepted method for investing these funds will undoubtedly be in government securities. Both safety and liquidity, which would be necessary characteristics of this type of investment, would be assured in this manner. The Federal Reserve Board, through the Open Market Committee, would be required to maintain both a supply of, and a demand for government securities. At the same time, Federal Reserve policy must be adjusted to maintaining member bank reserve levels consistent with the stabilization of the economy. This may be effected by appropriate discount rate policies, reserve requirement adjustments, and open market operations. This would largely be a continuation of present policies of providing a monetary policy appropriate at a particular time.

In previous legislation, the government has recognized and made allowances for the establishment and use of guaranteed
annual wage plans. It is probably not desirable that the government force companies to employ a guaranteed annual wage. The strength of the unions will likely force the acceptance of a guaranteed annual wage, or some modification of it, by an increasing number of firms. It is a legitimate and desirable bargaining issue, in that a greater amount of security should be provided to the labor force. The government's action should thus be one of encouraging, rather than requiring companies to establish a guaranteed annual wage. If necessary, however, the government might require that the reserve funds be invested in government obligations. In this manner, an appropriate monetary policy could be effected more easily.

In extremely seasonal industries, the employment of a guaranteed annual wage would be almost impossible. Actually, this type of work is done largely by part-time workers who may desire employment only part of the year, or by itinerant workers who depend upon many employers throughout the year for their income.

It is necessary, however, to emphasize that the guaranteed annual wage is only an additional method of maintaining greater stability. Little could be expected of it by itself; however, when used in conjunction with other methods of promoting economic stability, it could make a contribution to this end.


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