

COLLECTIVE BARGAINING AND INFLATION

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It is good to have this opportunity to discuss with you some vital issues relative to collective bargaining and price stabilization. The numerous proposals advanced in recent months to stabilize prices through direct government actions indicate the wide concern for our process of wage settlement. Proponents of direct action or guidelines point to the large negotiated wage increases in recent months as evidence that general monetary and fiscal stabilization actions are ineffective. It is my view that these sizable increases are to be expected following periods of excessive inflation.

Inflationary pressures developed strong momentum from 1965 through 1968 as a result of excessive spending fostered by overly expansive monetary and fiscal actions. Monetary actions were taken in early 1969 to reduce this excessive demand. Prices are now responding to these actions. The rate of price increase, using any of the commonly quoted indices, has declined since early last year. The course of the economy from an inflationary boom to growth at stable prices is not a costless transition. The nature of this course was brought sharply into focus in recent months by the continuing price and wage increases at a time of rising unemployment.

In my remarks, I shall first outline the course of the economy subsequent to the restrictive monetary actions that were taken. I will then discuss some problems of wage and price determination in the collective bargaining process and some proposals for smoothing the path of the economy during its adjustment to a lower rate of total spending growth.

In early 1969, when monetary action was first taken to reduce excess demand, resources for production were being fully utilized. The unemployment rate was down to 3.4 per cent, the lowest for any quarter since 1953. Although capacity utilization in manufacturing was somewhat below the levels of 1965 and 1966, a major investment boom was under way, indicating great demand for producer goods and equipment. The ratio of inventories to monthly sales in manufacturing and trade was below the average since 1957.

Reflecting the high level of resource utilization, the rate of gain in real output had declined in early 1969. Growth in real product had declined to a 3 per cent rate from a 4.8 per cent rate during most of the previous year. Spending, however, was maintained at an annual growth rate of 7.8 per cent, only slightly below the 8.8 per cent rate of two previous quarters.

Reflecting both the high rate of spending and resource utilization, price inflation was accelerating. Consumer prices, which rose at a 4.6 per cent rate from July 1967 to March 1969, increased at a 6.1 per cent

rate from March 1969 to April 1970. Wholesale prices and the general price index were likewise increasing more rapidly.

Reduction of Excessive Demand

This inflation like all others had its origin in monetary growth. It was caused by excessive total spending, which in turn was a result of excessive money creation. When the public has more money than it wants to hold, in relation to its expected income levels, it increases its rate of spending. Incomes are bid up to levels consistent with the increased stock of money. If real output is close to capacity, the rise in money incomes will be reflected mainly in price advances rather than increases in output. Conversely, a smaller quantity of money held by spending units than is consistent with expected income levels will cause a reduction in spending and relieve upward pressures on prices.

Given expected time lags, the inflationary buildup of 1965-68 and the slowdown of 1969-70 have followed this classic monetary pattern. From January 1967 to January 1969, the stock of money rose at a 7.6 per cent annual rate. Beginning in early 1969, monetary growth was slowed to about 5 per cent per year, and at mid-year the rate was reduced to almost zero. In early 1970, monetary growth resumed at a moderate 5.1 per cent rate.

Course of Economic Slowdown

Under ideal conditions, a slowdown in spending would not be a painful process. As spending units reduced their rate of spending, the upward pressure on prices would be eased. All markets would reflect this slower rate of demand growth. First, there would be a reduction in growth of demand for consumer goods and services. As producers received the lower demand signals through reduced sales, downward pressure would be exerted in the resource markets. Both labor and capital markets would reflect the reduced demand. Wage increases would subside, and nominal interest rates would decline, but employment and production would remain unchanged.

Unfortunately, this ideal functioning of the labor and other markets has not been realized in adjustments of modern industrial economies to lower levels of demand growth. The response to a reduction in total demand varies widely from one sector of the economy to another. Such variations not only cause hardships in employment, incomes, and profits but also prolong the period required for achieving relatively stable prices following a prolonged period of inflation.

As an example of this wide variation in response to reduced demand, let's take a carpet manufacturer. Our hypothetical manufacturer may have been operating at full capacity. During the inflationary stages of the business cycle, labor was in short supply,

and he negotiated regular wage and salary increases with the union. Each manufacturer was trying to hire the other's workers. In the early stages of the upswing, rising wages simply reflected higher profit incentives. The higher profit incentives resulted from increased demand for carpets.

Carpets are a type of good which consumers can purchase either now or in the future depending on their financial situation. When the rate of monetary growth was reduced, they found themselves with less money than anticipated. Spending on carpets was reduced or held constant, and our hypothetical carpet manufacturer quickly accumulated an excessive inventory. He was then forced to hold the line on prices or make price reductions in order to reduce inventory levels and maximize profits. If the manufacturer did all the work himself, he would doubtless accept lower returns to both his labor and capital and would continue to operate at full capacity by reducing the price on carpets until all that he could produce cleared the market.

In most instances, however, carpet manufacturers will first reduce hired labor costs by cutting the hours worked and eliminating overtime. Then if the profit incentive is not sufficient to maintain current output, they will lay off workers until the reduced output of carpets will clear the market at a profitable price.

If we take into account the thousands of other employers in similar situations, we can see why the economy's path toward price stability has not been a smooth or costless route. The recent rise in unemployment attributed to a decline in civilian spending was further aggravated by a sharp decrease in employment attributed to a cutback in defense expenditures.

In many instances, especially in the building trades, the bargaining power of unions has been sufficiently strong in wage negotiations to reduce the number of workers demanded at the higher wage rate after a sizable amount of unemployment developed. Nevertheless, labor unions cannot ignore supply and demand forces. This higher level of unemployment resulting from excessive bargaining power reduces the upward pressure on wages and prices. A growing number of unions realize that excessive wage gains lead to a reduction in the number of workers that firms will retain and will often moderate their wage requests during periods of slackening demand. Even in extreme cases there are limits to attainable wages. Such limits are provided by labor substitutes such as capital equipment, incentive for new technology, "do-it-yourself" techniques, and the rising threat from nonunion labor especially during periods of sizable unemployment.

Proposals for Improving Labor Markets

The disparity of adjustment in the various sectors of the labor market to reduced demand growth has led to numerous proposals for improving this market's performance during the current slowdown. Most proposals involve increased governmental action toward restraining wages and prices. Proponents of this view believe that monetary and fiscal restraints on total spending alone are not sufficient to reconcile price stability and a high level of employment.

Concurring with this view, the Committee for Economic Development recently stated that the percentage gains from major labor settlements negotiated in the first half of 1970 were well above those of a year earlier and more than three times those in 1964. To many businessmen such an observation indicates permanent incompatibility between the nation's goals of high employment and stable prices. In view of this incompatibility, they propose an "incomes policy," which when stripped of its diplomatic veneer, simply means some form of governmental action in wage and price determination.

Such arguments imply that wage and price determination by government guidelines or other methods of control provide greater welfare than wages and prices

which are determined through the collective bargaining process. In reply, I suggest that

- (1) The impact of collective bargaining settlements on the average price level has been greatly overstated.
- (2) The so called cost-push impact is essentially a short-run phenomenon. In the long run neither average prices nor total employment are greatly affected by excessive union bargaining power;
- (3) The guidelines and other government control proposals are neither workable nor compatible with a free society; and
- (4) Alternative government actions could be taken that will improve the functioning of the labor markets and at the same time avoid most flaws of governmental pricing. Furthermore, these actions will benefit both workers and consumers.

Overstatement of Collective Bargaining Power

Beginning with the first point, much of the impact on average prices attributed to excessive collective bargaining settlements more likely results from expectations of further inflation. First, it is my view that unions have sufficient bargaining power to negotiate wages much above equilibrium rates in only a few sectors of the economy. Even in these limited

sectors if wages and prices become excessive during a high level of unemployment, the unions face the prospect of major inroads from nonunion workers. It is estimated that only about two-thirds of nonresidential construction workers and no more than 20 to 40 per cent of those in residential construction are unionized.^{1/} The St. Louis Globe Democrat reported on March 3 that there is "deep concern among both the unions and unionized contractors over the inroads made by nonunion construction firms." Even in the absence of the nonunion factor, price and wage increases in such sectors are limited. All such increases, which reduce sales and increase layoffs, have a sobering effect on future bargaining.

As indicated by the large per cent of nonunion workers, not all construction price and wage gains of recent years can be traced to excessive bargaining power. Much of the wage increase in this sector thus may reflect the unattractive features of such employment. In this case, additional wage incentives are appropriate.

Larger wage increases than merited on the basis of supply and demand conditions for labor will create inefficiencies in the economy and cause problems in the allocation of resources. Furthermore, if labor unions through excessive bargaining power are able to obtain a larger share of real product, they will have

^{1/} Further Weapons Against Inflation, Committee for Economic Development, Nov. 1970.

a retarding effect on economic growth. The returns to capital will be reduced, and a lower than optimum rate of capitalization will result. It is my belief, however, that this problem of excessive bargaining power should be solved by improvement of the labor markets rather than through efforts to control wages and prices.

Cost-Push Impacts: Short-Run

Next let's briefly examine my belief that any cost-push impact on prices following periods of excessive demand is of short run duration unless accompanied by further monetary growth. Upward pressure on prices which results from collective bargaining will lead to layoffs if not accompanied by higher product demand. Those workers who are laid off will eventually obtain jobs elsewhere unless total demand continues to decline. This will tend to offset the wage gains and the higher prices in sectors where unions have excessive bargaining power.

Controls and Guidelines Unworkable

I will now set forth in detail my view that most alternative proposals to the collective bargaining process are neither workable nor compatible with our ideas on freedom. Although all-out war conditions are much more favorable than those at present for the implementation of direct controls, some of you will remember the numerous problems of administering the Office of Price Administration (OPA) during World War II. The number

of workers required to operate and enforce this program was staggering. By 1944, 325,000 price control volunteers^{2/} in addition to 65,000 paid employees^{3/} were being utilized.

When direct controls were used throughout the economy from March 1942 to October 1946, the consumer price index rose 6 per cent a year, and there is fairly general agreement that the index understated the actual rate of inflation because of black market operations and the declining quality of products. Wages rose at a slightly faster rate than consumer prices. Finally, in 1946, after a year of post-war domestic crises including numerous strikes, food shortages, and a high rate of inflation, most provisions for direct controls were ended.

Some proponents of an "incomes policy" suggest that controls on wages and prices should be limited to guidelines or voluntary wage-price policies rather than legally enforceable controls. It is my belief that such actions are useless. If conditions are such that wage rates can be increased through collective bargaining beyond levels dictated by the guideposts, I can imagine great flexibility in the morals and ethics of those to

2/ U.S. Office of Price Administration, Renewal of the Price Control Act, Congress, House Banking and Currency Committee, April 12, 1944, p. 58.

3/ U.S. Department of Commerce, Statistical Abstract of the United States, 1946, p. 207.

whom the guides apply. The social responsibility argument calls for major conflicts of interest on the part of union negotiators. The rewards to union members are in inverse proportion to the virtue demonstrated. Both for those who have blind faith in the guidelines and for the profit maximizers, the choice of action is easy - the former to obey and the latter to ignore them. For other Americans, the decision of whether or not to obey the guidelines is difficult.

Furthermore, if guidelines are effective, they perform all the functions of legal controls and have all the undesirable attributes of such controls. Someone must determine the appropriate wages and prices to assure a level of output that will just clear the market. I doubt that we have such wisdom lodged in either governmental or private agencies.

Even if a voluntary "incomes policy" were workable, it violates basic freedoms of our society. It invites the use of additional legal power of the government to produce compliance. Most business concerns could have major costs imposed on them through threats of anti-trust and tax investigations or ultra-rigid enforcement of other regulations. In fact, few of us are completely free of potential harm from governmental excesses. Thus, both voluntary and legally imposed controls open the door wider for more extensive government power. Government power used for apparently good purposes today, such as holding down wages and prices, may be used for less desirable purposes at some other date.

Greater Benefits Through Alternative Actions

Finally, there are actions which the government can appropriately take within a free market framework to improve the current situation. These alternative actions offer greater opportunity for welfare gains than do efforts to directly control wages and prices. I would first suggest further relaxation of import restrictions. The resulting increase in worldwide competition would tend to stabilize prices for all goods and services traded in the international market. The removal of archaic building codes would aid the construction industry. In addition, I would suggest the removal of some serious bottlenecks to labor entry into some sectors, especially construction. Action should be taken to completely eliminate discriminatory restrictions on entry into unions. Relatively higher pay scales for trainees after attaining moderate skills might be helpful in attracting more labor into sectors of short supply. Where bottlenecks to entry are retained through union action, I would suggest the application of anti-trust legislation.

Chairman Burns of the Federal Reserve Board of Governors has suggested the expansion of Federal training programs to increase the supply of skilled workers where wages are rising with exceptional rapidity, the suspension of the Davis-Bacon Act to help restore order in the construction trades, and the modification of the minimum wage laws in the interest of improving job opportunities

for teenagers.^{4/} I heartily concur with these suggestions and recently the Davis-Bacon Act was suspended. It seems to me that unions would prefer these proposed alternative actions to direct wage and price controls. Such controls actually replace a major union function while these measures would greatly improve the functioning of our labor markets.

SUMMARY

In summation, economic activity does not adjust painlessly from excessive demand and rapid inflation to relative price stability. Prices continue to rise long after the rate of increase in spending and output declines. The various sectors decline at uneven rates.

Labor markets adjust to the lower rate of demand growth through workers being laid off and accepting new jobs at lower wages elsewhere rather than through across the board wage adjustments within each firm or industry. This inefficient method of wage determination prolongs the period required to achieve price stability. The lags in price and employment adjustment to the slower rate of spending growth may extend over a three or four year period. During such periods of adjustment we often hear the warning that the price system is not working. Proponents of this view contend that cost-push forces emanating from collective bargaining are not subject

^{4/} Arthur F. Burns, "The Basis for Lasting Prosperity," (Paper delivered at the Pepperdine College Great Issue Series at the Beverly Hilton Hotel, Los Angeles, California, December 7, 1970), p. 22.

to supply and demand forces. This argument was made in the early 1950's, and it is being made again in the current slowdown.

The implication is that the Government must prevent prices and wages from rising in the private sector through legal prohibitions or other devices. Currently, an "incomes policy" is being proposed to meet assumed failures in the labor market.

It is my belief that the so-called excessive wages negotiated in collective bargaining are not as serious as indicated by the proponents of wage-price guidelines and direct controls. If the stock of money is insufficient to support inflation, higher wage agreements cause unemployment in these sectors. This is a restraining influence because excessive unemployment in any sector tends to reduce the bargaining power of the union.

Market distortions caused by a more moderate rate of demand growth are temporary, and Government regulations once in effect tend to become permanent. Workers laid off as a result of the slowdown will get other jobs eventually, and the shift will have little impact on average wages or prices.

Efforts to control wages and prices through guidelines or by force have never been successful when accompanied by excessive monetary expansion. Under the more favorable conditions of World War II, direct controls suppressed prices only slightly. The laws

were revealed soon after the fighting ceased despite the excessive demand for goods and services. The guidelines are an invitation for governments to use extra-legal power and are, in addition, a major source of conflict between personal gain and social responsibility.

Alternative proposals for improving the labor markets offer greater opportunities for success than the direct approaches proposed. Freedom of entry, reduction of discrimination, rewards to trainees in relation to productivity, and elimination of minimum wages are fruitful areas for government action. A broadening of anti-trust laws may be necessary in some instances where bottlenecks to entry are maintained. Organized labor should look upon each of these measures more favorably than direct controls since the latter obviates one of the major functions of unions.

Finally, inflations are caused by monetary excesses. Consequently, a slower rate of money growth is the solution to the problem. We had labor unions and collective bargaining covering a greater percentage of our labor force in the early 1950's but still halted a major post-World War II inflation with a slower rate of money growth. The economy is again moving along a similar course toward price stability. We have a relatively high level of unemployment, and the welfare of consumers and capital owners has declined. These are the prices we pay for earlier excesses in money creation.