CHAPTER 1

Economic Performance and Policy in 1969

THE GOALS OF STABILIZATION POLICY

THE AMERICAN ECONOMY began 1969 with production, incomes, and prices increasing rapidly from the momentum of earlier inflationary fiscal and monetary policies. As the year moved along, however, the economy began to respond to the constraints of policies which had been changed to combat inflation. The huge budget deficit had been closed with the aid of a tax increase in mid-1968, and the new Administration further tightened fiscal policy in 1969 by a sharp pruning of projected Federal outlays. Monetary policy also shifted its direction, becoming increasingly restrictive during the year.

This was not the ordinary problem of an economy that had veered momentarily toward excessive rates of expansion. It was the problem of an economy already in its fourth year of severe inflationary pressure. The momentum generated by 4 years of inflation was evident in widespread pressures for wage and price increases and in continuing expectations of more inflation. This momentum could not be stopped dead in its tracks without serious consequences. The policies of fiscal and monetary restraint followed in 1969 have reduced it, while at the same time they have laid the ground for a return to price stability and sound economic growth.

Continuation of fiscal and monetary restraint should bring a deceleration of inflation during 1970 and 1971. This will be an important step toward price stability, but it will not mean that the goal has been reached. History contains other instances in which inflation was slowed down or stopped only to break out again as policies shifted too sharply toward expansion. The Nation's goal should be more than just a year or two of declining rates of inflation. This time we should try to reach and maintain price stability.

The longer run goal of continuing price stability would not be served by a sharp or prolonged rise of unemployment. Such a development would be an evil in itself. In addition, by forcing a sharp shift toward expansionary policies, it would intensify the already difficult task of maintaining the restraint necessary for a lasting victory over inflation.

But inflations have seldom ended without a temporary rise in unemployment. While we must direct our efforts to altering the historical pattern, we cannot ignore the possibility that joblessness will rise in the period immediately ahead. But we cannot avoid this problem by allowing the current inflation to continue, for that would harden the expectations of inflation and make subsequent policies to curb it more difficult and harsh. The best hope of curbing inflation and restricting the rise in unemployment to a relatively small and temporary increase rests with a policy of firm and persistent restraint on the expansion in the demand for goods, services, and labor.

Such a policy should ultimately produce high employment with much less inflation than we have recently experienced. During the transition, we may find both unemployment and inflation to be higher than would have been desirable if the inflation had not been allowed to persist so long. This is the price we must pay for having long pursued inflationary policies. Once inflation has been set in motion, there is no way of correcting it without some costs. The aim of policy is to keep the costs as low as possible.

Over the longer run, further progress in reducing unemployment and getting as close to a stable price level as possible is dependent upon holding aggregate demand to moderate and sustainable rates of growth. It will require other measures as well. Public policies can help improve the efficiency of labor markets by providing information, opportunities for training, and assistance in relocation. Persistent effort in these and other ways to make the economy more flexible and adaptable will contribute to lower unemployment rates and to a more stable price level.

THE STRATEGY OF POLICY IN 1969

The current inflation was generated by the mounting budget deficits and rapid monetary expansion that began in 1965 with the escalation of the Vietnam War and the massive increases in Federal spending for domestic programs. These developments stimulated demand for output and labor at a pace which could not be met by growth in the labor force and other productive resources. The resulting pressures caused prices to rise rapidly. Any plan for arresting the inflation called fundamentally for arresting the forces which were causing it. In addition, it was clear that slowing down the inflation after it had gathered momentum would be more difficult than taking the steps necessary to avoid the inflation initially.

Steps to end rising budget deficits and to slow down monetary expansion had been taken in 1968. The Revenue and Expenditure Control Act of June 1968 had helped to shift the budget from a deficit of $25 billion in the fiscal year ended June 30, 1968, to a surplus estimated in January 1969 at $2.4 billion for the fiscal year 1969. Near the end of 1968, the Federal Reserve had turned to a policy of more restrained monetary expansion. Each of these moves, however, was only a beginning. Once they had finally been taken, it was important that they remain in force long enough to do the job. Yet the shift in the budget position to surplus had been achieved with the help of a temporary tax surcharge which was scheduled to expire on June 30, 1969. With continuing strong pressure for increased expenditures in fiscal year 1970, the danger of sliding back into a budget deficit could not be ignored. Nor could it necessarily be assumed that the new and more restrained monetary policy would continue as long as needed. In 1966 monetary tightness had contributed to a dampening of the economy and of the inflation, but the economic slowdown led in turn to a shift back to highly expansive policies in 1967 and to a resurgence of inflation. It was commonly thought that this pattern might be repeated.

At the beginning of 1969, as earlier, there were disagreements among economists about the relative roles of rising budget deficits and rapid monetary expansion in causing the inflation of 1965–68. On one view the rising deficits were the driving force and they would have been enough to cause substantially the inflation that was experienced, even if there had been much less monetary expansion. On the other view the rapid monetary expansion was the primary factor; with it there would have been substantial inflation even with a stable budget policy, and without it there would have been little inflation even with rising deficits. These different views led to different emphases in policy prescriptions for 1969. Following the one theory the critical matter was at least to stabilize the budget in its current position of moderate surplus. According to the other theory a reduction of the rate of monetary growth was the decisive way to slow down the inflation.

The Government could not prudently let the control of inflation depend on the choice of one of these strategies to the neglect of the other. Many uncertainties exist about the relative power of fiscal and monetary actions taken separately. There is much less doubt about the power of fiscal and monetary actions taken together. A reliable policy had to turn away from both the rising deficits and the rapid monetary expansion.

DIRECT INFLUENCE ON WAGES AND PRICES

The Administration's plan of policy for 1969 did not include an attempt to revive wage-price guideposts, such as those existing in 1962–66. The results of our own experience and numerous trials of such policies in other countries over the preceding 20 years did not justify confidence that such efforts would help solve the inflation problem in 1969.

In their usual form these policies enunciate general standards of noninflationary price and wage behavior, coupled with appeals to labor and business for compliance. The degree to which representatives of labor and business have participated with government in defining standards and seeking compliance has varied from country to country. The sanctions invoked in support of the standards are usually informal and have varied in their severity and nature.

Experience with such policies in other countries has been remarkably consistent. In some cases success in holding down wage settlements or price increases has been achieved in particular industries. There is usually a period in which these programs may have some overall deterrent effect, though evidence here is less certain. After an interval, however, there is a point at which accumulating pressures make the programs ineffective.

American experience conformed to this pattern. In January 1962, the Council of Economic Advisers promulgated a set of guideposts intended to describe the course of wages and prices that would be consistent with general price stability and certain other objectives. The main element in the statement of these guideposts was that hourly wages should rise in line with the average long-term gain in output per man-hour. Prices should ordinarily be stable; but in a particular industry they could rise if productivity rose less than the average, and they should fall if productivity rose more than the average. A number of exceptions were specified—and indeed these were necessary—to meet requirements of equity and efficiency.

As originally put forth the guideposts were to serve a general educational function of encouraging voluntary patterns of behavior that would be noninflationary. There was no suggestion that the Government would apply them in particular cases or try to enforce them. But it was natural to question whether actions in particular cases conformed to the guideposts, and the Government felt it necessary to comment on the justification for these actions. Once this threshold had been crossed, the Government also became involved in attempting to insure compliance in particular cases where it was considered necessary. Usually the attempt consisted of discussions with the persons involved. Sometimes there were public exchanges of charges and countercharges. In some cases the Government relied upon its power as purchaser, regulator, and law-enforcer to encourage compliance.

With the upsurge of inflation and inflationary pressure after mid-1965, the difficulty of reconciling the guideposts with market forces became more intense. Labor and business were being asked to act as if prices were not rising, when in fact they were. As it became evident that steps necessary to keep prices from rising were not being taken, it also became more obviously unrealistic and inequitable to make these requests in specific cases. By the fall of 1966 the policy was widely recognized to be unworkable, and it was allowed to fade away. In subsequent years, there were only episodic actions with specific companies regarding prices.

Whether the policy changed the overall behavior of the price level before it ran into intense inflation is uncertain. These were years of relative price stability. But they were also years of considerable slack in the economy, relatively high unemployment, and stable or declining farm prices. That is, they were years in which market conditions favored price stability. Econometric studies attempting to isolate a further contribution that guideposts might have made to price stability have produced uncertain results. The findings of some studies are consistent with the view that the guideposts may have had some effect in reducing the increase of the price level; other studies do not support this conclusion.

Whatever the uncertainties about this earlier period, the guidepost policy clearly did not work once the economy ran into strong and serious pressures of inflationary demand. By that time the question was not whether guideposts would have a measurable influence on the rate of inflation. It was whether they had any credibility and viability at all. The evidence is that they did not. The conspicuous cases in which guidepost policy could exercise some influence were too few and were overrun by the general tide of inflation in the economy as a whole.

The Administration in 1969 recognized that the speed of the disinflationary process would depend in part upon how quickly business and labor became convinced that the economic climate was changing. If business and labor continued to expect demand and prices to rise rapidly, and if they pushed up wages and prices in anticipation, disinflation would come slowly and more painfully. This meant that the public's understanding of the determination to check inflation, of the policies being pursued and of the progress being made would be important to success. There would be room and need for efforts to inform the public. But first there would have to be evidence that the new policies were actually working.

In the exercise of its ordinary functions the Government has a considerable influence on conditions of demand and supply and consequently on prices in particular markets. It would be important for the Government to make sure that its influence did not unnecessarily contribute to inflation in those markets, and beyond that to try to correct malfunctions in particular markets which might aggravate the consequences of the general inflation.

THE EXPECTED CHAIN FROM POLICY TO RESULTS

As the process was viewed at the beginning of 1969, the fiscal and monetary restraint that was the core of anti-inflation policy would slow the rate of inflation through a series of steps which can be summarized as follows:

A Slowdown in the Growth of Total Spending

The growth in aggregate spending for goods and services as measured by gross national product, which was 9 percent from 1967 to 1968, would be reduced. The Federal Government's own purchases would not rise so fast, nor would its payments to State and local governments and to individuals—payments which these sectors ordinarily use to make their own purchases. By avoiding the tax reduction scheduled for midyear, the Government would refrain from boosting private after-tax income and consequently from stimulating private spending.

Monetary restraint and the resulting scarcity and high cost of credit would slow down spending in various ways. Expenditures financed by borrowing—for new houses, for State and local construction projects, for business investment, and for consumers' durables—would be most directly affected. In addition, money balances would decline in relation to rising incomes and transactions, and the market value of other assets would be depressed because of higher interest rates. This would dampen the inclination of businesses and consumers to spend. These effects of monetary restraint on spending would not be immediate or follow a precise formula based on the amount of the restraint, but they would come if the restraint continued.

A Decline in the Rate of Growth of Production

The slowdown in the growth of purchases would mean a slowdown in the growth of sales; businesses cannot sell what others do not buy. Some businesses might respond to a decline in the growth of sales by allowing inventories to accumulate rather than by cutting their planned output, but this could only be a temporary reaction. Others might respond to a slowdown in the growth of sales by cutting prices in an attempt to keep volume up. But this was not likely to be the first response in 1969. Having already experienced several years of rapidly rising demand, costs, and prices, businesses would expect more of the same, and for the most part they would keep their own prices up and rising.

The most general and important response of business to a slowdown of sales would be a slowdown in the rate at which production was increasing. Initially this would involve a decline in the rate of growth and possibly some temporary decline in production itself. An absolute decline in output, however, would not be a necessary aspect of the disinflationary process. In a growing economy the labor force is increasing, new productive equipment is being added, new technology is being introduced, and the basic trend of labor productivity is rising; this means that the potential output of the economy also grows. Therefore, even though output is still rising absolutely, a slowdown in the rate of growth of output reduces actual production relative to its potential and is an anti-inflationary force. This is a part of the process that eventually builds up those back pressures which are essential to the development of a new stability in the level of costs and prices.

A Decline in Profits Per Unit

A deceleration in the rate of growth in real output would adversely affect productivity in the short run. The movement of fixed costs per unit of output would thus be less favorable for a time. After a sustained period of expansion and labor shortages, employers would tend to maintain work forces, and payrolls would tend to be fixed. The deterioration in productivity and increased costs per unit of output would reduce profits per unit. While even higher prices might consequently seem necessary, and while in many cases they might be posted, market conditions would make it difficult for such prices to hold, and the major effect would be heavier pressure on businesses to begin actions to reduce costs. The need to improve productivity and thereby pare unit labor costs would make labor "hoarding" more costly. Employment at overtime would diminish and layoffs would become more common.

A Slowdown in Wage Increases

As profits per unit weakened, employers would become more resistant to granting wage increases. At the same time, a softening labor market would lessen workers' insistence on large wage increases as a condition for employment, since they could not be so sure of finding another job quickly if they left a current one or rejected a new offer. Moreover, if business profits were less favorable, a major rationale for heavy wage demands would be removed. As a consequence, the average rate of wage increase would ultimately begin to diminish. However, in view of the momentum of past increases in wages and the cost of living, this could not be expected to happen quickly. Nor could it be expected to happen evenly in all sectors.

A Slowdown in Price Increases

While, as already indicated, the unfavorable development in profits would create some incentive to mark up prices, more sluggish market conditions would encourage businesses to pursue temperate pricing policies, especially as this influence began to be reinforced by a slowdown in the rise of wage rates and unit labor costs. The reductions in wage and price increases would tend to reinforce each other. The longer price increases moderated, the weaker would become the expectation of further inflation. In turn, business and labor would be increasingly inclined to respond to the waning inflation by making appropriate price and wage adjustments, in preference to accepting a lower volume of production and less employment. With this change the economy would be on the road to regaining full employment without setting off another round of inflation.

* * *

At the beginning of 1969 no one knew how much of this process might occur during the year. As this Council indicated in its testimony before the Joint Economic Committee in February 1969, the growth of demand would be slowed only a little in the first half of the year, because demand was strong at the outset and the turn to monetary restraint just before the year opened would not have had much time to work. A more marked slowdown of demand was likely for the second half. At first almost all of the slack in demand would probably be taken up by a slowdown of production. Price and cost trends at the beginning of the year were too strong to be deflected by the moderate deceleration expected in the first half. But it could be expected that after midyear the slower growth of real output and of employment would create sufficient excess in the supply of products and labor to begin to have visible effects on price and wage increases. By the end of the year the rate of inflation would be lower than at the beginning. The effects to that point might not be great. Still, the economy would have crossed the threshold from a state of accelerating inflation to one of decelerating inflation, and we could count on making further progress.

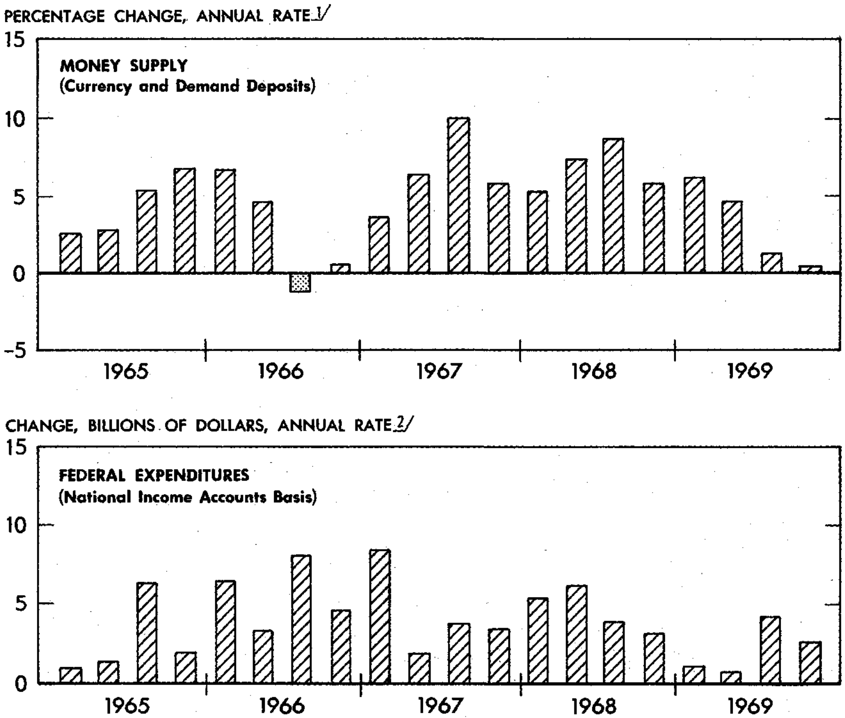
THE RECORD IN 1969

Fiscal and monetary policies in 1969 followed the general course that seemed desirable at the beginning of the year. In general the economy responded to those policies by moving through some of the stages just outlined—more slowly than was expected at the beginning of 1969 but in a manner that confirmed the initial view of the necessary stages in the process. The policy and economic developments of the year are summarized in the next few pages after which the main elements in the story are told in greater detail.

The contribution of fiscal policy to disinflation was a slowdown in the growth of Federal spending and the maintenance of a moderate budget surplus. During calendar 1969 Federal expenditures (as measured in the national income accounts) increased by about $9 billion as compared with about $20 billion a year in the 3 preceding years; and the budget surplus amounted to almost $10 billion for the year as compared with a deficit of $5 billion in 1968. Monetary policy reduced the rate of growth of the money supply (demand deposits and currency) from 7.2 percent in 1968 to 2.5 percent in 1969. The reduction occurred in successive steps that brought the rate of growth close to zero in the fourth quarter (Chart 1).

Chart 1

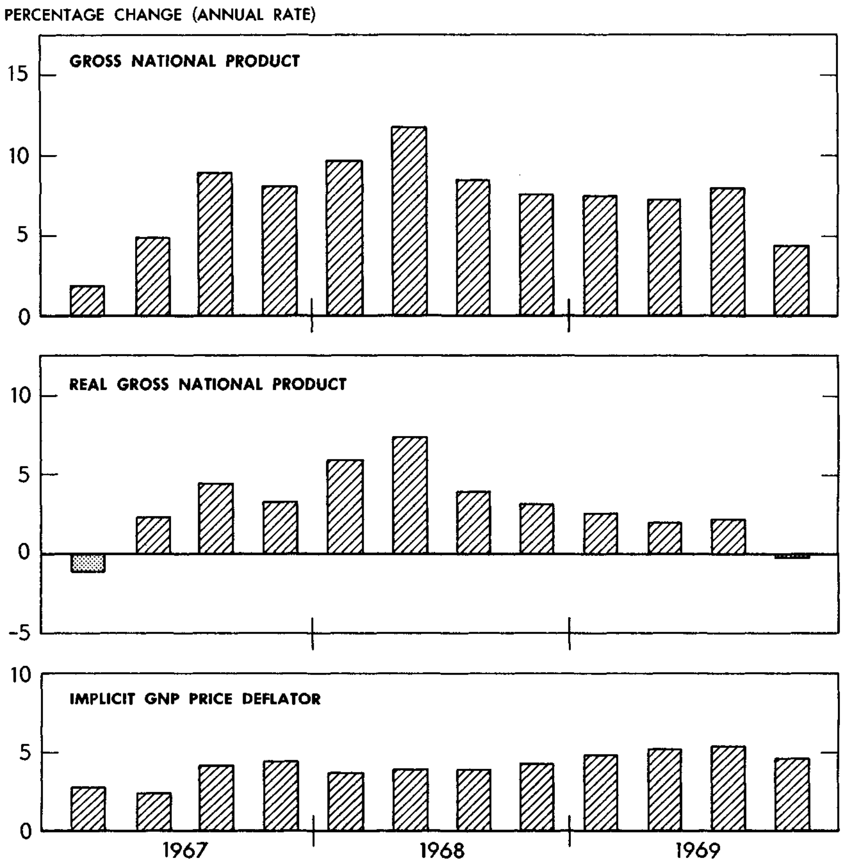
Changes in the Money Supply and Federal Expenditures



1/ BASED ON SEASONALLY ADJUSTED QUARTERLY AVERAGES OF DAILY FIGURES.
2/ SEASONALLY ADJUSTED.
SOURCES: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM AND DEPARTMENT OF COMMERCE.

Chart 2

Changes in GNP, Real GNP, and GNP Deflator



NOTE: BASED ON SEASONALLY ADJUSTED DATA.
SOURCE: DEPARTMENT OF COMMERCE.

As the year progressed, it became more and more likely that these developments which led to accelerating inflation were transitory. Profits reported by corporations declined after the middle of the year. Also, the slower growth of total output—including an actual decline of industrial production—began to be translated into slower growth of employment and reduction of working hours. This combination of conditions marked a necessary step toward a subsequent decline in the rate of inflation.

FISCAL DEVELOPMENTS

The operating objective of fiscal policy in 1969, initially and throughout the year, was to keep a budget surplus at least as large as had been achieved by the Revenue and Expenditure Control Act of 1968—in the neighborhood of $3 billion to $5 billion. The first step in the process of fiscal control was a review of the budget for fiscal 1970 that the outgoing Administration had submitted. A program-by-program examination indicated that $4.0 billion could be cut from the 1970 totals. Of this amount, $1.1 billion would come from reducing defense outlays, $1.0 billion from deferring increases in Social Security benefits, and $1.9 billion from cuts in a wide range of other Federal programs. As a result, the Administration announced in April its intention to hold fiscal 1970 expenditures to $192.9 billion.

During 1969 the necessary costs of certain "uncontrollable" items, such as interest on the debt, Medicare, public assistance, civil service retirement, and veterans benefits increased beyond the earlier estimates. At several points Congressional action also increased expenditures. In order to hold to the $192.9 billion total for fiscal year 1970, the Administration therefore announced further cuts in mid-September amounting to $3.5 billion, of which $3.0 billion was in the defense program.

Adherence to the $192.9 billion ceiling required not only making these gross reductions of $7.5 billion in existing programs but also firmly resisting proposals, originating in Congress, that would have required spending many billions of dollars for new programs or program expansions. By the beginning of 1970 it was clear that the ceiling could not be maintained for the entire fiscal year. For calendar year 1969, however, the tight restraint on expenditures allowed fiscal policy to contribute to the fight against inflation.

The initial review of the budget also revealed that, in order to avoid an abrupt shift from surplus to deficit, it would be necessary to extend the 10-percent income tax surcharge, scheduled to expire on June 30, 1969, and to defer the scheduled reduction of the excise taxes on automobiles and telephone services. Accordingly, in March the President recommended their retention, with the 10-percent surcharge to continue until June 30, 1970.

Subsequent consideration of the longer-range issues led the Administration to conclude that the 7-percent tax credit enacted in 1962 to stimulate business investment should be repealed. The national priorities of the 1970's did not require or justify this special incentive.

Once the decision was made to ask for repeal of the investment credit, the repeal had to be effective immediately, in order to minimize disruptions from heavy advance order placements. Thus, although the repeal served a long-run objective, there would be some revenue increase in the short run, and therefore a gradual phasing out of the tax surcharge was possible. Consequently, on April 21, when the Administration asked for repeal of the investment credit, it also recommended that the surcharge rate be reduced to 5 percent on January 1, 1970, and then allowed to expire on June 30.

The extension of the surcharge was the subject of prolonged debate in Congress. Extension for the last 6 months of 1969 was not signed into law until August 7, and extension for the first 6 months of 1970, at the 5-percent rate, did not become law until December 30. Continued uncertainty about tax prospects, which raised doubts about how determined the fight against inflation was going to be, contributed to the persistence of an inflationary psychology during the year.

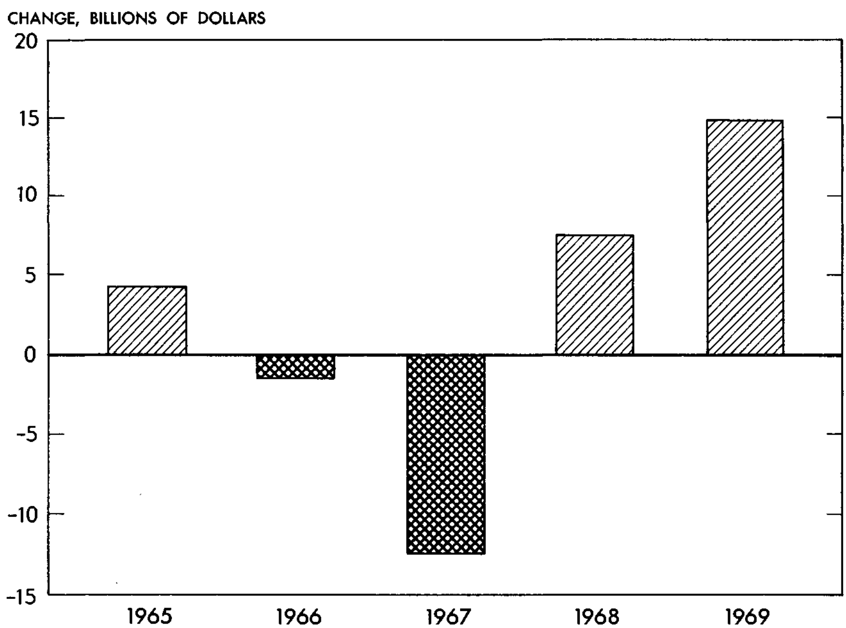
As already indicated, the growth in Federal expenditures slowed down substantially in 1969. The Federal pay raise that went into effect on July 1, 1969, accounted for about one-third of the year's increase. Federal purchases of goods and services, including the pay raise, increased by approximately $1 billion from the end of 1968 to the end of 1969. All other Federal expenditures combined, however—Social Security and other transfers, grants to States and localities, net interest paid, and subsidies—continued their upward trend, though at a somewhat more moderate pace. Among these, net interest paid rose because of sharply higher interest rates.

On the revenue side, the increase in Social Security tax rates on January 1, 1969, from 8.8 to 9.6 percent, added about $3 billion to collections in 1969. During the year other tax rates were stable, except that the elimination of

Chart 3

Changes in Federal Surplus

National Income Accounts Basis



SOURCE: DEPARTMENT OF COMMERCE.

the investment tax credit effective April 21, 1969, increased total tax liabilities for calendar 1969 by $0.9 billion; only the corporation share of this, $0.5 billion, is counted as Federal receipts within calendar 1969 in the national income accounts. Only a small part of eligible investment made in 1969 lost the advantage of the tax credit because of the rather long leadtime between order placement and expenditures. Total Federal receipts (as measured in the national income accounts) rose by more than $15 billion from the fourth quarter of 1968 to the fourth quarter of 1969.

The reported figures distort the pattern of receipts and consequently of the budget surplus during the year, because the insufficient withholding of personal income tax payments in 1968 increased final settlements in the first half of 1969. A correction for the bunching of these payments would show that the surplus stayed within a fairly narrow range during the year. (Year-to-year changes in the surplus are shown in Chart 3.)

MONETARY RESTRAINT

Last February, Chairman Martin described the goal of Federal Reserve policy as being "to disinflate without deflating." It was difficult to tell then, or later in the year, however, what rate of growth in the money supply would in fact achieve this general goal. Certainly it was necessary that the money supply grow more slowly than the 7.2-percent increase of 1968. In the circumstances of 1969, with interest rates high and rising and with strong and spreading expectations of inflation, businesses and families would be likely to hold declining money balances in relation to their income. Therefore, to bring about even a moderate slowdown in demand for goods and services might require a very low rate of monetary growth—lower than would be consistent with prosperity in a more stable economy. Past experience, however, threw little light on the requirements of this transitional period, and policy had to be tentative and watchful.

During the first half of 1969 the growth of the money supply fell to a seasonally adjusted annual rate of 4.4 percent. (Before revisions in the data were made in late summer, the first half growth had appeared to be lower.) For the second half the policy became even more restrictive, and growth in the money supply was only 0.7 percent at an annual rate (Chart 1). For the year as a whole, time and savings deposits at commercial banks declined by 5.2 percent, as market interest rates rose well above the ceiling rates that banks could pay on these deposits and thus diverted funds to market securities.

The Federal Reserve restricted monetary growth primarily by reducing the expansion of its monetary liabilities. Although currency outside banks expanded during 1969 by 6.0 percent, almost as much as the 7.4 percent expansion in 1968, total reserves of commercial banks (adjusted for changes in reserve requirements) were practically constant for 1969, whereas they had increased 7.8 percent for 1968. Other restrictive steps were also taken in April. The discount rate on loans to member banks secured by U.S. obligations or other eligible paper was raised from 5½ to 6 percent, and reserve requirements on demand deposits at all member banks were raised one-half of a percentage point.

THE FLOW OF CREDIT

One way in which the monetary restraint was transmitted to the economy was through its effect on the supply of credit. Banks were less able to expand credit through increases in the money supply. Also, as the year went on, the combination of continued slow growth of money and rising transactions and income lessened the inclination of individuals and businesses to reduce

TABLE 1.—*Funds raised in credit markets, nonfinancial sectors, 1968–69*

[Billions of dollars; seasonally adjusted annual rates]

Borrowing sector	1968				1969		
	I	II	III	IV	I	II	III
Total funds raised	94.2	81.5	117.7	95.2	96.3	88.8	100.9
Change in U.S. Government cash balance outside Federal Reserve	−5.3	−16.2	26.4	−9.6	−5.7	−9.2	14.8
Net funds raised	99.5	97.7	91.2	104.8	101.9	97.9	86.1
U.S. Government net of cash balance	25.5	25.5	2.9	4.1	5.2	−9.6	.3
Other sectors	74.0	72.2	88.3	100.7	96.7	107.5	85.8
State and local governments	8.2	5.5	12.8	14.3	12.1	11.8	7.4
Business	32.0	35.6	39.9	48.7	47.9	54.4	45.1
Households	29.4	29.1	33.0	34.7	30.9	33.1	28.1
Home mortgages	15.5	14.2	14.2	15.6	15.6	17.1	15.6
Foreign	4.4	2.0	2.6	2.9	5.7	8.2	5.2

Note.—Detail will not necessarily add to totals because of rounding.

Source: Board of Governors of the Federal Reserve System.

their money balances further in order to acquire other financial assets. Whereas earlier the restraint on bank lending could be made up by more borrowing from other lenders who started the year with ample liquidity, this solution became more difficult as the year progressed. The tightening of credit supplies affected borrowing on the open market as well as through financial intermediaries. As a result, by the third quarter of 1969 total funds raised in credit markets, net of changes in Treasury cash at commercial banks, were nearly 20 percent less, seasonally adjusted, than in the fourth quarter of 1968 (Table 1). Most of this decline came in the third quarter.

A dramatic turnabout was made, of course, by the Federal Government. On a seasonally adjusted net basis, it changed from a heavy borrower in the first half of 1968 to a moderate borrower through the first quarter of 1969, then to a substantial lender in the second quarter; in the third quarter it borrowed only a small amount on a net basis. As a result, even though the net funds raised by all sectors declined in the second quarter of 1969, the net funds raised by borrowers other than the Federal Government actually increased. In the third quarter, however, when the Federal Government was not active in the market on a net basis, borrowing of all other sectors declined and, consequently, total net funds obtained fell sharply.

This restraint in the amount of credit being supplied occurred in the face of an unusually strong private demand for credit. In addition to the strong demand which ordinarily accompanies a high level of economic activity, the expectation of more inflation acted as a further stimulus to borrowing. The fact that inflation had been accelerating since 1965 intensified expectations of future price increases. Individuals and businesses, seeing an opportunity to invest in real assets that would be expected to increase in money value with inflation, were eager to borrow in the expectation of repaying with dollars of reduced purchasing power. They were willing to pay high interest rates because they believed that inflation would substantially reduce the real cost of those rates. On a loan made at the beginning of a year at an 8-percent interest rate and repaid at the end of a year in which prices have risen by 4 percent, the return on the loan in real purchasing power is, of course, about 4 percent.

In these circumstances interest rates would have risen even if the money supply had continued to rise rapidly, as happened in 1968. But the curtailment of monetary expansion in 1969, and the curtailment of the supply of credit that accompanied it, temporarily raised interest rates even more. Until the slowdown of monetary expansion could reduce economic expansion and lessen the expectation of inflation, an extraordinary demand for credit would collide with a more restricted supply, and interest rates would soar.

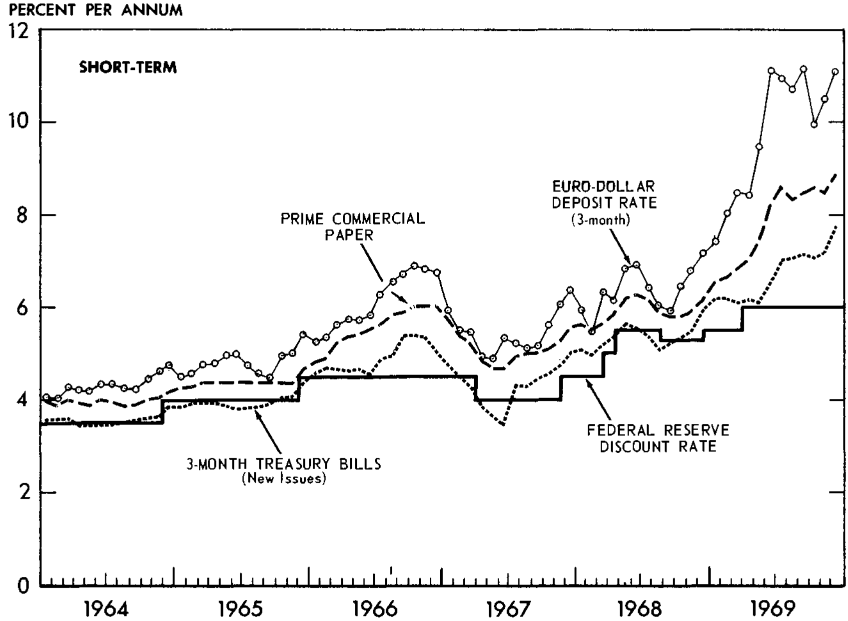
In fact interest rates did soar in 1969 (Chart 4). By the end of 1969, most interest rates had climbed around 4 percentage points above their 1965 level. One must consult records for the Civil War and earlier to find comparable interest rates. And the steepness of the advance, on long-term as well as short-term securities, may well have been unprecedented.

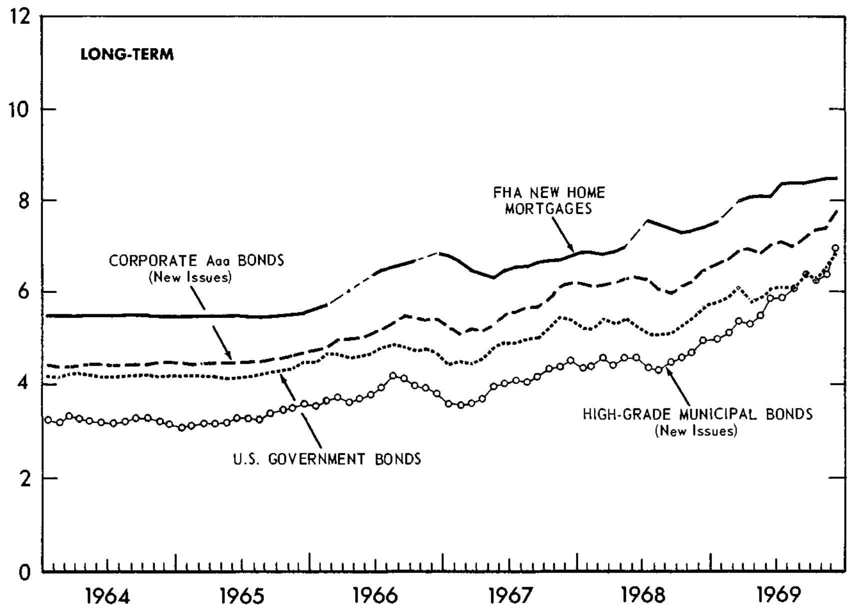
The high interest rates of 1969 substantially altered financial flows, in large part because legal ceilings put some borrowers at a disadvantage and shunted funds to unrestricted parts of the market. Ceilings on deposit interest rates were particularly important. The maximum interest rates that banks could pay on time and savings accounts and on certificates of deposit had not been changed since April 1968, while market interest rates increased sharply. As a result, commercial banks could not compete, and large certificates of deposit outstanding fell from $22.8 billion at the end of 1968 to $14.7 billion at the end of June, and to $10.8 billion at year-end 1969. (The ceiling rates were adjusted upward in January 1970.)

The two other financial institutions subject to deposit-rate ceilings, mutual savings banks and savings and loan associations, also felt the competition for funds. They experienced heavy withdrawals, and their net growth declined substantially. Time and savings deposits which the public held with

Chart 4

Interest Rates





SOURCES: TREASURY DEPARTMENT, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, FEDERAL HOUSING ADMINISTRATION, MOODY'S INVESTORS SERVICE, AND STANDARD & POOR'S CORPORATION.

all deposit-type financial institutions grew by $33.1 billion in 1968 but declined by $20.5 billion at an annual rate during the third quarter of 1969. Life insurance companies also faced heavy demands for automatic policy loans, since the standard 5-percent rate on such loans became a bargain as other interest rates rose.

TABLE 2.—*Changes in deposits and selected nondeposit sources of bank funds, 1968–69*

[Billions of dollars]

Selected source of bank funds	1968	1969	1969, not seasonally adjusted I	II	III	IV
Commercial bank time and savings deposits	22.2	−10.8	−0.4	−2.6	−6.3	−1.5
Negotiable certificates of deposit	2.8	−12.0	−4.0	−3.5	−3.6	−.9
Other time and savings deposits	19.4	1.2	3.6	.9	−2.7	−.6
Selected nondeposit sources of bank funds	(1)	13.0	[2] 10.2		2.2	.6
Euro-dollar borrowing [3]	1.8	7.0	3.6	3.6	1.1	−1.3
Direct foreign borrowing [4]	(1)	1.7	[2] 1.0		.1	.5
Commercial paper [5]	(1)	4.2	[2] 1.2		1.4	1.6
Loan RP's [6]	(1)	.2	[2] .8		−.3	−.3

[1] Not available.
[2] Change during first half of 1969.
[3] Bank liabilities to foreign branches.
[4] Euro-dollars borrowed directly or through brokers and dealers, and liabilities to banks' own branches in U.S. territories and possessions.
[5] Paper issued by a bank holding company, affiliate, or subsidiary.
[6] Loans or participations in pools of loans sold under repurchase agreements to other than banks and other than affiliates or subsidiaries.

Source: Board of Governors of the Federal Reserve System.

Commercial banks were able to offset deposit withdrawals at first by tapping other sources of funds. They borrowed more heavily in the Euro-dollar market, negotiated repurchase agreements of their loans with corporations, and expanded commercial paper issued by subsidiaries and affiliates. In total, as shown in Table 2, banks raised about $10.2 billion by these devices during the first half of 1969.

Later in the year the Federal Reserve took steps to make the use of these sources more expensive to banks. Most repurchase agreements had to be treated like deposits after August 27 and were thus subjected to reserve requirements and interest-rate ceilings. In effect, this prohibited their further use. Euro-dollar borrowings above May levels were also subjected to reserve requirements beginning in September. Banks did not raise additional funds from these sources after midyear. Commercial paper sales continued to grow, however, and provided $3.0 billion more in the second half. (Recent proposals, not yet effective, would bring these sales under either reserve requirements or interest rate ceilings, or both.) To meet heavy demands for loans, commercial banks also sold U.S. and municipal securities, depressing the bond market, and they traded actively in the Federal funds market. With time deposits declining and nondeposit sources of funds quite costly, large commercial banks made the terms of their lending more restrictive, and the expansion of business loans slowed significantly after midyear.

The funds withdrawn from or not placed in banks or other financial institutions were not lost to the supply of credit. Funds returned by way of the open market. This can be seen in the shift in the composition of assets acquired by households and nonfinancial businesses. Households accumulated only $2.1 billion in money and savings deposits at a seasonally adjusted annual rate during the third quarter of 1969, far below usual amounts, and diverted their savings increasingly into market instruments because of the much higher yields. They invested at an annual rate of $29.1 billion in all credit market instruments in the third quarter of 1969, well above any quarterly rate in recent years. Most of this was accounted for by the purchase of $27.4 billion of U.S. Government and agency securities. Nonfinancial corporations withdrew funds from time deposits at an annual rate of $12.3 billion in the third quarter of 1969 and purchased $13.3 billion (annual rate) of commercial paper.

TABLE 3.—*Sources and uses of funds, nonfarm nonfinancial corporate business, 1968–69*

[Billions of dollars; seasonally adjusted annual rates]

Source or use of funds	1968				1969		
	I	II	III	IV	I	II	III
Sources, total	109.9	101.3	110.5	118.9	118.0	114.0	108.6
Internal funds	59.1	63.9	65.3	64.1	62.9	62.7	62.9
Credit market instruments	25.7	26.6	31.1	40.7	38.7	43.6	36.2
Stocks	1.3	−.6	−1.9	−2.2	.1	2.4	1.6
Bonds and mortgages	16.4	18.3	18.0	22.2	20.1	16.1	15.7
Bank loans	3.7	6.7	9.8	18.2	12.7	12.6	7.8
Other loans	4.4	2.2	5.1	2.6	5.9	12.5	11.1
Trade debt and tax liability	18.9	2.9	6.0	8.3	8.4	4.6	7.8
Other liabilities	6.2	7.9	8.1	5.8	8.0	3.1	1.7
Uses, total	102.7	93.4	104.7	112.4	111.6	107.3	103.6
Acquisition of financial assets:							
Liquid assets	13.7	8.4	13.5	4.5	8.0	1.8	−6.1
Consumer and trade credit	16.9	10.4	18.5	19.6	15.7	15.6	17.1
Other assets	1.4	−2.3	−3.5	4.6	3.2	4.1	2.9
Capital expenditures	70.7	76.9	76.2	83.7	84.7	85.8	89.7
Discrepancy (sources less uses)	7.2	8.1	5.7	6.5	6.4	6.7	5.0

Note.—Detail will not necessarily add to totals because of rounding.

Source: Board of Governors of the Federal Reserve System.

Businesses which could borrow on the open market were able to meet their credit needs despite this shift in fund flows from financial intermediaries to credit market instruments. Although the third quarter of 1969 saw a decline in the funds raised by businesses in credit markets compared with the second quarter, the total of funds raised represented an annual rate higher than during most of 1968. Businesses expanded capital expenditures steadily during the first 3 quarters of 1969 despite little increase in the generation of funds internally and a decline in their borrowing from banks

(Table 3). They made up the difference in large part by selling liquid assets. In the third quarter, nonfinancial corporations sold liquid assets at an annual rate of $6.1 billion, whereas these corporations are typically net purchasers of liquid assets, often by substantial amounts.

For the housing sector the job of tapping the open market to find the funds no longer available through private financial intermediaries fell upon federally sponsored agencies, chiefly the Federal National Mortgage Association and Federal Home Loan Banks. These agencies stepped up their support of the mortgage market substantially. Their annual rate of support for residential and farm mortgages, furnished either directly by purchases of mortgages or indirectly through loans to savings and loan associations, increased from $3.0 billion in all of 1968 to a $10.3 billion annual rate in the third quarter of 1969. This represented 47 percent of the total supply of noncommercial mortgages, as compared with 14 percent in 1968. Despite this increased assistance, the growth of total mortgage credit declined in the fourth quarter.

The support of mortgages by federally sponsored agencies was financed by issuing securities, which competed with other financial assets and to some extent depleted private sources supplying the mortgage market. Total issues of sponsored Federal credit agencies, made mainly for mortgages, rose from $3.2 billion in 1968 to a $12.3 billion annual rate in the third quarter of 1969.

The largest and earliest decline in net funds raised outside of the Federal Government was experienced by State and local governments. By the third quarter their acquisition of credit was one-fourth below the 1968 rate. Many States and localities were prevented from borrowing in 1969 by legal ceilings on the interest rates they could pay. Also, during parts of the year the market was disturbed by uncertainty about possible changes in the tax status of State and local securities in addition to heavy selling of these securities by commercial banks.

THE DEMAND FOR OUTPUT

The policies of fiscal and monetary restraint and the associated credit stringency, described earlier, affected the behavior of the economy by slowing down the total demand for output.

Total expenditure for goods and services (gross national product or GNP) rose $67 billion from 1968 to 1969, when it reached $932 billion. This was an increase of 7.7 percent as compared with the 9.1 percent rise from 1967 to 1968 (Table 4).

A major factor in the slower growth of spending was the slower increase of Federal purchases, mainly for defense. In fact, GNP other than Federal purchases rose as much in 1969 as in the preceding year. The most marked shift within the non-Federal total was the much larger increase in business fixed investment and the much smaller increase in residential construction than had occurred in the preceding year. These movements were at least partly related. The large absorption of funds to finance business

TABLE 4.—*Changes in gross national product and components, 1968–69*

[Billions of dollars]

Component	Change from preceding period					
	1968	1969 [1]	1969, seasonally adjusted annual rates			
			I	II	III	IV [1]
Gross national product	72.2	66.6	16.2	16.1	18.0	10.3
Federal Government purchases	8.8	2.5	−.3	−1.0	2.6	−.5
Non-Federal purchases	63.4	64.1	16.5	17.1	15.4	10.8
State and local government purchases	11.4	12.0	3.7	3.8	1.5	2.4
Fixed investment	10.4	12.5	5.2	1.9	2.0	2.0
Nonresidential	5.1	10.5	3.8	2.5	3.3	1.9
Residential structures	5.2	2.0	1.4	−.6	−1.3	.2
Personal consumption expenditures	44.3	39.4	11.3	10.8	7.0	9.4
Net exports of goods and services	−2.7	−.4	.3	.1	1.1	−.1
Change in business inventories	−.1	.7	−3.9	.3	3.8	−2.9

[1] Preliminary.

Note.—Detail will not necessarily add to totals because of rounding.

Source: Department of Commerce.

investment, together with tightening monetary conditions, meant that less funds were available to finance residential construction. Monetary restraint also had some effect on State and local government purchases, which nonetheless continued to rise at a much higher rate than GNP.

The main categories of GNP other than Federal purchases and net exports are reviewed below. Exports and imports are discussed in Chapter 5.

Fixed Investment by Business

Business demand for plant and equipment was strong throughout 1969 and offered stubborn resistance to restraint even though the rate of expansion moderated within the year. The 12-percent increase in investment over that of 1968 was the eighth annual advance in a row, marking the longest sustained increase since before World War I. However, businessmen spent less than they had anticipated in the February 1969 Commerce-SEC annual survey of investment plans.

The rise in investment during 1969 was an extension of a recovery that started haltingly in late 1967 and early 1968 but gathered momentum from the upsurge in sales and profits in the first half of 1968. The surtax on corporations resulting from the passage of the tax increase in mid-1968 did not seem to have much impact on the developing investment expansion, perhaps in part because the tax rise was small and was expected to be temporary. During the second half of 1968, the financing of these programs was facilitated when the monetary authorities shifted to an easier policy and the Federal deficit declined sharply, making additional funds available for the private sector. At the end of 1968 businessmen projected for the first half of 1969 one of the largest half-year increases ever recorded in the Commerce-SEC survey.

Several influences that should have inhibited business investment emerged in 1969, although at best they served only to slow down the increase in the second half. They included the shift to monetary restraint and the rapid rise in interest costs; the tapering in the expansion of demand and output, and the emergence of excess plant capacity in a number of industries; the decline in book profits after the second quarter; and the proposed repeal of the investment tax credit announced on April 21, 1969, although this move could not have greatly affected spending until late in the year because of the sizable backlog of equipment orders that existed in mid-April. In any event, speculation that the termination of the investment tax credit might be in the Administration's proposals led to an upsurge in order placements immediately prior to April 21, as businessmen acted to take advantage of the credit while it was still allowed.

Although their spending fell somewhat short of expectations in the first half of the year, businessmen forged ahead with their investment programs as 1969 progressed. New appropriations by manufacturers and new projects started by manufacturers and public utilities rose through the third quarter. And at the end of 1969, businessmen reporting in the Commerce-SEC survey were once again projecting a substantial increase in expenditures in the coming year.

The industrial composition of investment provides a clue to the strength of business investment. Over the past few years the demand for capital goods by electric and gas utilities and telephone companies has been exceptionally strong. In contrast to other groups, investment in these industries has increased steadily and substantially each year. Several successive years of sharply rising demand have strained facilities, and the service failures that have appeared in particular areas have accentuated the need for additional capacity. High interest rates have not seriously deterred these industries from investment because they must meet demands for service and because the regulatory authorities permit such cost increases to be reflected in higher rates. Actual spending by these firms rose sharply in 1969, and their planned spending is a major source of strength in the near-term investment outlook.

Housing

Housing in 1969 showed the effects of disrupted capital markets and high interest rates. Private nonfarm housing starts, at about 1.45 million units for the year as a whole, were unchanged from 1968, but they declined irregularly from an early 1969 peak. Expenditures for the full year were 6½ percent greater than in 1968, but the increase was due almost entirely to higher prices. During the year, private housing outlays declined 6.7 percent (annual rate) from the first to the fourth quarter, and this decline was a major reason for the dampening in the rise of aggregate demand.

Homebuilding never did recover fully from the effects of the credit stringency of 1966. The housing upturn in 1967 came to a temporary halt in the first half of 1968 because of rising interest rates. Since housing starts from 1966 to 1968 fell considerably below the number needed to satisfy the requirements created by new households and the replacement of obsolete units, a substantial backlog in demand built up. Vacancy rates continued to be low, prices for new and existing homes recorded sharp increases, and rents rose at an accelerated rate.

In the second half of 1968, the somewhat easier credit market conditions that followed enactment of the surtax led to a pronounced pickup in private nonfarm starts. From a seasonally adjusted annual rate of 1.4 million units in the second quarter of 1968 they rose to 1.7 million in the first quarter of 1969. However, this upsurge in starts was also short lived. The slower monetary growth near the beginning of 1969 was followed by a further rise in what were already high interest rates. Some lending institutions shifted from mortgages to more lucrative investments, and most experienced much less favorable savings flows. The further sharp tightening by the monetary authorities after mid-1969 hampered housing. As was indicated earlier, the thrift institutions, which are important in mortgage financing, were handicapped in their attempt to compete for savings. These institutions experienced large outflows of savings because depositors sought the higher yields available on market securities. After starts had fallen to a 1.5 million unit rate in the second quarter, they declined to 1.4 million units in the third and 1.3 million in the fourth.

Partly in an effort to support homebuilding, the Administration took several steps to alter supply and demand conditions in ways that would curb inflationary trends in construction (including the homebuilding industry). Early in the year, lumber and plywood prices rose sharply as a result of tight supply conditions and the expectation of further tightness. The Government curtailed its own purchases and initiated measures to increase the supply of timber from the national forests. These actions played a part in the sharp retreat of lumber and plywood prices from their speculative peaks.

Increases in construction wage rates were very pronounced in 1969, with collective bargaining agreements commonly calling for rises in excess of 12 percent per year for 2 or 3 years. These increases and the consequent advances in costs made it even more difficult to sustain an already weak residential construction industry. Moreover, building such large wage increases into costs for future years raised the danger that the entire construction industry would be left stranded by excessive costs when inflation abated. There was also concern that the exceptional wage increases in this industry would set an example that might be followed in other industries.

On September 4, the President announced a program to attack the inflationary aspects of construction wage settlements.

1. The Federal Government would cut new contracts for direct Federal construction by 75 percent, with the cut to continue until conditions eased

in the economy or in the construction industry. If that limitation were to remain in effect through fiscal 1970, it would reduce contract awards by $1.8 billion.

2. State and local governments were requested to cut their new construction contracts voluntarily. If not enough voluntary restraint was forthcoming, the Administration would consider a reduction in Federal grants for construction.

3. Private business was requested to cooperate in restricting nonresidential construction.

4. The Departments of Labor and of Health, Education, and Welfare were directed to apply more of their manpower training programs to increasing the number of skilled construction workers.

5. A Cabinet Committee on Construction, headed by the Chairman of the Council of Economic Advisers, was established to develop long- and short-range programs for analyzing problems in the construction industry.

On September 22, the President established a tripartite Construction Industry Collective Bargaining Commission to consider solutions to a number of labor-management and manpower problems in the industry, including productivity, seasonality, settlement of disputes, and the training of labor.

Consumer Income and Spending

Personal income rose $59 billion, or 8.6 percent, from 1968 to 1969 (Table 5). There were large increases in payrolls and incomes from property, and still larger percentage rises in transfer payments (such as payments for Social Security, Medicare, and veterans benefits).

Personal taxes rose last year by $20 billion, or 20 percent, an even greater increase than from 1967 to 1968, when the surtax went into effect. Last year

TABLE 5.—*Changes in personal income, taxes, and saving, 1967–69*

Period	Change from preceding period (billions of dollars)					Saving rate for period (percent)
	Personal income	Personal tax and nontax payments	Disposable personal income	Personal consumption expenditures	Personal saving [1]	
1967	42.2	7.5	34.6	26.0	7.9	7.4
1968	58.5	15.0	43.5	44.3	−2.0	6.5
1969 [2]	59.2	19.6	39.6	39.4	−.8	6.0
	Seasonally adjusted annual rates					
1967: Second half	21.5	4.4	17.0	13.8	3.1	7.5
1968: First half	32.0	5.9	26.2	26.2	−.8	7.1
Second half	31.4	13.8	17.6	22.4	−5.5	5.9
1969: First half	28.8	11.6	17.3	19.6	−2.7	5.3
Second half [2]	29.3	2.2	26.9	17.1	9.5	6.6

[1] Disposable personal income less personal outlays (personal consumption expenditures, interest paid by consumers, and personal transfer payments to foreigners).
[2] Preliminary.

Note.—Detail will not necessarily add to totals because of rounding.

Source: Department of Commerce.

was the first full year of the surtax; for this reason surtax liabilites were higher, rising from 7½ to 10 percent. In addition, 1969 tax payments were unusually high because of the underwithholding of taxes in 1968. Because of the substantial increase in taxes, personal disposable (after-tax) income rose only 6.7 percent, the smallest percentage advance in 6 years.

Consumer spending rose more rapidly than disposable income from 1968 to 1969. The pattern of consumer expenditures within the year was particularly interesting for the light it threw on the impact of the surtax. When the surtax was imposed in mid-1968, it was recognized that some of its effects might be offset if consumers decided to reduce their rate of saving. For reasons that are still not entirely clear, the rate of saving had been rather high for almost 2 years before the tax increase was enacted. Furthermore, there was always the possibility that consumers might be slow in adjusting their expenditures to an anticipated change in disposable income, especially if they regarded the surtax as temporary. As it turned out, consumers did reduce their rate of saving—but to an extent that was much greater than anticipated.

The imposition of the tax had little immediate impact on consumer spending. In the third quarter of 1968, spending rose sharply, and the saving rate fell; not until the fourth quarter did spending show signs of slowing down. At the start of 1969, many analysts counted on the slowdown in consumer spending that had finally emerged in the fourth quarter of 1968 to continue in the first half of 1969, particularly since consumers had heavy tax payments to make on their 1968 liabilities and since Social Security taxes were increased at the start of the year. In fact, however, consumer spending rose sharply in both the first and second quarters, despite the slow expansion in disposable income. The personal saving rate fell to exceptionally low levels. Helping to explain the high rate of spending relative to disposable income in 1968 and 1969 was the rapid monetary expansion and the substantial accumulation of liquid assets that preceded these 2 years. The liquidity of households increased at very rapid rates throughout 1967 and 1968. The process of attempting to adjust these liquid asset holdings to normal levels may have contributed to the heavy consumer spending in 1968 and the first half of 1969, as it did in the case of business investment.

During the second half of 1969, increasing concern over the economic outlook, which showed up in a number of surveys of consumer sentiment, was reflected in a more subdued pace of consumer spending and a rise in the saving rate. Spending for durable goods edged down, bringing to a halt a rise that had started in the summer of 1967. Auto purchases showed considerable weakness late in the year, as a result of which auto producers made substantial cuts in production.

State and Local Purchases

State and local government purchases, with a 12-percent increase, showed the largest percentage advance of any of the major demand components in

1969. The somewhat slower rise as compared with the increases from 1966 to 1968 was the result of credit tightness. Several State and local jurisdictions either found it impossible to sell securities because of statutory ceilings on interest rates or decided to postpone new bond issues because of high rates. Hardest hit was construction, which accounts for about one-fourth of State and local government purchases, and which rose very little after annual increases of about 10 percent in the 3 preceding years. The Administration's request to State and local governments in September to curb construction came too late in the year to influence 1969 outlays significantly.

Inventory Investment

Investment in business inventories totaled $8 billion last year—about as much as the year before. Businessmen tended to be cautious in their inventory policies, possibly because of the high cost of borrowed money and uncertainties over the sales outlook. Accumulation was moderate in the first half, but during the third quarter there was some evidence that unwanted stocks were piling up. However, the actual rate of accumulation apparently fell in the final quarter as steps were taken to adjust production. A good part of the swing in inventory accumulation centered in the automobile industry.

SHARES IN THE NATIONAL INCOME

The value of the Nation's production can also be measured by the national income, which is obtained by adding up all of the incomes earned in current production—wages and salaries, corporate profits, proprietors' incomes, net interest, and rental incomes of persons. Since incomes are the factor costs of production, an analysis of them is particularly instructive in a time of inflation. It provides a useful backdrop for the discussion of the labor market, profits, and prices that follows.

The 1969 rise in employee compensation, approximately 10 percent, matched the large increase from 1967 to 1968. The combination of higher employment and substantial increases in rates of pay resulted in the largest percentage increase in private payrolls since 1951. Government payrolls grew less rapidly than in the preceding year, mainly because the growth in employment slowed. The slowdown in military payrolls was especially pronounced because for the first time since 1965 the size of the Armed Forces showed no increase. The rise in Federal civilian employment was deliberately held down as a measure of restraint. Growth in State and local government employment remained substantial, but its rate of increase fell for the third year in a row.

In 1969, the national income accounts measure of corporate profits (that is, adjusted to exclude inventory profits) was slightly above the 1968 total. However, according to preliminary data, profits declined in each quarter of 1969, continuing a movement that started in late 1968. Book profits (including inventory profits) made a better showing in 1969 than the national

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income version; the rise from 1968 came to $3 billion, bringing the total to more than $94 billion. After-tax profits rose $1 billion to a new peak, the repeal of the investment tax credit adding $½ billion to 1969 tax liabilities. Corporations increased dividends more than after-tax profits rose so that undistributed profits edged down.

Both farm and nonfarm proprietors experienced increased incomes in 1969. Large increases in farm prices helped raise the total net income of farm proprietors by $1.5 billion. Last year's income of about $16 billion was the same as the 1966 total, which in turn was the highest since 1948. Cash receipts from marketings of livestock and livestock products were bolstered by a 12-percent price rise that reflected a continued increase in consumer demand for meat coupled with only moderate increases in market supplies and in imports, which are limited by voluntary restraints. In the case of crops, however, another record harvest, combined with big carryovers of grains and soybeans, resulted in a 3-percent decline in prices. Direct Government payments totaled about $3¾ billion last year, up $⅓ billion from 1968. They accounted, as in 1968, for 6 percent of the cash receipts from farm marketings.

Inflation had an important effect on farm expenses as well as on receipts last year. Prices were higher for all major inputs except fertilizers. Sharp increases were recorded for farm wage rates, which were up 10 percent from 1968. Because the number of hired farmworkers dropped, however, total cash wages showed an increase of 6 percent over the 1968 figure.

THE LABOR MARKET

The pressures of excess demand that the economy has experienced most of the time since 1966 have been nowhere more evident than in the labor market. The tight market that prevailed during most of 1969 showed up in many different ways. For the year as a whole, the unemployment rate was the lowest since 1953. In response to the heavy demand for workers, there was an abnormally large increase in the civilian labor force; the number of persons employed rose by 2 million to a record 77.9 million. The workweek remained long. Wage rates continued their rapid advance, and the rise in productivity came to a halt. Within the year, labor demand was less intense in the second half than in the first.

Employment

The increase of 2 million persons in the civilian labor force was not only some 600,000 greater than the average rise of the 5 preceding years, but it was the largest since 1946–47, after the demobilization of the Armed Forces. With their unemployment rates extremely low and labor force participation rates already high, adult men accounted for a significantly smaller proportion of the increase in total employment than in the 2 preceding years. Adult women and teenagers, apparently attracted by the ease of finding jobs, accounted for about three-fourths of the employment rise, a much larger proportion than in 1967 and 1968, when employment increases were not so great (Table 6). A large proportion of the jobs that women and young persons found last year were part-time jobs, which have been growing in importance over the past several years.

TABLE 6.—*Changes in civilian employment and distribution of change, 1965–69*

Year	Change from preceding year			
	Total employment	Both sexes 16–19 years	Females 20 years and over	Males 20 years and over
	Thousands of persons			
1965	1,783	520	727	536
1966	1,807	685	877	245
1967	1,477	−39	890	626
1968	1,548	98	884	566
1969	1,982	337	1,116	529
	Percentage distribution of change			
1965	100.0	29.2	40.8	30.1
1966	100.0	37.9	48.5	13.6
1967	100.0	−2.6	60.3	42.4
1968	100.0	6.3	57.1	36.6
1969	100.0	17.0	56.3	26.7

Note.—Detail will not necessarily add to totals because of rounding.

Source: Department of Labor.

The long-term downward trend in agricultural employment, which had slowed markedly in 1967 and 1968, accelerated in 1969. All of the major industry divisions in the nonagricultural sector recorded employment increases, but most of the gains were outside manufacturing, increases in construction and retail trade being especially noteworthy. The rise in manufacturing employment was moderate, far below the advances in 1965 and 1966 when the buildup for the Vietnam War was underway.

Unemployment

The average number of persons out of work in 1969 was almost the same as in 1968, and the unemployment rate edged down from 3.6 percent to 3.5 percent of the labor force. Most groups experienced decreased rates. The shortage of adult male workers, who account for nearly 60 percent of total employment and constitute the mainstay of the labor force, was especially evident last year. Their unemployment rate fell from 2.2 to 2.1 percent—the lowest for any year in the postwar period. Last year's 12.2 percent rate for teenagers was the lowest since 1957, and the 6.4 percent rate for Negroes and other nonwhite races combined showed a decline. Decreases occurred in the relatively unskilled occupations, but they were also significant among craftsmen and foremen (Table 7).

TABLE 7.—*Selected unemployment rates, 1961 and 1965–69*

[Percent]

Group of workers	1961	1965	1966	1967	1968	1969
All workers	6.7	4.5	3.8	3.8	3.6	3.5
Sex and age:						
Both sexes 16–19 years	16.8	14.8	12.8	12.8	12.7	12.2
Men 20 years and over	5.7	3.2	2.5	2.3	2.2	2.1
Women 20 years and over	6.3	4.5	3.8	4.2	3.8	3.7
Race:						
White	6.0	4.1	3.4	3.4	3.2	3.1
Negro and other races	12.4	8.1	7.3	7.4	6.7	6.4
Selected groups:						
White collar workers	3.3	2.3	2.0	2.2	2.0	2.1
Blue collar workers	9.2	5.3	4.2	4.4	4.1	3.9
Craftsmen and foremen	6.3	3.6	2.8	2.5	2.4	2.2
Operatives	9.6	5.5	4.3	5.0	4.5	4.4
Nonfarm laborers	14.7	8.6	7.4	7.6	7.2	6.7
Private wage and salary workers in nonagricultural industries	7.5	4.6	3.8	3.9	3.6	3.5
Construction	15.7	10.1	8.1	7.4	6.9	6.0
Manufacturing	7.7	4.0	3.2	3.7	3.3	3.3

Source: Department of Labor.

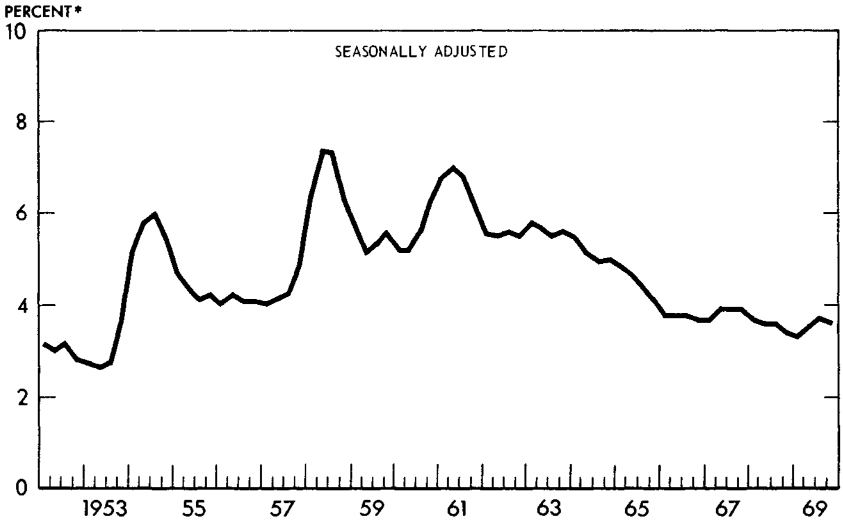
Although the demand for labor was strong through the year, it showed some easing as the year progressed, notably after midyear. In nonfarm establishments, employment increases, which had averaged 700,000 per quarter in the first half, fell to 300,000 per quarter in the second half. The length of the workweek in private nonfarm industries fell noticeably in the final quarter after remaining high and remarkably steady through September. The unemployment rate rose from 3.3 percent in the first quarter to 3.5 percent in the second and edged up further in the second half, showing little change, on average, from the third to the fourth quarter (Chart 5).

Productivity Changes

Output per man-hour for all employees in the private nonfarm sector recorded no change from 1968 to 1969. This was the poorest performance for productivity growth since the mid-1950's. The absence of comprehensive and detailed data makes it difficult to specify the reasons for this poor showing. The explanation probably involves two factors which differed in importance from industry to industry and time to time. One is that the slower rate of increase of demand and output itself limited the gains of productivity. Employers not only retained staff, technical, and other "overhead" workers as they usually do; they also expanded their work forces despite the slower sales rise in order to be prepared for a future higher level of demand. The consequence of combining this with slow growth of current output was a poor performance of output per man-hour. The other explanation is that productivity was limited by the shortage of labor, as evidenced by the low unemployment rates, especially for experienced workers. Employers were forced to turn to marginal workers such as teenagers and housewives, most of whom have relatively little work experience and a lower

Chart 5

Unemployment Rate



*UNEMPLOYMENT AS PERCENT OF CIVILIAN LABOR FORCE.
SOURCE: DEPARTMENT OF LABOR.

than average rate of productivity. Probably also as a result of labor shortage, absenteeism and turnover were both unusually high, which depressed productivity. Finally, under the conditions that prevailed in 1969, delays in the delivery of materials and equipment were common, especially in the capital goods sector, and production schedules were hard to maintain, at least through the summer.

Wage Changes

Since the demand for labor in recent years has been strong in relation to supply at existing wage rates, labor has been in a position to win large gains in hourly compensation. During this period, the rapid rise in living costs and expectations of further increases in the cost of living have added to labor's wage demands. Employers have bid up wages because of their own expectations that higher costs could readily be passed on in the form of higher prices.

Increases in average hourly earnings, excluding fringe benefits, were again very large in 1969 (Table 8). In construction and mining, where the demand for labor was extremely strong, hourly earnings showed their sharpest gains since 1951. In manufacturing, where the increase in labor demand was more moderate, the rise in earnings fell a little short of the increases in 1968.

TABLE 8.—*Increases in average gross hourly earnings of private nonagricultural production or nonsupervisory workers since 1960*

Industry	Percentage change per year					
	1960 to 1964	1964 to 1965	1965 to 1966	1966 to 1967	1967 to 1968	1968 to 1969[1]
Total private[2]	3.1	3.8	4.5	4.7	6.3	6.7
Mining	1.9	3.9	4.5	4.6	5.0	7.2
Contract construction	3.6	4.2	5.1	5.7	7.1	8.4
Manufacturing	2.9	3.2	4.2	4.0	6.4	6.0
Durable goods	2.8	3.0	3.9	3.4	6.3	6.0
Nondurable goods	2.8	3.1	3.8	4.9	6.6	6.2
Wholesale and retail trade	3.5	3.6	4.9	5.2	7.1	6.7
Wholesale trade	3.0	3.6	4.6	5.5	5.9	5.9
Retail trade	3.6	4.0	4.9	5.2	7.5	6.5
Finance, insurance, and real estate	3.3	3.9	3.3	4.5	6.6	6.2

[1] Preliminary.
[2] Includes transportation and public utilities and services, not shown separately in this table.

Note.—Data relate to production workers in mining and manufacturing, to construction workers in contract construction, and, generally, to nonsupervisory workers in all other industries.

Source: Department of Labor.

TABLE 9.—*Wage and benefit decisions, 1965–69*

Measure	Median annual rate of increase in decisions reached in—				
	1965	1966	1967	1968	1969[1]
Major collective bargaining situations:[2]					
Wage and benefit changes (packages):					
Equal timing[3]	3.3	4.0	5.2	6.0	7.4
Time weighted (actual timing)[4]	([5])	4.7	5.5	6.6	8.2
Negotiated wage-rate increases averaged over life of contract:					
All industries	[6] 3.3	3.9	5.0	5.2	7.1
Manufacturing	([5])	3.8	5.1	4.9	5.9
Nonmanufacturing	([5])	3.9	5.0	5.9	8.8
Negotiated first-year wage-rate increases:					
All industries	3.9	4.8	5.7	7.2	8.3
Manufacturing	4.1	4.2	6.4	6.9	7.1
Nonmanufacturing	3.7	5.0	5.0	7.5	10.5
Wage increases in manufacturing:					
All establishments	3.7	4.2	5.3	6.0	[7] 6.2
Union establishments	3.6	4.1	5.5	6.5	[7] 6.9
Nonunion establishments	4.0	4.4	5.0	5.0	[7] 5.8

[1] Preliminary.
[2] Except for packages, data are for contracts affecting 1,000 workers or more. Package cost estimates are limited to settlements affecting 5,000 workers or more (10,000 in 1965). The package cost of a few settlements affecting relatively few workers has not been determined.
[3] Based on estimated increases in hourly costs at end of contract period and assumes equal spacing of wage and benefit changes over life of contract.
[4] Takes account of actual effective dates of wage and benefit changes.
[5] Not available.
[6] Based on settlements affecting 10,000 workers or more.
[7] Data not available for year 1969; data apply to first 9 months of 1969.

Note.—Possible increases in wages resulting from cost-of-living escalator adjustments (except those guaranteed in the contracts) were omitted.

Source: Department of Labor.

Although 1969 was not a year of collective bargaining agreements on an extensive or major scale, the increase in wage rates and benefits won by unions was considerably above their gains in 1968. Pay raises were not only much larger in nonmanufacturing industries than in manufacturing—as was true in 1968—but the acceleration in comparison with that in the preceding year was also much greater in nonmanufacturing (Table 9). As in earlier years, "front-end loading" was common last year. This is the practice of concentrating a pay raise in the first year of a contract covering more than 1 year. It reflects attempts by unions to make up quickly for the erosion of prior wage gains because of rising living costs.

The combination of higher hourly compensation and no rise in productivity resulted in a 7-percent rise in labor costs per unit of output—the sharpest annual advance for employees in the private nonfarm sector since 1951. It was far above the preceding year's rise of 4 percent because of the pronounced difference in productivity performance (Chart 6). The rise in unit labor costs continued throughout the year.

PRICE MOVEMENTS

As a result of last year's pressures in the economy, all major price indicators—the comprehensive GNP price deflator, the consumer price index (CPI) and the wholesale price index (WPI)—rose more rapidly than in any year since 1951. Changes in GNP deflators by sector are shown in Table 10 while changes in the CPI and WPI are shown in Table 12.

The rise in the GNP deflator was intensified by the sharp advance in farm prices and by continued large increases in pay scales for Government workers and members of the Armed Forces. Although the price rise for the private nonfarm business sector (which produces about five-sixths of the GNP) was smaller than for the GNP as a whole, it represented a significant stepup over the preceding year's change.

TABLE 10.—*Changes in implicit price deflators for GNP, by sector, 1965–69*

Producing sector	Percentage change			
	1965 to 1966	1966 to 1967	1967 to 1968	1968 to 1969[1]
Gross national product	2.7	3.2	4.0	4.7
Private	2.6	2.9	3.6	4.5
Business	2.4	2.8	3.5	4.5
Nonfarm	2.0	3.2	3.5	4.3
Farm	11.5	−7.5	3.8	7.4
Households and institutions	4.9	6.6	7.7	4.2
General government	5.1	5.6	7.6	7.0

[1] Preliminary.

Source: Department of Commerce.