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Industrial Relations

"Inflation is an immoral tax
that leads to immoral values."
— South American bank officer

Like most other areas of business management, industrial relations are greatly affected by hyperinflation. The characteristic inflationary spiral exerts continuous pressure upon businesses to keep wages in line with prices. Regardless of what steps are taken, the wage/price gap never quite closes.

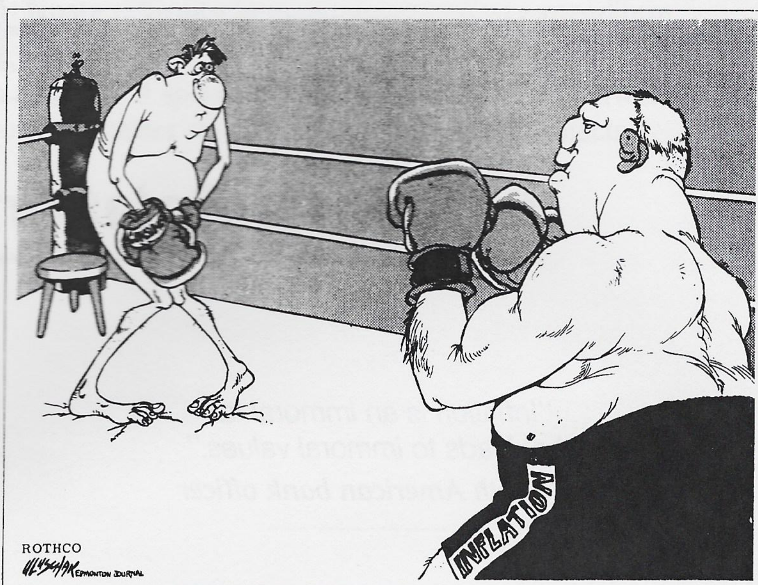
The result is often increased tension between management and labor, and a general deterioration in employee morale.

The impact of hyperinflation on wages and benefits is immense. For example, Brazilian employees who were not given raises in the first three months of 1988 watched their buying power plummet 64 percent. Even worse was the spring of 1985, when Bolivians saw their real income drop 90 percent in only three months.

Perhaps even more ominous is the fact that, throughout South America, the assets of pension funds — as well as savings accounts and insurance policies — have dropped in value to near worthlessness.

The pace of labor/management negotiations is both faster and more frantic under hyperinflationary conditions. The demands upon management to grant wage increases are virtually

continuous, yet government regulations tie employers' hands, often controlling their ability both to grant raises and to pass higher labor costs on via price increases.



In South America, the demand for wage increases is typically initiated by government unions and, when granted, private industry is forced to follow suit. Whether it is the government or a particular industry or business that initiates the action, increases give way to higher prices, which in turn create inflationary expectations and pave the way for further wage increase demands. This continuous wage/price spiral, if unchecked, can build ever-increasing government deficits, and increases the cost of doing business, eroding private sector profits as well.

■ ***Labor relations staffs should be prepared to face stronger unions and virtually continuous negotiations.***

In hyperinflationary economies, individuals tend to seek the support of a group to represent them in order to survive constantly rising prices.

This is certainly true in Bolivia, Brazil and Argentina, where the union movement is very strong in both the public and private sectors. Some South American business leaders go so far as to complain that union leaders actually use hyperinflation to their own advantage, recognizing it as a major source of their power.

Because wages continually lag behind rising prices during hyperinflation, there is a near-constant need for negotiations, as union members press their leaders to push for higher wages.

Like South America's, unions in the United States have historically grown more dominant during unstable economic times. It is therefore reasonable to expect that the instability and uncertainty that would likely result from high rates of inflation in America would once again lead to increased union activity.

■ *There is a high likelihood that wages will at some point be frozen, and labor will apply pressure on management to circumvent controls.*

Wage freezes are as common as price controls among governments struggling to control inflation, so it is reasonable to anticipate the enactment of freezes in the United States. As mentioned earlier, President Nixon imposed wage controls in 1971 with inflation at only 4.7 percent.

The pressure on companies to circumvent these controls tends to be intense, and sidestepping regulations has become all but routine in South America. Companies in Bolivia, Brazil and Argentina have devised a number of paths around wage controls, including: pay bonuses for such things as punctual attendance; changing job classifications; pay for hours not actually worked; interest-free loans; and loans that are not expected to be repaid.

These tactics are widespread for two reasons: Price controls do not stop inflation, which causes the real wages of workers to decline; and once one firm breaks the wage control guidelines, other companies are forced to follow suit in order to keep good employees.

Under wage and price controls, a company is in the untenable position of having to negotiate with the unions for wage increases and with the government for price increases. Often it is caught in the middle. During one adjustment period in 1987, the Argentine government allowed a 4 percent wage increase. The unions were demanding 10 percent, but the government made it clear to businesses that anything more than 4 percent could not be passed on in the form of price increases, and therefore would have to come from company profits.

A similar situation existed in the United States during the 1971 controls, which dictated a general guideline of 5.5 percent annual

wage increases, but only 2.5 percent annual price increases. Individual companies were expected to make up for the 3 percent difference either from their profits or through gains in their productivity.

■ *Larger companies should anticipate being used to set an example, as happened in 1971.*

As pointed out earlier, small companies tend not to be subject to wage and price controls, and therefore are able to pay their workers more than large firms. The former also tend to have more flexibility to increase their prices so they accurately reflect the higher costs.

Larger companies, on the other hand, are often used as examples, and are routinely subject to stricter controls. Not only is this true in Brazil, Argentina and Bolivia, but it was also true when wage and price controls were enacted in the United States in 1971.

Larger companies, especially multinationals, should be prepared to face especially stringent controls in the event such regulations are introduced.

■ *Prepare to shorten pay periods.*

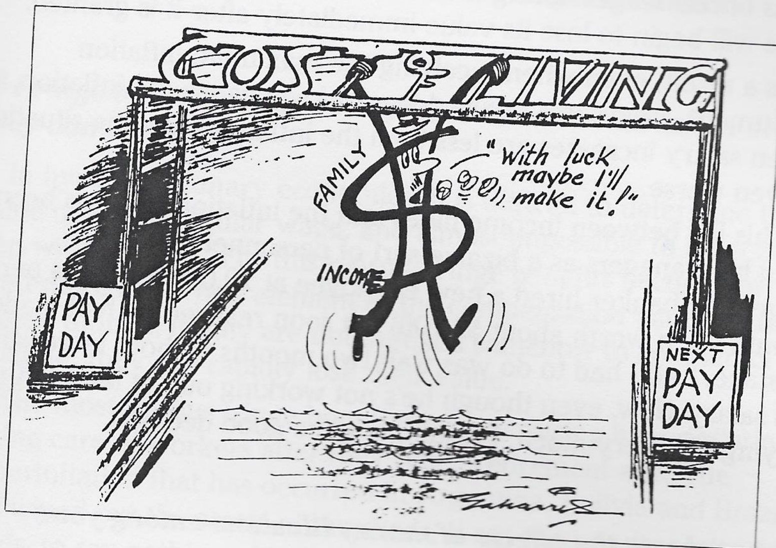
During hyperinflation, the purchasing power of wages tends to deteriorate rapidly. Workers are driven to spend their pay immediately, before it loses its value, and before prices climb beyond their reach. Given the lag between wage adjustments and price increases, employers are pressured to shorten pay periods.

During the worst of Bolivia's hyperinflationary crisis, for example, workers were paid every two or three days. Though events in the United States may never require such drastic adjustments, American firms should be aware that shortened pay periods are commonly a result of rising inflation rates.

■ *Anticipate morale problems among middle management, which often bears the greatest burden during hyperinflation.*

Because they have limited negotiating power of their own, and no union representation to pursue their demands for higher wages, middle management often suffers the greatest relative

losses when inflation takes off. Companies that wish to retain and foster that management level should be careful to maintain equitable wage policies.



■ ***Consider the type of index you will use for cost-of-living adjustments, and be prepared to make adjustments often.***

Should inflation take off in the United States, it is likely that the type of index used to make cost-of-living adjustments — and the frequency with which they are made — will become issues that American businesses will have to settle.

South Americans use a wide variety of indexes for their cost-of-living adjustments. In Brazil, for example, the OTN is the official index, but there are several others — some created by the unions — that are used to adjust wages on an individual basis.

No matter which index is used, the adjustments are made often, with a wide variation in frequency, depending on the rate of inflation, the type of industry, and the nature of government wage and price controls. During the worst of Bolivia's hyperinflationary crisis, most workers received wage increases three times per month. In Argentina, some employees receive increases only once per quarter, and in Brazil, wage increases are triggered when the government's inflation index increases by 20 percent.

Regardless of the frequency of wage hikes, they rarely keep pace with inflation. For example, if an increase is given every three months while inflation is running at 18 percent monthly — as it frequently is in South America — employee purchasing power

will drop by 39 percent compounded between wage hikes. Even if workers then receive a 39 percent raise, they lost a great deal in terms of real wages during those three months, and their adjusted wage will begin to lose its value immediately after it is granted.

As a result, even when receiving the maximum inflation adjustment, a worker's salary does not keep pace with inflation. When salary increases are less than the inflation rate, the situation is even worse.

This lag between income hikes and the inflation rate has been used by managers as a bizarre sort of personnel tool. One Argentine banker hired a new employee at 10,000 australes per month (then worth about $2,700) but soon realized he had made a mistake. "All I had to do was wait two months without increasing his salary. Now, even though he's not working out, at least I'm not paying him very much. Presto, I made a good decision."

■ ***Anticipate the effects of money illusions among your employees.***

One of the problems in controlling wage demands in a high inflationary economy is that workers suffer from a money illusion. When they receive inflated wage increases — especially during the early phases of hyperinflation — they tend to believe that their real income is increasing, even though it is generally being eroded.

The opposite side of the money illusion occurs once inflation rates begin to fall and wage increases begin to slow or shrink. Though their purchasing power may actually be rising, employees often become disgruntled because they are accustomed to larger increases.

This is particularly true for hourly workers. More sophisticated workers tend to translate their wages from the local currency into U.S. dollars in order to determine for themselves whether in real terms they were paid more this pay period than last.

The money illusion is a common condition during inflation in all economies, and its chief

impact is that, when the inflation rate begins to subside, companies are still pressured to maintain the pace of wage increases that was necessary during the height of inflation.

■ *Fringe benefits must be adjusted to reflect inflation or they can disappear.*

In hyperinflationary economies, it is difficult to determine the value of any particular wage, and almost impossible to keep it in step with inflation. For this reason, fringe benefits become an even more important element of the compensation package. Like wages, though, if they are not indexed somehow to counteract inflation, they can rapidly lose their value.

The most serious fringe benefit problem during hyperinflation is taking care of workers after they reach retirement age. The hyperinflation that has occurred in Argentina, Bolivia and Brazil has wiped out the assets of hundreds, if not thousands, of pension funds, to say nothing of individual savings accounts. In Bolivia, prior to the 1983 de-dollarization of the peso, retirement plans were often held in dollars. When the de-dollarization plan transferred all dollar-denominated accounts into peso accounts, at one-tenth the black market exchange rate, pensions became virtually worthless.

Because of this erosion of pensions, in all three countries adequate means for retirement do not exist for the vast majority of people. Only a handful of companies have any kind of pension program, and government plans are woefully inadequate, if not totally bankrupt. Consequently, employees either have to initiate and fund their own form of retirement plan or, more typically, have large families to support them in their old age, or keep working until death.

In the United States, consideration will have to be given to indexation of pension funds to compensate for the effects of inflation. It will also be necessary that the rate of return on the pension fund assets match the index, or those assets will be drained and perhaps depleted.

SUMMARY

- Labor relations staffs should be prepared to face stronger unions and virtually continuous negotiations.
- There is a high likelihood that wages will at some point be frozen, and labor will apply pressure on management to circumvent controls.
- Larger companies should anticipate being used to set an example, as happened in 1971.
- Prepare to shorten pay periods.
- Anticipate morale problems among middle management, which often bears the greatest burden during hyperinflation.
- Consider the type of index you will use for cost-of-living adjustments, and be prepared to make adjustments often.
- Anticipate the effects of money illusions among your employees.
- Fringe benefits must be adjusted to reflect inflation or they can disappear.