INCOMES POLICY, NON-FINANCIAL BENEFITS AND MACRO-ECONOMIC MANAGEMENT

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C O N T E N T S

SECTION 1: Introduction*

Incomes policy, largely confined to wage and salary regulation through control of per period rates of pay, has been a central feature of stabilization and adjustment programmes in the Caribbean. However, an employee's compensation package, and hence a firm's outlay on labour may contain **three elements**, namely, **the per period rate of pay; additional earnings** which vary with the ebb and flow of work within given pay periods, e.g., bonuses, and overtime; and, **non-pecuniary benefits**, e.g., housing and medical care. The last element is termed, **industrial social welfare benefits** or **ISWBs.** While there is some recognition in the literature of the importance of the first two elements, ISWBs have been a neglected area of study, particularly in developing countries.

This paper emanated from a larger on-going project at the Institute of Development Studies (IDS), University of Guyana, which is examining the sugar and bauxite-alumina industries in order to establish the level and monetary value of Industrial Social Welfare Benefits (ISWBs), analyse their origins, determine their role among the various communities which "benefit", and to make policy recommendations. The project is being conducted in the period of transition of these two industries from parastatal enterprises to privatized entities.

*I would like to acknowledge the assistance of Garfield Barnwell in collecting the data used in this report, and in tracking down the literature.

It should be noted that the literature recognizes changes in the first two elements of the compensation package are frequently not uniform. From this has emerged the concept of **wage drift**, i.e., the difference between rates of pay in a job and the actual earnings of employees over any given pay period (weekly, fortnightly or monthly). However, the realisation that movements in overall earnings may vary from movements of the rate structure has led in many countries to the frustration of stabilization, structural adjustment, and incomes policies, which seek to control wages directly by limiting percentage increases in rates of pay. Given these circumstances, the neglect of ISWBs as an area of study and analysis is altogether surprising, as this category also has the same disruptive potential for macroeconomic management.

While theoretically we may expect non-financial benefits to respond to their own dynamics and those of the total worker compensation package, they should not be treated as compartmentalized and unresponsive to the dynamic interplay in the broader macroeconomy, as well as to **sectoral and industry-wide trends.** This paper reports the main findings on how, and to what extent, the macroeconomic context and sectoral-industry trends might have **conditioned or constrained** the movement of workers' compensation packages and non-financial benefits in the two industries.

SECTION 2: Theory: Rates of Pay, Wage Drift and Non-financial Benefits

Although received by workers as in-kind benefits, ISWBs affect a firm's input costs in two ways. It is part of the enterprise's financial outlay on labour, and because of the nature of this outlay, it also influences labour productivity. Further, because this outlay forms part of input costs, ISWBs also directly affect the profitability of enterprises. Viewed as part of the overall worker compensation package therefore, non-financial benefits combine to form a substitutable element within an enterprise's total employment costs. And, because of the relation of these to input costs and profitability, they are similar to the other elements of employment costs, in that the amount outlayed on them are also dependent on the cost of other inputs to the enterprise, (the amount used and their productivity), as well as the technical relations of the particular production process.

Because non-financial benefits affect such variables as productivity, the total value of employment benefits, profitability, and so on, they have in addition, a direct impact on the main macro-economic relations in the economy: employment, aggregate expenditure (consumption, investment, net exports, and government spending) as well as aggregate supply. In an economy like Guyana, where sugar and bauxite are the largest sectors of production, foreign exchange earnings, employment, and revenue yield, if non-financial benefits form a significant element in the worker's compensation package, their effect on the macroeconomy can be expected also to be significant. The relation, however, is not one-sided. Macroeconomic change and policies can also be expected to impact significantly on the overall compensation packages as well as their composition in these industries.

From the standpoint of labour market analysis and macro-economic regulation, we may argue that the expansion of non-financial benefits in the compensation package **reduces** the role of market prices as information signals to economic actors. This expansion, however, could be consistent with an economy in which direct controls, rather than market forces play the major role in economic affairs. As we shall indicate later, this was the case for much of the period in which these industries were public enterprises.

Neo-classical welfare theory would no doubt posit, that in economies with developed markets, non-financial benefits are not perfectly substitutable with money income. The reason being that they must be to some extent, "company determined" commodities which are being exchanged for labour. Their existence therefore, would represent a **constraint on choice**, and a labour market imperfection. It would seem however, that in an economy where shortages are acute and the underground economy widespread, their existence in state owned enterprises might well have introduced an element of **preferred access** to wage goods for state employees. Instead, therefore, of constraining choice, they might **have expanded the availabilities of wage goods.**

SECTION 3: Macroeconomic Context: Propositions

To facilitate reporting in the time at my disposal, I shall only state **the key propositions and preliminary findings** which emerged from the analysis of the macro-economic context in which ISWBs have developed in the sugar and bauxite industries, during the past three decades. All the statistics and other details can be found in the larger study. Particular emphasis is placed on the period since the early 1970s, after both industries were nationalized, as part of a broader Government programme "to seize the commanding heights of the economy," and which resulted in its ownership/control of 80% of the economy. It ends at the present time when these policies have been all but completely reversed. The propositions are presented serially, and in the historical-logical order of their development. The nuances which inevitably accompany them can only become clear if the economic data and the analysis of macro-economic performance are studied. Unfortunately time and space preclude this.

Proposition 1

Nationalization of the "commanding heights" and the centralized state direction of the economy which followed was a period in which macro-economic management and economic policy were based on physical controls, administrative direction, restraints and incentives, and a highly centralized incomes policy. The last item took the form of a more or less uniform wage and salary administration for public employees, who formed a large part of the labour force. This had a strong **demonstration effect** on wage and salary settlements, as well as employment practices in the private sector. In this way **the Government established a _de facto_, if not _de jure_ enforceable national incomes policy**, with three primary objectives: to contain inflation (through restricting aggregate expenditure); to improve the balance of payments (through the restraint on expenditure, controls on imports, and lowering of export and import substitution costs through wage restraint); and to attract investment (through lower wage costs and interest rates and other subsidies to capital).

Proposition 2

State control of the economy and enforced party political paramountcy of the state, led to **corporatist control of the trade union and labour movement. This facilitated the transition to centralized salary and wage administration.**

Proposition 3

State control of the economy was accompanied by immiserizing growth, so that **incomes policy manifested itself as extreme wage repression, defined as a situation in which over a long period the real wage persistently declines.**

Proposition 4

Shortages of basic wage goods, massive price inflation and reduced foreign exchange availability, alongside administrative controls on the prices of key commodities (including labour), fostered a huge underground economy, particularly in foreign exchange and wage goods. Even at their reduced levels of earnings, the foreign exchange earned by export industries nevertheless gave them a huge premium in local dollar earnings. **Centralized wage administration sought to prevent the management of the sugar and bauxite industries from going their own way in wage and salary settlements, and to the extent that it succeeded, it contained wage rates in these industries to levels below which they might have otherwise risen, if free collective trade union bargaining had obtained.**

Proposition 5

Following on the above, **management in these enterprises had an incentive to encourage wage drift and to reinforce the role of non-financial benefits** in the worker's compensation package, as this would serve as one means of securing the loyalty of their workforce and in recruiting certain skill areas in short supply.

Proposition 6

Centralized incomes policy also tended to reinforce **three further distortions in the labour market which management supported. First,** it encouraged **overstaffing and employment at**

levels beyond that which would otherwise obtain if purely commercial criteria were employed in the state sector. **Second,** by doing so these enterprises became **"extensions" of the welfare state,** taking on much of the responsibilities of "protecting" labour from the full effects of the economic decline. **Third,** because of the geographic concentration of the communities in which these enterprises operated, this welfare function was also seen as a **community support function** in a period of hard times.

Proposition 7

There was an increasing tendency for the **convergence of interests in the treatment of non-financial benefits,** by management and the workforce in the two industries. Shortages and the burden of high marginal rates of taxation which emerged as the inflation of money incomes occurred while real incomes fell, **encouraged workers and their trade unions to have a preference for non-taxable forms of compensation.** This was reinforced by the **expanded availabilities to wage goods** which this development also made possible. When linked with (6) above this convergence of interests facilitated:

- mutual support in circumventing government's incomes policy;
- the mutual use of ISWBs as a hedge against inflation;
- the exchange of expanded availabilities for the workers, for the reduction in time lost while acquiring scarce wage goods, and the accompanying negative effects on workers' attitudes and productivity which this produced.

Proposition 8

In the wake of the recent turnaround in economic policies there has been a significant unravelling of the institutional supports for wage repression in the public sector. The liberalization and market emphasis of the IMF/World Bank/Economic Recovery Programme have also **undermined the impact of public sector wage and salary settlements on the private sector.**

Proposition 9

As the transition to privatized entities continue certain developments seem likely:

(i) a **dual structure of wage and salary payments and other elements in the worker's** compensation package will develop;

(ii) consequent on the greater emphasis on commercial criteria, management is increasingly likely to **seek trade-offs and the buying out of non-financial benefits** in the wage-bargaining process;

(iii) "rationalization" of the work force will inevitably be high on the agenda of the new management, as it seeks to shed the welfare role; the new management is likely to claim that the present level of ISWBs expenditures cannot be carried by a commercial entity, if it is to make a profit. Strong efforts will therefore be made to displace them to one or other level of government, or some other private agency;

(iv) the pressures placed on the state by this development will be critical, as state resources continue to be meagre, and the state over-extended. The risk therefore is that these non-financial benefits will fall by the wayside;

(v) because these benefits continue to play a crucial role in the survival of the work force the emergence of serious industrial conflict is very likely;

(vi) as these issues intensify, with workers being laid off, and non-financial benefits hived off, given the geographic concentration of the two industries and their great importance to many local areas, the likelihood is that industrial conflict could spill over into communal, social, regional and political conflicts;

(vii) finally, because of the different historical paths and evolution the two industries have taken, there will not be either uniformity or identity in these developments.

SECTION 4: Sectoral/Industry Trends: Propositions

As in the previous Section I shall only report on the findings/propositions which emerged from the detailed review of the sugar and bauxite-alumina industries.

Proposition 1

Despite annual variability, the period since the mid 1970s has been characterized with **spectacular and persistent declines in physical output in the two industries**, brought about by **inefficiency** in production and mismanagement, and not to declines in the demand for the industries' output at competitive prices.

Proposition 2

This **production crisis** which developed after nationalization, was mainly linked to state mismanagement of the industries, this being a **mirror image of the wider mismanagement of the macroeconomy.**

Proposition 3

Poor performance in the two industries was the major contributor to the overall poor performance of the economy, and formed **the core of the production crisis.**

Proposition 4

Declining production and falling productivity constrained the "ability" of the two industries to pay better wages. Because, however, they were the main foreign exchange earners, they could still secure **preferred access**, to the reduced foreign exchange, thereby earning themselves a foreign exchange premium or economic rent, which could be encashed in local currency. The result was that the observed decline in output and the real value of overseas sales, **understated their ability to meet workers' compensation packages.**

Proposition 5

Being nationalized industries generating the bulk of output, income, and employment in the age of cooperative socialism, these industries were inevitably forced to **play a major social welfare role.** Government pressure led to resistance to labour lay offs, efforts to "rationalize" the workforce, and prevent the lowering of real wages so as to protect the standard of living of the workers and the communities in which they lived.

Proposition 7

For the future, it seems that privatization of these industries will lead inexorably to certain **crucial** developments:

- The increasing application of **commercial criteria to labour market interventions** by management. In contrast to the earlier period, this will mean retrenchments, lay-offs, rationalization of the work force and the restructuring of the workers compensation package.

- Non-financial benefits will be fully costed and efforts made by the new management at **"buy-outs"** of these.
- These "buy-outs" will be presented in a manner which states that it is the Government or some other agency to provide basic services; the new industries should be **"lean and clean"** and free from carrying state welfare functions.
- Wherever non-financial benefits are provided, the principle of **user cost recovery** will be introduced. This will increase real costs to households.
- Depending on their vigilance the developments indicated above will be **resisted** by the workers and their trade unions.
- Company strategy will be to offer **large money wage increases** with **two** objectives in mind. One is to hope that a **"money illusion"** prevails in the workforce which will not apply **"rational expectations"** in calculating the value of the remuneration package. At the same time acceptance of the package will be expected to lead to changed working conditions such as **elimination of "wage drift"**, and increased **intensity** of labour effort.

Proposition 8

Finally, because of differing historical, cultural and political factors in the two industries, as expressed earlier the above developments will not take place in a uniform or identical way. Macro economic management will have to recognize that these **differences** could play a **role** in determining how the workforce in the two industries, as well as other social, economic and political interests, respond to privatisation.

CONCLUSION

In conclusion Table 1 below gives an illustration of the relative magnitudes between wages and salaries, wage drift and non-financial rewards. Because of difficulty of data collection the non-financial benefits are likely to be under estimated. Yet as a percentage of wages and salaries it ranged from 20-70 per cent, and averaged 28 per cent for the period 1977-92. A significant slice of income therefore escaped incomes policy.

GUYSUCO: WAGES AND SALARIES, WAGE DRIFT AND NON-FINANCIAL REWARDS 1977-1992

Year	Wages and Salaries $ million	Wage Drift[1] $ million	Wage Drift[1] % of Wages & Salaries	Non-Financial Benefits[2] $ million	Non-Financial Benefits[2] % of Wages & Salaries
1977	93.9	5.6	6	21.7	23
1978	132.3	6.5	5	26.0	20
1979	124.9	3.8	3	28.7	23
1980	139.6	3.9	3	33.2	24
1981	164.2	10.1	6	39.0	24
1982	156.3	12.6	8	36.3	23
1983	158.1	6.2	4	36.6	23
1984	174.4	4.7	3	39.4	23
1985	158.8	4.8	3	37.5	24
1986	171.7	14.4	8	39.1	23
1987	236.6	21.3	9	56.0	24
1988	256.6	7.8	3	63.2	25
1989	377.5	57.3	15	116.7	31
1990	618.0	80.4	13	437.4	70
1991	1828.4	457.7	25	672.6	37
1992	3263.8	658.4	20	1156.0	35

Note: [1] Includes Incentive Payments
[2] Includes Sugar Industry Special Funds, Community Service, Other Employment Benefits, and Transport Costs.

Source: Guysuco, Accounts and Annual Reports