Wages, Prices, and Productivity

On the basis of past experience, the continued slack in labor and product markets that typified the year 1971 should have generated a pronounced slowdown in the rate of inflation. However, that did not happen. Whereas the rate of price increase did moderate in some sectors early in the year, much of the improvement reflected the influence of special factors instead of the usual forces of demand and supply. In general, wages and prices continued to increase at a rapid rate throughout the first half of the year. Workers sought higher wage increases to make up for past reductions in real purchasing power and to protect future gains in wages from expected further inflation. But businessmen too expected that inflation would continue, and since their profit margins were already low, they passed the higher labor costs on in the form of higher prices, where possible.

WAGES

Despite the relatively large amount of unemployment, compensation per manhour continued to grow at a rapid pace in the first half of 1971. Average hourly compensation in the private nonfarm economy increased at an annual rate of 7.2 per cent in this period, slightly higher than the 7.0 per cent increase for 1970 as a whole. Relatively large wage gains occurred in most industries, with the greatest being in contract construction and in transportation and public utilities. In manufacturing, average hourly earnings—after allowance for changes in the industrial composition of factory employment and for overtime—increased at a rate of 7.0 per cent in the first 6 months of 1971.

One factor contributing to the high rate of wage increases was the disproportionately large number of major long-term contracts expiring and new settlements negotiated in the latter part of 1970 and in the first half of 1971, including contracts in such highly visible and pattern-setting industries as autos, railroads, containers, and communications.

Another factor was that wage increases of many union workers, particularly in the manufacturing sector, had lagged behind price in-

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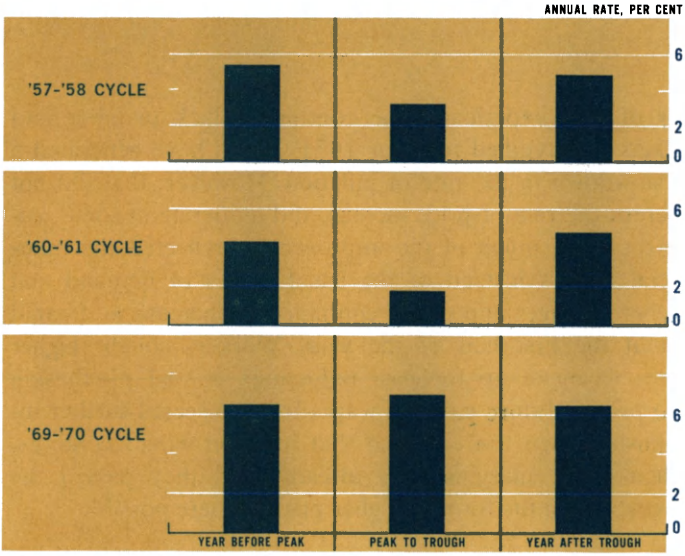
2. COMPENSATION PER MANHOUR
Changes in Recent Business Cycles



NOTE.—Bureau of Labor Statistics data, seasonally adjusted, for private nonfarm economy. Periods covered are as follows:

	1957–58 Cycle	*1960–61 Cycle*	*1969–70 Cycle*
Year before peak	1956 III–1957 III	1959 II–1960 II	1968 IV–1969 IV
Peak to trough	1957 III–1958 II	1960 II–1961 I	1969 IV–1970 IV
Year after trough	1958 II –1959 II	1961 I –1962 I	1970 IV–1971 IV

creases in the late 1960's. Consequently, there was strong pressure by union members to catch up on their wages. As a result, contracts were front-loaded—that is, they had larger increases in the first year than in following years. In manufacturing, first-year increases averaged 8.7 per cent in the first half of 1971; in nonmanufacturing, they were smaller than in 1970 but were still considerably larger than in manufacturing.

Contract settlements in the construction industry, which had been exceptionally high in recent years, moderated somewhat during 1971; this apparently reflected the efforts of the Construction Industry Stabilization Committee, which was set up in March 1971. Nevertheless, wage increases allowed in the construction industry continued to be much higher than the average for all workers.

A slowing in wage increases did become evident in some sectors. In trade and services, which are typically not unionized, the rate of advance in wage rates declined somewhat; among nonunion workers

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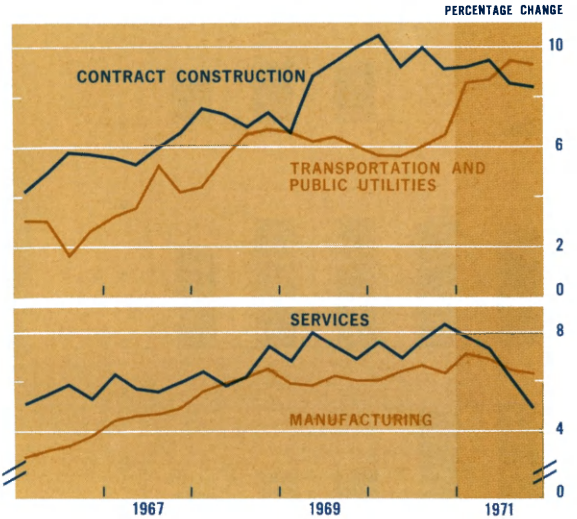
3. AVERAGE HOURLY EARNINGS



NOTE.—Change from corresponding quarter a year earlier, calculated from BLS data without seasonal adjustment.

in manufacturing also, wage increases moderated and were less than for union workers. Still, movements in wage rates in 1971 generally continued to respond less to slack demands for labor than in previous periods of relatively high unemployment.

PRODUCTIVITY AND UNIT LABOR COSTS

Despite continued rapid increases in wages, pressures on unit labor costs eased somewhat in the first half of 1971 as a result of a faster growth in productivity. Output per manhour in the private nonfarm economy rose at an annual rate of about 3.5 per cent in the second half of 1970 and the first half of 1971, after showing no gain in late 1969 and early 1970. Productivity increases for the manufacturing sector of the economy were slightly higher. The higher rate of productivity gains stemmed mainly from cost-cutting efforts by business, which sought to restrict increases in employment even after demand and output had started to expand. Hence, increases in unit labor costs slowed from a peak annual rate of more than 6 per cent for the private nonfarm economy in 1970 to about 3.5 per cent during the first half of 1971. Even though cost pressures were reduced,

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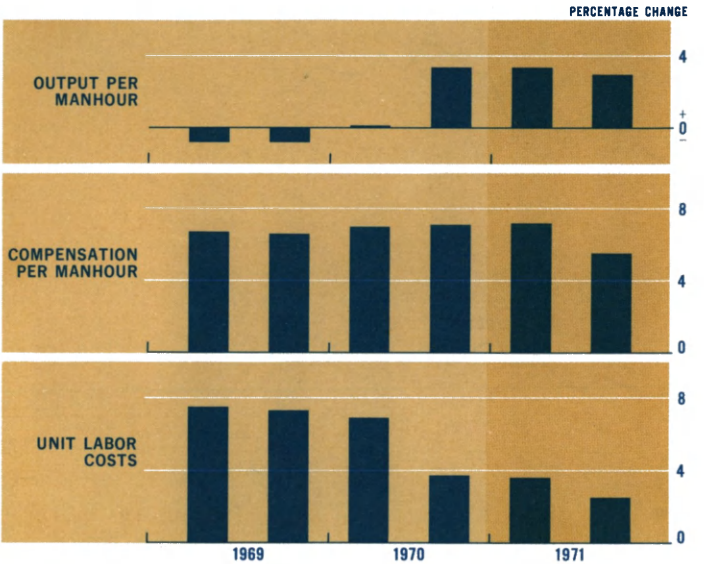
4. OUTPUT PER MANHOUR AND RELATED DATA



NOTE.—Changes, expressed at annual rates, are based on half-year averages of BLS data for the private nonfarm economy.

they were still strong enough to generate unacceptably high rates of price increase—since business was experiencing unusually low profit margins and was unwilling or unable to absorb higher costs.

PRICES

Against this background, only a few signs of abatement in the rate of price inflation were apparent during the first half of 1971. A significant reduction did occur in the rate of increase of consumer prices in the first quarter of 1971, but this improvement reflected in large part a decline in mortgage rates. In the second quarter the general level of consumer prices resumed a more rapid upward movement, increasing consumer and business doubts that inflation would be brought under control in the near future.

Wholesale prices of farm products and food began to rise again in early 1971. Inflationary tendencies were further intensified by a resurgence in the second quarter of price increases for industrial prod-

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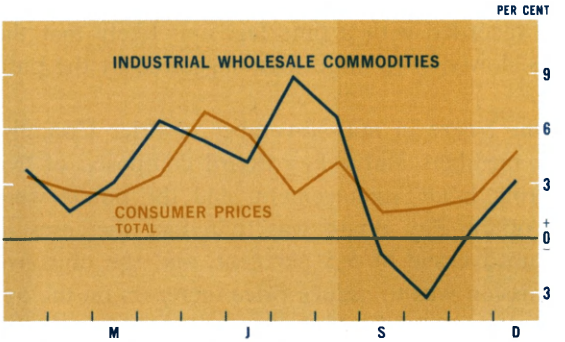
5. PRICES IN 1971



NOTE.—Month-to-month changes at compounded annual rate.

ucts included in the wholesale index; prices of these products had leveled off in the second half of 1970 and in early 1971. The resurgence reflected in part an upturn in the prices of materials. Prices of construction materials accelerated sharply as the housing boom gained momentum, and steel prices were increased in response to the build-up in inventories and in anticipation of higher labor costs.

The fixed-weighted deflator for gross private product—the broadest measure of the prices of goods and services produced in the private economy—also showed a continued rapid rate of increase. In the first half of the year the rise was at an annual rate of 5.4 per cent, more than the increase in 1970.

EFFECT OF THE NEW ECONOMIC PROGRAM

The acceleration of price increases in the second quarter was a factor in the re-evaluation of economic policy. The new economic program announced by the administration in mid-August included, as noted earlier, measures that temporarily stabilized wages and prices as part of a package to restrain inflation while promoting faster economic growth and restoring the basis for balance of payments equilibrium.

The 90-day wage-price freeze included in the program was quite effective. Gross hourly earnings of private nonfarm workers rose at an average annual rate of only 2.3 per cent between August and November. Wholesale prices of industrial commodities actually declined

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during this period, while the rise in consumer prices slowed to a 1.7 per cent annual rate. Moreover, since some price changes in the consumer price index are recorded with a time lag, it is likely that the rise in consumer prices slowed even more than suggested by the published figures.

Before the end of the freeze in mid-November, a Price Commission with seven public members and a Pay Board composed of five representatives each from labor, management, and the public were established. The goal of the Pay Board was to reduce increases in annual wage rates to an average of 5.5 per cent, and the objective set by the Price Commission was to reduce price increases on the average to a rate of no more than 2.5 per cent—a rate consistent with the Pay Board's guideline, given the expectation of a growth in productivity at the long-term average rate of about 3 per cent per year. The Price Commission stated that price increases generally would be allowed to cover cost increases, but only after productivity gains had been taken into account, and only so long as profit margins did not rise above the average of any two of the previous three fiscal years.

It was expected that after the end of the freeze there would be a period of transition—one in which wage and price increases would exceed the guidelines in part because of a bunching of increases deferred during the freeze. Also, in the early months the Pay Board was expected to have difficulty holding wage increases within the guideline because of wage contracts previously negotiated that called for either deferred or retroactive increases of more than 5.5 per cent. In December, the first full month after the freeze, average gross hourly earnings for private nonfarm workers increased at an annual rate of 6.8 per cent.

By the end of the year only a few decisions had been announced by the Pay Board. In the decisions covering coal miners and railway signalmen, wage increases well above the guideline were allowed because the contract settlements had occurred prior to the end of the freeze. For aerospace workers, the Board rejected a 12 per cent, first-year wage increase negotiated in a new contract concluded after the freeze and limited any increase in a new contract to 8.3 per cent. The contracts considered by the end of 1971 covered only a minor portion of the work force. Moreover, a vast majority of workers are employed by small companies that are excluded from the prenotifica-

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tion requirement. Thus, it is still too early to judge the ultimate effectiveness of Phase II in limiting wage rate increases.

The Price Commission requires that large firms give notification of intended price increases, and by the end of December a large number had filed such applications. The Commission appears to have had some success in reducing requested price increases. Moreover, in some instances where price increases were approved by the Commission, they have not been put into effect, due to competitive pressures. However, as expected, an acceleration of price increases occurred in the immediate postfreeze period. In December, the increase for consumer prices was 4.7 per cent at a compounded annual rate (Table 1); and for all commodities excluding food, it was 4.2 per cent. Wholesale prices of industrial commodities advanced at an annual rate of 3.2 per cent, with about half of the increase reflecting a rise in prices of autos and trucks. The implicit deflator for GNP rose at an annual rate of only 1.5 per cent in the fourth quarter—reflecting mainly the effects of the freeze.

In the second half of 1971, productivity rose at a 3.0 per cent annual rate in the private nonfarm economy while the rise in compensation per manhour slowed to a 5.5 per cent annual rate. As a result, the increase in unit labor costs was reduced to a 2.5 per cent annual rate. As economic activity continues to expand, productivity gains at least as large as those experienced in 1971 seem likely.

Table 1: PRICE CHANGES

Per cent

Series	Year				1971, compounded annual rate		
	1968	1969	1970	1971	Dec.–Aug.	Aug.–Nov.	Nov.–Dec.
Wholesale prices, total	**2.5**	**3.9**	**3.7**	**3.2**	**5.1**	**−0.8**	**8.9**
Industrial commodities	2.6	3.3	3.8	3.6	4.9	−1.3	3.2
Farm products, processed foods, and feeds	2.4	5.4	3.4	2.0	5.9	..	28.2
Consumer prices, total	**4.2**	**5.4**	**5.9**	**4.3**	**3.8**	**1.7**	**4.7**
Food	3.6	5.1	5.5	3.0	4.7	1.7	8.3
Other commodities (less food)	3.6	4.2	4.2	3.8	2.4	..	4.2
Services	5.2	6.9	8.1	5.6	4.5	3.1	3.7

NOTE.—Based on Bureau of Labor Statistics data.

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Wage pressures should be less in 1972 than in 1971, particularly if price increases are smaller. Most of the Pay Board's decisions relating to large contracts associated with the pre-freeze round of bargaining should be resolved early in 1972, and fewer major labor contracts are scheduled to be negotiated than in 1971. In addition, wage increases scheduled in existing contracts are smaller for the second and third years than for the first. If wage pressures are moderated and productivity gains are relatively strong, unit labor costs should come under appreciably better control. Moreover, such a slowing of the rise in labor costs would help to limit price increases. As price increases moderate, worker demands for wage increases in anticipation of future inflation should also abate, and thereby assist the Pay Board and the Price Commission in achieving their goals.

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