A Unique Experiment in Escalated Wages

The Wage Reform of 1947 in Finland

In Finland, escalated wages on a national level were first being applied in 1942, as soon as government regulation of wages had been established. The wages were linked to the cost of living index and were, during the war years, allowed to be raised by two-thirds of the rise of the index. After the war, the clause was changed so as to give full compensation for rising costs of living, but already in 1945 was again repealed. In the ensuing epoch of inflationary anarchy prices were rapidly shooting to the heights but even more rapid was the rise of wages, as will appear from the following table:

October	Cost of living index	Index for industrial wages	
		men	women
1944	100	100	100
1945	139	174	203
1946	222	240	278
1947	288	326	368

The rise of industrial wages was substantially exceeded by that of agricultural wages, whereas salaries lagged far behind.

The steep rise of manual wages in the first postwar years was partly a consequence of acute shortage of labour, and partly, of the growing political power amassed by the trade unions during this turbulent epoch. Wages rising in relation to prices need not, of course, have any inflationary effect, provided that they do not rise, on an average, more rapidly than the productivity of labour. In Finland the national product per capita had, however, been substantially reduced during the war years; in 1945 it stood at 85% of the corresponding figure of 1938, and attained its prewar level only in 1948. Obviously there did not exist in this "empty economy", where "too much money was chasing too few goods", a margin in the national income wide enough to allow wages to be raised at the pace as actually happened without thereby releasing additional inflationary pressure on prices.

Towards the end of the epoch this "wage inflation" became still more intensified, as labour was finding out that the attempts to control the prices by government regulations proved futile, each rise of wages being followed by rising prices. In the summer of 1947, the growing dissatisfaction gave birth to numerous local strikes and finally to new radical wage demands launched by the Federation of the Trade Unions and accompanied by the threat of a general strike, if not accepted. The ensuing negotiations led to a truce, the government conceding to most of the wage demands, and the trade unions on their part, declaring themselves willing to withdraw the strike call and to follow in the future certain "rules of the game". The most noteworthy features of this remarkable truce, as it was confirmed by a government decree of October 3, 1947, may be summed up as follows:

1. The country was divided into four districts according to variations in the cost of living, and the manual wage-earners in each of these geographical districts into four groups according to their status as skilled labour, semi-skilled, etc.

2. The wage rates fixed for each group represented, including some fringe benefits, on an average a 25 to 30% rise in wages.

3. The lower rates being raised relatively more, as the outcome of economic and political necessity and the egalitarian principle applied, the margin between the lowest and the highest wage categories was narrowed down from about 30% to roughly 20%.

4. The decree included, however, numerous "escape clauses" for those wage-earners who could not be pressed into these narrow margins. Thus, the wage norms might under special circumstances be raised or lowered by 5%, in individual cases even by 10 to 15%; for extra heavy or dirty work, for night work and for work paid by the piece, the standard rates could be raised varying from 10 to 30%; regard could also be taken to such personal qualifications like educational training, etc.

5. The wages were linked to a new cost of living index by an escalator clause which provided for a 5½% increase in wages from their basic level of October 1947 whenever the index showed an increase of at least 5% from the same base period. The wage-earners were, consequently, guaranteed an 110% compensation, equal to a 10% over-compensation, for a rise in the price index. This over-compensation became, however, gradually reduced with prices continuing to rise and would e.g. be only 5% when the index had reached the point 200. The necessary adjustments of wages were to be made quarterly, in January 1948 for the first time, on the basis of the index figure two months earlier.

6. The wages were, on the other hand, to be reduced by 5% if the index showed a decline of at least 10%. Though this case remained only a theoretical one, as the index never declined as much, it is interesting to note that, whichever way prices happened to turn, the wage system was constructed, not only to secure the level of real wages, as established by the government decree, but also to give the wage-earners over-compensation for price changes.

7. The new cost of living index was to be based on actual living costs in October 1947. This led to the curious result that illegal black market prices of butter were included in this official price index, as it was found out that about 40% of the national butter consumption was, at that time, still covered by the black market.

8. The wage system was clearly invulnerable as long as the two partners of the truce, the government and the Federation of the Trade Unions, remained unanimous in backing it, for together they formed a strong monopoly power in the labour market. The opposition of the employers and of the official Economic Council to this reform and their warnings of a new inflationary wave in the wake of it were, consequently, of no avail.

The avowed end of the wage reform was to "attain a fair and stable order of prices and wages" and it attempted further to bring about a new division of the national income by steeply adjusting manual wages upwards on an egalitarian line and by securing, with a safe margin, the real purchasing power of the wages thus established by an over-compensatory escalator clause, all this reinforced by a collective support of the government and labour. It was a bold and in some respects even unique experiment in wage policy, but it left also a difficult legacy for the coming years to solve.

The Legacy: Increased Pressure on Prices

The inflationary pressure on prices, already effective before, was, on account of the increased costs of production and the enhanced purchasing power of the wage-earners, substantially intensified by the wage reform. That would not have been the case, not to the same extent at least, if prices would have been allowed to adapt themselves to the new level of wages *before* these were linked to the cost of living index by the escalator clause.

Evidently, as long as such pressure on prices persisted, the stability between prices and wages, if attained, would have been a precarious one and could not have lasted for long. The latent inflation could namely, at an unguarded moment, burst into open inflation whereby wages also would have automatically been forced upwards with an even accelerated pace, on account of the overcompensatory escalator clause, thus, possibly, starting a pernicious price and wage spiral. Such gloomy predictions were, at any rate, uttered on the enactment of the government decree; the leading economic journal of the country foresaw, e.g. that within one year prices and wages would have climbed to twice as high a level, or even more.

In order to avoid such a fatal course of things it was pertinent for the economic policy to remove, as soon as possible, the pressure of latent inflation by restoring the disturbed balance between prices and wages, or else — in the short run — to try to prevent the prices, or rather the cost of living index, from shooting upwards. That was, indeed, the line which the policy set in, deliberately or just under the pressure of circumstances.

After the generating of new inflation had ceased, there were, in principle, three ways for removing the inflationary pressure at hand (1):

1. *Activation of Latent inflation* by allowing prices to rise until the inflationary pressure was eliminated. Obviously, this way was not possible under the conditions prevailing in Finland at the time, as any rise of the price level would necessarily have put the escalator clause in operation and the result would have been a spiral rise of prices and wages.

2. *Wiping Out Latent Inflation* by reducing the excessive purchasing power, emanating from wages just raised, by heavy taxation, forced loans, etc. Evidently, neither was this way passable, as it would have been firmly opposed by the trade unions, and in fact was at some slight attempts in this direction by the government. If persisted in, the result would have been new disturbances on the labour market.

3. *Working Off Latent Inflation.* The inflationary pressure exerted by wages upon prices can, in an expanding economy with rising productivity, be made gradually to disappear, provided wages are not raised pari passu with increased productivity and the prices remain stable for the time being. This line of policy was, indeed, the only one left for the Finnish stabilisation efforts, nor was it an impossible one on account of the steadily increasing productivity during subsequent years. As a matter of fact, the real domestic product per capita rose by 31% from 1948 to 1955.

Nevertheless, a policy carried on along these lines could meet with success only provided that, until the inflationary pressure had been removed, all efforts were directed towards preventing prices, relevant for the escalator clause, from rising, and, of course, provided further that no disturbing factors turned up, powerful enough to upset the stabilisation plan.

In conformity with this guiding principle, the economic policy was subsequently labouring in keeping price regulations, inherited from the war time, intact and even intensifying existing restrictions. Especially house rents, rates of exchange and even interest rates were "frozen", as far as practicable. Similarly, cheap imports were used at critical moments for lowering strategically important home market prices and a policy of so-called "points buying" was initiated with the purpose of keeping, by subsidies, the cost of living index a few points lower than otherwise would have been the case. All this price controlling machinery was, of course, developed only gradually, it was alternatively moderated or tightened, and ultimately, also gradually, demolished, though this work is not even today finally finished.

(1) Cf. E. M. Bernstein, "Latent Inflation: Problems and Policies", *Staff Papers*, International Monetary Fund, Vol. I, No. 1, Washington, D.C., 1950.

First Round: 1947-1950

"A fair and stable level of prices and wages", aimed at by the wage reform of 1947 was not achieved, for the prices continued to rise and, on account of the escalator clause, wages too were now automatically drawn upwards by prices. Thus already in November 1947, the new cost of living index, to which the wages had been linked, exceeded by one point the critical line of 105 and the wages were, according to the rules of the game, two months later raised by 5½%. Again, in February 1948 the point 110, the next critical line in order, was surpassed by no less than four points and the wages had consequently once more to be raised by 5½%. The much dreaded escalator clause had thus been called into action and the pessimistic forebodings of a continuous price-wage spiral seemed to have become true.

Fortunately, the rise of the index stopped at this. For more than one year and a half it remained fairly stable. A brake on the inflationary forces had been put on, partly by falling import prices in connection with a business recession which set in late in 1948 and deepened in 1949, and partly by rapidly declining black market prices, the legal markets being filled with a growing supply of consumer goods.

Had this favourable trend of prices continued and had wages too remained stable, the inflationary pressure caused by "wage inflation" might have been "worked off" in a relatively short span of time, the productivity of labour steadily increasing. Unfortunately, however, the stability, temporarily achieved, was unstable and was broken by de-stabilising factors soon entering the stage.

The labour market became again restless towards the end of 1948, though peace was then restored by the government conceding wage adjustments to certain groups of labour whose wages lagged behind. The situation grew, however, more critical about one year later, the trade unions requesting a 10% wage increase in excess of the automatic adjustments ensuing from the operation of the escalator clause. The dissatisfaction of labour with the prevailing order was mainly caused by the divergent courses taken by the old cost of living index and the new one which included black market prices and to which wages had been linked. Whereas the former had advanced from October 1947 to November 1949 by 30%, the latter

showed simultaneously, on account of the crash on the black market, only a rise of 13%. And whereas the former would have given labour a 5½% wage rise in six scores, they had actually received only two automatic wage rises, and the last one as far back as in April 1948.

Another factor arousing vexation in the labour camp was the government's inability, on account of internal and external strains on the price structure, strictly to adhere to the price freeze policy which was essential for keeping a stable price level. Thus, rents were from time to time moderately adjusted, as they were lagging far behind the rising costs of house construction. The same was true with respect to exchange rates which very belatedly were raised by about 40% during the latter half of 1949. This action had become unavoidable, as Finland was suffering from a severe slump in her export trade and as it had to be done even in the face of the danger that a subsequent rise in import prices might upset the stabilisation policy carried on. The situation the policy was thus confronted with represented a topsy-turvy world: the restoring of equilibrium between different price categories would have required unfreezing of controlled prices whereas a continuous price freeze seemed obligatory for the preservation of stable prices and wages. A policy vacillating between conflicting aims became a cruising between Scylla and Charybdis.

Put against the wall by the demand of a 10% rise in wages just mentioned, the Government conceded to a 7½% rise, due from January 1950. Almost simultaneously the wage decree of 1947 was repealed and the Government control of wages abolished. The fixing of wages was now left to normal market procedure. The Central Association of the Employers and the Federation of the Trade Unions being, however, unable to reach an agreement, the Government had to take the lead in May 1950 once more: wages were raised by 15 to 20% and linked again to the cost of living index.

This new stabilisation attempt proved a total failure, as the outbreak of the Korean war soon afterwards sent prices in foreign trade shooting upwards. It took more than a year of recurrent negotiations and compromises, of labour unrest and even a general strike, as well as of increased subsidies, before, in October 1951, a new wage system of any durability could be established. Meanwhile, during the two-year inter-regnum of 1950 and 1951, wages had risen by about 60%, the wholesale prices by nearly 70%, whereas the simultaneous rise in the cost of living index stopped halfway to that, mainly on account of the policy of subsidies.

Second Round

The new wage system of 1951 lay primarily on the same foundation as that of 1947, as the policy of Government controlled wages was continued and a new lease of life was given to the escalator clause. But there were also some significant differences between the two systems:

1. The wages were now linked to a new cost of living index, with October 1951 as the basic period. In this specially constructed index, the effect of direct taxes on prices (as well as, on the other hand, that of children's allowances and other fringe benefits on the consumer's budget) was eliminated. This innovation gave the Government more elbow room in its fight against inflation, as it was no longer necessary to consider, at least not to the same extent, the possible reaction of the escalator clause to a tax raising policy.

2. Wage adjustments were to take place quarterly, and only after the quarterly average had gone up to the point 105. Each five point rise in the index was to call forth a corresponding rise in wages. Consequently, the principle of full compensation had been substituted for that of over-compensation from the year 1947, a reform obviously reducing a possible inflationary effect of the escalator clause.

3. Even more important was the fact that the enactment of the new wage system was this time not connected with a simultaneous, all-over rise of wages. The linking of wages to prices was, therefore, effected in a more realistic way than had been the case in 1947 when the escalator clause had been tied to a too low and already obsolete index point.

All these " built-in " features, new in the wage system, represented, from the viewpoint of their inflationary effect, evident improvements in comparison to 1947. They seemed thus to point to a smoother road for the wage policy. Nevertheless, there was in the system still the fatal weakness that the price level to which the wages were linked, had been artificially lowered by a liberal use of

subsidies and other similar devices. The inflationary pressure still persisting was, however, temporarily mitigated by the severe slump in world trade which followed after the Korean boom. This was reflected in Finland by steeply falling prices of imported goods as well as by rising unemployment which reached its climax during the winter months of 1952-1953 and 1953-1954. These events helped to keep prices and wages under fairly effective control during the period 1952-1955, as is demonstrated by following figures:

Year	Cost of living index (October 1951 = 100)	Industrial wages (men) (III and IV quarter 1951 = 100)
1952	101	102
1953	103	104
1954	103	106
1955	100	111
1956	111	123
1957	124	130
1958	132	136
1959	134	144

It must be added, however, that the picture given by these figures is somewhat treacherous, especially for 1954. With awakening trade revival the price trend began again to point upwards and pressed the cost of living index already in January 1954 up to 104 where it was halted by the " points buying " policy. This aroused, however, the disfavour of labour which was deprived of the 5% wage increase which the index point 105 automatically would have brought about. The trade unions came forward under such circumstances with an ultimative request, backed again with the threat of a general strike, that the index had either to be pressed back to 100, or else was to be allowed to rise to 105 and constantly kept there.

In this dilemma, the Government chose the former alternative as a lesser evil, as it would not call the escalator clause into operation. Prices were in November 1954 pressed down even to the point 98. By this heroic effort, peace was indeed restored on the labour market and the stabilisation policy could be carried on. The reduced excises and customs duties as well as the enlarged subsidies, by which the points had been bought, cost the state, however, in diminished income and increased expenses the equivalent of one-tenth of the total of its annual budget and swelled simultaneously the purchasing power of the consumers without a corresponding rise in the supply of goods. In both ways, the inflationary pressure was enhanced. All in all, it was a shortsighted policy for rescuing the stabilisation plan by piling up difficulties further ahead.

Final Round

The second round terminated, like the first one, in a breakdown of the stabilisation policy pursued. In January 1956 the government decided, labouring as it was under the heavy fiscal load ensuing from "points buying", to free the state from the embarrassing escalator clause. The control of wages by the government was, therefore, abolished and the labour market organisations were instructed to come to a mutual agreement about wages within three months. Simultaneously, most of the price controls for home market products as well as some subsidies were removed.

The prices of agricultural products, however, started to rise immediately after the liberalisation whereby the cost of living index was forced upwards too. This instigated the trade unions to come forward with their old request that the index had to be pressed back to point 100 or else wages to be raised equalising the rise in consumer prices. As this request was not accepted offhand, a general strike broke out in March 1956. After having lasted three weeks, an agreement was attained, by which wages were raised all-round and then linked to the index at 107, a point, which had been reached already before the wages were raised. The old story was thus repeated and the equilibrium between wages and prices again badly disturbed, with the result that a new inflationary spiral could not be avoided. Thus, at the end of 1956 wages were about 15% higher than a year earlier and the prices even relatively higher or about 18%.

Meanwhile, a slump in trade was on its way. The ball was set rolling by the Bank of Finland which, determined to rescue the value of the currency, refused to extend any new credits either to the government or to private financial institutions, and ordered these latter even to reduce the total amount of outstanding loans. This tightening of the money market was not seriously felt by the business community at first, the course of exports continuing favourably. The tables, however, became turned as towards the end of 1956 the sales in some of the leading exporting branches of national industries began to decline, or the prices to fall.

With the slump in trade, which deepened in 1957 and 1958, unemployment started to rise and achieved subsequently dimensions not experienced since the days of the Great Depression in the 1930s. This meant a new blow to the strained financial situation, as the state had undertaken to provide employment, directly or indirectly, for all unemployed, at the current level of wages.

Finally, in the spring of 1957, and subsequently, the government found itself out of liquid means to meet its financial obligations. The central bank continuing to turn a deaf ear to the government's entreaties for aid, steps were taken to ease the strain by raising taxes. As far as this action included raising also indirect taxes and excises as well as charges for public services, it meant a reversal of the policy until then adhered to, for the cost of living index was thereby drawn upwards with the imminent danger that the escalator clause also would be called into action.

In this predicament, a new move was made in March 1957 by the government to disentangle the state from the escalator clause. The labour market organisations were again entrusted to find a mutual agreement about wages, the government confining itself to the recommendation that such agreements should be based, until the end of 1958, on the principle of a two-thirds compensation in wages for the rise in the cost of living index, and that from 1959 onwards, wages should no more be automatically adjusted to the cost of living index.

All earlier attempts to loosen the strings linking the wages to the price index had met with a flat refusal from the trade unions, as demonstrated above. Now, however, things took a different turn, for practically all collective wage agreements concluded in the latter part of 1957 and extending over the year 1958, followed closely on the lines recommended by the government. This change in labour's attitude seems partly to have been brought about by a spreading conviction that the system of full or even overfull compensation had done labour no good, as it had lead to a persisting inflationary pressure. The hard facts of economic depression may also have had a sobering effect, the employers having become less ready to yield to new wage demands, and the trade unions again, in the face of spreading unemployment, more cautious in their aspirations.

The last index-linked rise of wages, on a two-thirds compensation basis, occurred in March 1958, the index having then reached the point 132. After that no new adjustments were made, partly because the rise of prices came to a standstill in 1958 and definitely, because the new collective wage agreements, signed at the turn of the year 1958-1959, and subsequently, did not contain any escalator clause. That was, consequently, the inglorious end of the bold experiment with escalator clauses initiated with the wage reform in 1947.

With the decay and final downfall of a wage system which for a whole decade had held the community under its sway, the market mechanism of prices could again start to function in a normal way. Thus, in September 1957 the Bank of Finland raised the exchange rates by nearly 40%, an action that was overdue but which had been regarded as too risky so long as wages were linked to prices on a full-compensation basis. By this step, a better equilibrium in Finland's balance of payments was restored and the depleted exchange reserves began to be replenished. That again enabled the government to reduce existing exchange regulations and to move towards the liberalisation of foreign trade.

The most stubborn to overcome, was the slump in trade. Though in the spring 1958 first signs of an approaching economic recovery were discernible, the improvement was so slow that unemployment in the winter 1958-1959 was still record high. Soon afterwards the recovery was speeded up, however, and turned, before the end of 1959, into a boom, which in 1960 has continued in accelerated tempo. Happily this change in the trade situation has not yet seriously affected prices; the cost of living index reached in June 1960 the point 138, which represented a rise of 5 points within one year, after two years of a near standstill in prices. This may forebode a new era of rising prices, a tendency strengthened by the fact that the agricultural income is still protected by an escalator clause.

The Inflationary Effect of the Escalator Clause

Professor Gottfried Haberler has in his excellent study on "Inflation Its Causes and Cure" expressed the opinion that cost of living clauses in wage and salary contracts and, in later stages of inflation, also in debts and securities and other contracts are an accelerating factor in inflation: "Such arrangements obviously eliminate some, though not all, injustices of the inflationary process, but by the same token tend to bring the process more quickly to a head — accelerating the speed of inflation, if the money supply is elastic, or raising costs and thus slamming on the brakes, if there is no slack in the monetary system". A universal or near-universal adoption of escalator clauses "would take most (though not all) pleasure, profit, and stimulus out of inflation", for "if any group, say labour or agriculture, or business, or the government tried to steal a march on society as a whole, it would drive up all other incomes and prices and even the first recipients would gain only little (how much depending on the speed and frequency of the adjustments)" (2).

Haberler's proposition that escalator clauses have an inherent bias to accelerate inflation, is undoubtedly right. Still one may question whether at a certain stage of inflation such clauses, instead of slamming on the brakes, actually would not help to put a brake on the inflationary process, and this exactly on account of the psychological factor that "most pleasure, profit and stimulus" is taken out of inflation. This seems, indeed, to have been one of the motives why labour in Finland at last acquiesced in bringing down their claims on escalated wages, and finally, to discard them. For the course of events was, that the example set by wage-earners in trying to protect their real income against the ravages of inflation, and even to raise them, was followed in growing degree by other groups of income-earners in a position to do so: office workers, farmers whose wages became linked to wages by law, owners of different categories of money capital such as securities, loan contracts, bank deposits, and even life insurance policies.

With this spreading practice the aspirations of the trade unions to cut by this device a larger slice of the national income was

(2) Gottfried Haberler, *Inflation Its Causes and Cure*, p. 34, Washington, D.C., 1960.

appreciably reduced, a rise in nominal wages in excess of the rise in labour productivity leading to rising prices, a tendency only temporarily held back by subsidies, etc. Thus, whereas the ratio of labour income to national income grew from 50% to about 60% in the decade 1938-1948, this ratio was in the following decade raised only slightly and stood in 1958 at 63%. But even this figure gives a wrong picture of the real course of wages, for, if the effects of structural shifts are eliminated — production having expanded more rapidly in those trades where the proportion of wages was high in relation to the net product — it will appear that the ratio of labour income to national income actually somewhat decreased from 1948 to 1958 (3).

But leaving aside this particular aspect of the inflationary effect of the escalator clauses and reverting to more central issues of the problem, it should be observed that this effect varies considerably according to the construction of the clause and the framework within which it is built. That may here be illustrated by comparing recent experiences in Denmark and in Finland in this respect (4).

In Denmark, the wage system still prevailing has been in force since 1946. The government control of wages was then discontinued and wage negotiations left in the hands of the labour market organisations, as before the war. The agreement actually concluded was based on the prevailing wage level, but it provided for an automatic adjustment of wages for increases in the cost of living index, the base period of which was October 1945. For every 6-point rise in the index, equivalent roughly to a 1½% rise in the price level, wages had to be raised approximately by 1% on the average. A two-thirds compensation for the index rise was thus given the wage-earners. The wage adjustments were to be effected half-yearly, two months after every 6-point rise in the index. If the rise was more than that but less than 12 points, the additional points were to be carried over to the next adjustment period, whereas at increases of 12 points or more, the amount of escalated increases had to be doubled.

(3) Cf. Timo Helelä, "Wages in Finland in 1938-1958", *Bank of Finland Monthly Bulletin*, No. 4, 1959.

(4) Cf. E. Hoffmeyer, *Stabile priser og fuld beskaeftigelse*, Köbenhavn, 1960; Dudley W. Johnson, "Wage escalators and inflation in Denmark, 1945-1955", *Journal of Political Economy*, No. 2, 1960.

Furthermore, it was decided that the wage agreement thus concluded was to be renewed at negotiations recurring within two or three yearly intervals, as also happened. The original agreement has all the time remained intact, in its main features, in spite of the employers' repeated requests that the escalator clause be eliminated or modified, at least. One further trait of great importance in the procedure of the negotiations is that the contract rates agreed upon may well be higher than those provided for by the escalator clause, and, moreover, that individual employers are free to pay their workers even higher than contract wages fixed at general negotiations between the labour market organisations.

The actual wage increases of the postwar period fall in Denmark, consequently, in the following three categories: 1) automatic increases brought about by the escalator clause; 2) contractual increases agreed upon at negotiations recurring at two or three yearly intervals; 3) individual "wage drift" increases. During the eleven years of 1946-1957 there occurred, according to Hoffmeyer, escalated increases every single year except one, yet they covered, all in all, only 48% of the aggregate increase in wages, whereas about 21% fell on "contract wages" and 31% on "wage drift". Taken together, these latter two, consequently, weighed more than the escalated increases and were continuously feeding the "built-in" inflation mechanism of the escalator clause, which remained a factor of rather secondary importance in the inflationary process. There is even the possibility that labour might in any case, clause or no clause, have come forward with about similar wage requests as they actually did, and the employers would in any case have conceded to those demands. On considerations like these, Mr. Johnson has drawn even the more general conclusion that "wage escalation has negligible inflationary effects, for employers will offer under the name of the cost-of-living adjustments part of the increases which they would normally have given as a result of the competition of labour".

This may be a plausible conclusion as far as Denmark is concerned during the period in question, though one may suggest that the psychological effects of the escalator clause may have been here underrated. With regard to Finland, the case is, however, fundamentally different, in spite of the fact that there was the common factor of escalated wages. The most conspicuous divergences between the two systems were: in Denmark, wages were in the hands of the main labour market organisations and partially decentralized — in Finland, they were government controlled and, therefore, centralized; in Denmark, wages were linked to the index on a realistic basis and the compensation given by the escalator clause was less than full — in Finland, wages were recurrently raised at the very moment when they were linked to the index with a resulting inflationary pressure and the compensation was full or even over-full, before the final breakdown of the system; in Denmark, wages were adjusted half-yearly and the wages thus adjusted were minimum wages — in Finland, the adjustments took place quarterly and there was, in principle at least, no elasticity in the wage system. Evidently, in nearly all these respects, the built-in inflationary bias in Finland was much stronger than in Denmark, and that was also the main reason, together with the apparent lack of elasticity, that in Finland the escalator clause underwent continuous changes and that the stabilisation programs developed from crisis to crisis, whereas in Denmark the system is still intact after the lapse of some 15 years.

Thus, absolution cannot be given to the system of escalated wages in Finland for the sin of inflation, even if possibly in the case of Denmark. On the contrary, the escalator clause represented in Finland a built-in mechanism ready to affect prices and wages either directly, when called into action, or indirectly, when such action was repressed by subsidies and other " point buying " devices, which themselves were bound to intensify the inflationary pressure through the enlarged purchasing power created by this procedure. The most pernicious feature of the whole was not, as one might imagine, the principle of over-compensation — at rising productivity of labour it was, in fact, relatively harmless — but the linking of wages to an already obsolete price level, as was repeatedly done. The economy was relieved from this load, brought about by escalated wages, only through the piecemeal and painful tearing down of the system.

Something might, however, be said in defence of the Finnish experiment with escalated wages. It may be regarded as a measure of political necessity in a state of emergency, without which the chaotic course of wages and prices of the previous epoch might have continued and even worsened, after 1947. Actually, there occurred, after the wage reform of 1947, a distinct change for the better as is demonstrated by the fact, that whereas the annual rise in the period 1945-1948 was in the cost of living index 41% and the wholesale price index 38%, the corresponding figure for the decade 1949-1958 in both cases was 7%.

The wage system of 1947 may thus be regarded as the lesser evil of two bad alternatives — a poor defence, indeed, for things are seldom so bad that they could not be excused by asserting that they could be even worse. A better argument for defence might be, that there was a chance, as pointed out above, that the inflationary pressure, brought about by the wage system, could possibly have been " worked off " by keeping wages stable at rising productivity of labour. This possibility, if it ever was present in the minds of the actors on the scene, was, however, so remote that it was utterly hazardous to build anything upon it, for " too much is expected of governments if they are to be asked to keep wage rates stable in the face of increased productivity ", as was emphasized by Mr. Bernstein in the article referred to above.

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