Wages, Productivity, and Prices

In view of the sluggishness of the economy, the main thrust of monetary policy during 1970 was directed toward achieving financial conditions that would stimulate demands for goods and services. At the same time, however, persisting inflationary pressures, generated mainly from the cost side, remained a very serious problem for the economy and a threat to the efficiency of its future performance. Thus, the interrelationships among wages, productivity, and prices that appear to be developing are critical factors in appraising the progress being made toward setting the stage for sustainable, noninflationary economic growth.

In the latter half of the 1960's, excess demand persisted for an exceptionally long period, with the unemployment rate dropping and remaining below 4 per cent. Strong demands for goods and services exerted upward pressures on prices, and the associated competition for labor resulted in sizable wage increases, which on the average exceeded gains in productivity. Price and wage increases became mutually reinforcing in an upward spiral.

During the latter half of 1969 and early 1970, the demand-pull component of the inflationary spiral was broken. Total real output of goods and services rose only moderately in 1969, and indeed had declined in the fourth quarter. In 1970 demands for goods and services continued weak while productive capacity continued to expand; there was a marked further reduction in the rate of capacity use in manufacturing and a considerable easing in labor markets. Under these circumstances, the persistent increase in 1970 in the principal indexes of prices resulted, for the most part, from continued pressures associated with costs. The dominating role of costs in the further price increase is indicated by the sharp decline in the ratio of prices to unit labor costs in manufacturing. This ratio, which had reached a high of 105 (with 1957-59 as 100) in the strong demand-pull inflation of 1965-66, had dropped to 97 by the end of 1969, and then declined further to 95 by the end of 1970. Concurrently with the decline in this ratio, after-tax profits per dollar of sales in

1970

Principal Federal Reserve Policy Actions, 1970: Digest

Principal Federal Reserve Policy Actions, 1970: Digest

Period, or announcement date	*Action*	*Purpose*
January	Directed that System open market operations be conducted with a view to maintaining firm conditions in the money market, while taking account of the desire of the Federal Open Market Committee to see a modest growth in money and bank credit, with a provision for modification of operations depending on the course of money and bank credit developments.	To foster financial conditions conducive to the orderly reduction of inflationary pressures, with a view to encouraging sustainable economic growth and attaining reasonable equilibrium in the country's balance of payments.
January 20	Increased maximum interest rates payable by member banks on time and savings deposits, effective January 21. This action, in combination with a minor further amendment on February 26 (retroactive to January 21) bringing rates on multiple-maturity deposits in line with those on single maturities, set the following maximum rates: (1) Passbook savings, raised from 4 to 4.5 per cent. (2) Other types of consumer-type deposits—those of less than $100,000—raised as follows:	To readjust the structure of maximum interest rates payable by member banks for deposits to bring it somewhat more in line with going yields on market securities and to set the stage for renewed expansion of bank credit; to bring about greater equity in the rates payable on smaller savings balances, and to encourage longer-term savings within the framework of continued over-all credit restraint.

Maturity	Rate (%) New	Rate (%) Previous
Multiple-maturity:		
30-89 days	4.50	4.00
90 days to 1 year	5.00	5.00
Single-maturity:		
30 days-1 year	5.00	5.00
Single- and multiple-maturity:		
1 to 2 years	5.50	5.00
2 years or more	5.75	5.00

(3) Time deposits of $100,000 or more, raised as follows:

Maturity	Rate (%) New	Rate (%) Previous
30-59 days	6.25	5.50
60-89 days	6.50	5.75
90-179 days	6.75	6.00
180 days to 1 year	7.00	6.25
1 year or more	7.50	6.25

February

Directed that System open market operations be conducted with a view to moving gradually toward somewhat less firm conditions in the money market, taking account of the Committee's desire to see moderate growth in money and bank credit over the months ahead, with a provision for modification of operations depending on the course of money and bank credit developments.

To foster financial conditions conducive to the orderly reduction of inflationary pressures, with a view to encouraging sustainable economic growth and attaining reasonable equilibrium in the country's balance of payments.

Principal Federal Reserve Policy Actions, 1970: Digest—Continued

Period, or announcement date	*Action*	*Purpose*
March through late May	Directed that System open market operations be conducted with a view to maintaining money market conditions consistent with the objective of moderate growth in money and bank credit over the months ahead, with a provision in effect during much of May for modification of operations as needed to moderate excessive pressures on financial markets, should they develop.	To foster financial conditions conducive to orderly reduction in the rate of inflation, while encouraging the resumption of sustainable economic growth and the attainment of reasonable equilibrium in the country's balance of payments.
May 6	Reduced the margin requirements on loans by banks, brokers and dealers, and other lenders for the purpose of purchasing or carrying registered equity securities from 80 to 65 per cent.	To be less restrictive in view of the sharp reduction in the use of credit for stock purchases.
	Reduced the margin requirements on such loans by these lenders against securities convertible into registered equity securities from 60 to 50 per cent.	
Late May through late July	Directed that System open market operations be conducted with a view to moderating pressures on financial markets while, to the extent compatible therewith, maintaining bank reserves and money market conditions consistent with the longer-run ob-	To foster financial conditions conducive to orderly reduction in the rate of inflation, while encouraging the resumption of sustainable economic growth and the attainment of

	jective of moderate growth in money and bank credit, with allowance after late June for a possible shift of credit flows from market to banking channels.	reasonable equilibrium in the country's balance of payments.
June 24	Suspended limitations on the maximum rate of interest member banks may pay on single-maturity deposits of $100,000 or more that mature 30 days or more but less than 90 days after date of deposit.	To facilitate meeting any unusual demands upon commercial banks for short-term credit accommodation that might occur as a consequence of serious current uncertainties in financial markets.
Late July through mid-August	Directed that System open market operations be conducted with a view to maintaining bank reserves and money market conditions consistent with the objective of moderate growth in money and bank credit over the months ahead, allowing for a possible continued shift of credit flows from market to banking channels, with a provision for modification of operations as needed to counter excessive pressures on financial markets, should they develop.	To foster financial conditions conducive to orderly reduction in the rate of inflation, while encouraging the resumption of sustainable economic growth and the attainment of reasonable equilibrium in the country's balance of payments.
August 17	Reduced reserve requirements against time deposits in excess of $5 million at each member bank from 6 to 5 per cent and applied a 5 per cent reserve requirement on funds obtained by member banks through the issuance of commercial paper by their affiliates, both actions to become effective in the reserve computation period beginning October 1 and be applicable to such deposits and commercial paper outstanding in the week beginning September 17.	To maintain the effectiveness of the reserve requirements of Regulation D by applying those requirements to funds received by a member bank as the result of issuance of obligations (commonly described as commercial paper) by an affiliate, and to provide a net release of reserves to the banking system.

Principal Federal Reserve Policy Actions, 1970: Digest—Continued

Period, or announcement date	*Action*	*Purpose*
Mid-August through mid-September	Directed that System open market operations be conducted with a view to maintaining bank reserves and money market conditions consistent with the objectives of some easing of conditions in credit markets and of somewhat greater growth in money over the months ahead than had occurred in the second quarter, taking account of possible liquidity problems and allowing bank credit growth to reflect any continued shift of credit flows from market to banking channels.	To foster financial conditions conducive to orderly reduction in the rate of inflation, while encouraging the resumption of sustainable economic growth and the attainment of reasonable equilibrium in the country's balance of payments.
Mid-September through mid-December	Directed that System open market operations be conducted with a view to maintaining bank reserves and money market conditions consistent with the objectives of some easing of conditions in credit markets and of moderate growth in money and attendant bank credit expansion over the months ahead, with allowance in the latter part of the period for temporary shifts in money and credit demands related to the auto strike.	To foster financial conditions conducive to orderly reduction in the rate of inflation, while encouraging the resumption of sustainable economic growth and the attainment of reasonable equilibrium in the country's balance of payments.
November 10	Reduced discount rates from 6 to 5¾ per cent at 6 Reserve Banks, effective November 11. (By No-	To bring the discount rate into better alignment with short-term in-

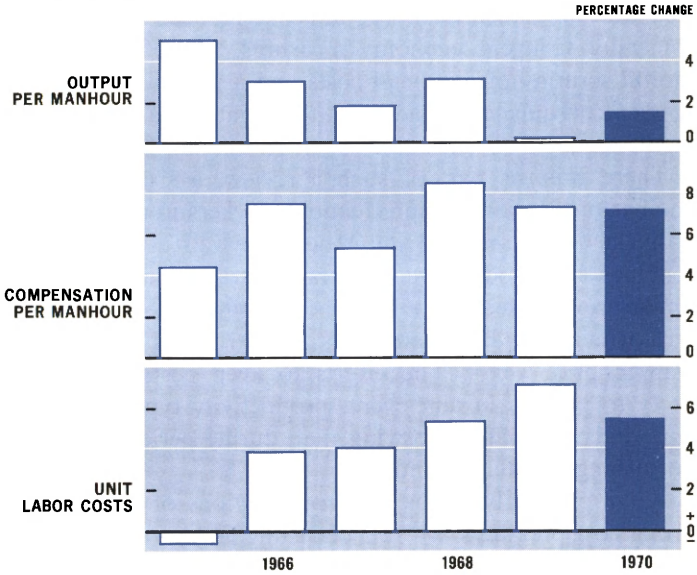
	vember 16, the 5¾ per cent rate was in effect at all Reserve Banks).	terest rates, in which reductions had recently taken place.
November 30	Amended rules governing member bank reserves (Regulation D) and foreign branches of member banks (Regulation M), effective January 7, 1971, to (1) raise from 10 to 20 per cent the reserve ratio applicable to a member bank's Euro-dollar borrowings to the extent that they exceed a specified reserve-free base and (2) apply an automatic downward adjustment feature to the minimum reserve-free bases applicable to Euro-dollar borrowings.	To give banks an added inducement to retain Euro-dollar borrowings in order to preserve reserve-free bases.
	Reduced discount rates from 5¾ to 5½ per cent at 5 Reserve Banks, effective December 1. (By December 11, the 5½ per cent rate was in effect at all Reserve Banks.)	To re-establish better alignment between the discount rate and short-term interest rates, in recognition of further downward movements that had recently taken place in the latter.
Mid-December through year-end	Directed that System open market operations be conducted with a view to maintaining the money market conditions recently attained, provided that the expected rates of growth in money and bank credit were at least being achieved.	To foster financial conditions conducive to orderly reduction in the rate of inflation, while encouraging the resumption of sustainable economic growth and the attainment of reasonable equilibrium in the country's balance of payments.

1970

manufacturing declined in 1970 to levels near the lows reached in the recessions of 1957-58 and 1960-61.

Nevertheless, some progress was made in 1970 toward moderating cost pressures. For the private economy as a whole, the rise in overall unit labor costs was smaller from the third quarter of 1969 to the third quarter of 1970 than over the preceding year—5.5 per cent as compared with 7 per cent. To avoid the distorting influence of the strike in the auto industry, Chart 4 shows changes between the third quarters of 1969 and 1970, rather than between fourth quarters as in preceding years. In the manufacturing sector, however, unit labor costs apparently increased more in 1970 than in 1969.

4. OUTPUT PER MANHOUR AND RELATED DATA



Bureau of Labor Statistics data for the total private economy. Changes are from fourth quarter to fourth quarter—except for 1970, which is from third to third.

The deceleration of the rise in unit labor costs in the private economy as a whole in 1970 was attributable to a resumption of productivity gains. After having shown little net change over 1969, output per manhour—accompanying gains in real output—rose appreciably in the second and third quarters of 1970; the annual rate of gain in

these two periods averaged about 4 per cent. Productivity in manufacturing also improved in that period, although the gain in output per manhour was a little less for that sector of the economy. It is difficult to evaluate the extent to which progress may have continued in the fourth quarter because sharp cutbacks in output resulting from the auto strike distorted the aggregate productivity figures at that time.

The increase in productivity during the middle quarters of 1970 is somewhat atypical since the largest gains in output per manhour are usually achieved during periods of rapid growth in output. However, the increase in real GNP was quite small in the second and third quarters, and manufacturing output was declining. Nevertheless, productivity gains were achieved as the sluggishness of demands, coupled with continued advances in costs, induced management to adopt unusually stringent economy measures. These measures included a careful scrutiny of overhead costs and a paring of conventional management perquisites, in addition to an intensive review of labor force needs.

There was, as part of such a review, a sizable reduction in the number of salaried (nonproduction) workers in manufacturing—especially in defense-related industries—as well as a cyclical decline in demands for production workers. In trade, finance, and services a similar review seems to have been going on, since the increase in employment in these industries in 1970 was substantially smaller than in prior years. The efforts to keep costs under control seem likely to persist; in any event, productivity typically increases faster in periods of cyclical upswing than during periods of recession or of sluggish aggregate demands.

While productivity has shown indications of a faster rate of gain, strong cost pressures are still persisting as hourly labor compensation (which includes wages, salaries, and fringe benefits) has continued to increase rapidly for the private economy as a whole. But while the increase in hourly compensation from the third quarter of 1969 to the third quarter of 1970 was not much different from that over the preceding year, it was smaller than during 1968. In the manufacturing sector, however, the aggregate increase in hourly compensation during 1970 was larger than over the preceding year, even though the rise was held down by reduced overtime pay resulting from a

shorter workweek and also by a shift away from the relatively high-pay durable goods industries.

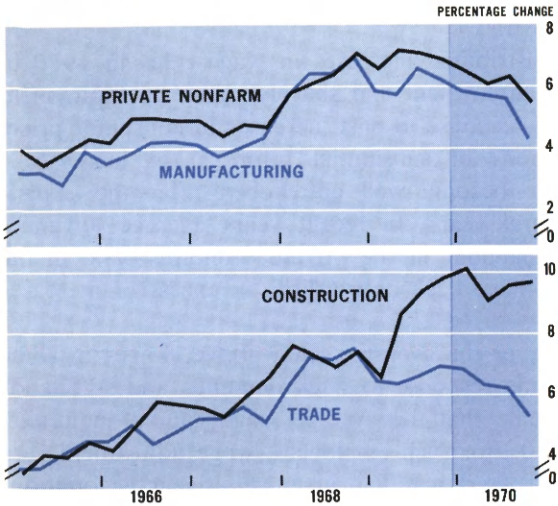
Large and widely distributed increases in wage rates in 1970 in the face of declining employment and sharply rising unemployment reflect in part a lagged response to past increases in consumer prices and in part expectations of substantial future price increases—expectations that have become well entrenched after the experience of the past several years. In recent years average advances in compensation per manhour in the private economy—and in the manufacturing sector—have been only a little in excess of increases in consumer prices.

Despite the behavior of the averages cited above, wages in some sectors have shown some response to slack demands and soft labor markets. Thus, it appears that the average wage gain of nonunion workers slowed in 1970. For such employees, wage adjustments are commonly made each year rather than in the multiyear negotiations that are typical of contracts involving unionized workers. In part because of this, wages in the nonunion sector appear to respond more quickly to cyclical changes in the demand for labor.

Nonunion workers are heavily concentrated in retail trade, finance, and other services. There was a marked slowing in 1970 in the advance of average hourly earnings in trade. On the other hand, the rise in average hourly earnings of construction workers remained exceptionally large—with year-over-year increases averaging 9 per cent in both 1969 and 1970. The substantial increase in earnings of this group reflects mainly the extraordinarily large increases for union workers. In manufacturing too, union workers received larger increases on the average in 1970 than did nonunion workers; furthermore, relatively more union than nonunion workers received wage increases—two-thirds as compared with only about one-third.

There has been a substantial escalation since 1968 in the size of wage increases negotiated in collective bargaining settlements—not only for first-year wage increases but also for the life of the contract. The increases provided in 1970 to cover the second and third contract years were well above the long-term trend of growth in productivity. Moreover, there has been some shift—after a lapse of many years—toward the incorporation in long-term contracts of escalator provisions based on the consumer price index and an insistence, as in

5. AVERAGE HOURLY EARNINGS



Change from corresponding quarter a year earlier, calculated from Bureau of Labor Statistics data, without seasonal adjustment.

recent contracts in the automobile industry, on an unlimited escalator. Since the amounts involved in such increases are, of course, unknown, they are not reflected in the data on the size of settlements negotiated. Relatively few workers are covered by escalator clauses; at the beginning of 1971 only about 3 million workers were covered by cost-of-living clauses providing for adjustments in wage rates tied to increases in the consumer price index.

In 1971 new wage agreements will be negotiated for nearly 5 million workers under major contracts in private nonfarm industries; this will make 1971 the second successive year of heavy collective bargaining activity. In the 1960's the largest number of workers covered by major contract settlements had been 4.6 million—in 1968. Moreover, in 1971 another 5.3 million workers already covered by multiyear contracts will receive deferred wage increases averaging 7.8 per cent—exclusive of cost-of-living increases—compared with an average deferred wage increase of 5.6 per cent in 1970.

The persistence of strong upward wage pressures raises questions concerning the extent to which market forces will moderate cost in-

TABLE 9: WAGE RATE ADJUSTMENTS IN MAJOR COLLECTIVE BARGAINING SETTLEMENTS

Mean percentage increases

Item	1968	1969	1970
All private nonfarm industries:			
Over life of contract	5.9	7.6	8.9
First year	7.4	9.2	11.9
2nd and 3rd year average	5.2	6.8	7.4
Manufacturing:			
Over life of contract	5.2	6.0	6.0
First year	7.0	7.9	8.1
2nd and 3rd year average	4.3	5.1	5.0
Construction:			
Over life of contract	8.6	13.1	14.7
First year	8.7	13.1	18.3
2nd and 3rd year average	8.5	13.1	12.9

NOTE.—BLS data. Major settlements are those affecting 1,000 workers or more.

creases as economic recovery proceeds in 1971. It seems likely that some cost abatement will develop, in part as a result of the business economies already undertaken and in part because the widely anticipated upturn in aggregate output may be associated with gains in productivity that are more rapid than those in recent years. But the underlying strength of wage demands, if they persist well in excess of likely gains in productivity, would pose a major threat to the containment of price inflation, not only for 1971 but also over the longer run. □