

**THE FIGHT AGAINST
INFLATION: BAREBONE,
JAWBONE, OR LAWBONE?**

**THE WAGE-PROFIT
BATTLEGROUND**

**SERVICES:
BRIDGE OVER
TROUBLED
CITY WATERS?**



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. . . Immediately appealing policies may involve undesirable long-run costs.

The Wage-Profit Battleground

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Services: Bridge Over Troubled City Waters?

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The Fight Against Inflation: Barebone, Jawbone, or Lawbone?

by Mark H. Willes

When the nation's policymakers set about to engineer a slowdown in the economy, the objective was to halt inflation without precipitating large increases in unemployment. Now many observers claim these policies have failed. Analysts note that prices are still rising at an excessively rapid clip and unemployment is higher than it has been in almost a decade.

Doubts about the effectiveness of the traditional tools of monetary and fiscal policy, therefore, grow more insistent. Many argue that these "old" techniques are woefully inadequate in the face of today's problems, and that more refined (or drastic) methods like the use of an incomes policy are required if we are to achieve price stability while providing jobs for those willing to work.

Calls for an incomes policy are based mainly on a legitimate concern for the severe social costs of dealing with inflation in the usual monetary and fiscal way. Yet no one

really knows how effective or desirable an incomes policy would be. It may be that some types of incomes policies are valuable tools in the policymakers' bag. If so, their use could be beneficial. On the other hand, incomes policies might involve some risks which could be quite serious. In fact, there is some possibility that these policies might do more harm than good.

INSIDE THE TOOL KIT

Policymakers have a large number of options to choose from when they want to change policy in pursuit of short-run economic stabilization. They can alter tax rates or expenditure programs, engage in operations to influence bank reserves or interest rates, call for voluntary action "in the public interest," or change the legal and administrative rules under which individuals and firms operate.

If we simplify greatly, we can put these

various tools into three classes or general approaches to policy:

1. The *barebone approach* to policy includes the traditional tools of monetary and fiscal policy. In the current fight against inflation, such an approach would suggest that policymakers keep total demand in the economy low and unemployment high long enough until price stability is restored. It can be called the barebone approach because that creates visions of bare bones in the cupboards of the unemployed.

2. The *jawbone approach* to policy includes attempts to talk down wage and price increases. In the current situation, this would be done either by calling on individuals and firms to recognize that moderation in their demands is in everyone's best interests or, in the extreme, by calling them names if they fail to abide voluntarily by some implicit or explicit guideline.¹ It can be called the jawbone approach because that identifies the main point of action. Another name for this approach is moral suasion, but some suggest it be dubbed the hot-seat approach.

3. The *lawbone approach* includes all forms of mandatory wage and price controls. These controls could be set specifically by law or by administrative fiat under some broad legal authority. The name lawbone connotes the rigid strength of such measures and the maze of legal and administrative entanglements that might follow.

CHOOSE YOUR WEAPON

Each policy approach has its advocates and detractors. Far too often, however, the debate draws more on conviction than fact, with the result that one side rarely persuades the other. To some extent, this is probably unavoidable, since so little information about the important issues is available. This

lack of information is probably one reason why many who formerly considered any form of an incomes policy anathema are now joining the ranks of those calling for significant steps in that direction. It's not that they are convinced that an incomes policy will work. Rather, they are so frustrated by rising unemployment when inflation is still steamed up that, failing to see persuasive facts to the contrary, they figure an incomes policy is worth a try.

What Do We Know? But more facts are available than is generally recognized. Most of us can agree, for example, that overly expansive monetary and fiscal policies in the middle sixties set off an inflationary buying binge. Similarly, most observers agree that those initial bursts of "demand-pull" inflation set in motion significant cost-push elements in the economy as workers and businessmen tried to keep ahead of rising prices.

There are some additional facts which are widely accepted but are not generally recognized to be relevant to the current situation. One of these is that abstracting from all other factors, when the price of some good or service goes up, buyers ordinarily will want to purchase less of it. Another is that while those who produce goods and services may be willing to increase their output and sell it at the current price as long as they have a fair amount of unused capacity, at some point they will only produce more if they can get a higher price. This is mainly because in order to produce that additional output, they will have to use less efficient and, therefore, more costly machines or workers or both.

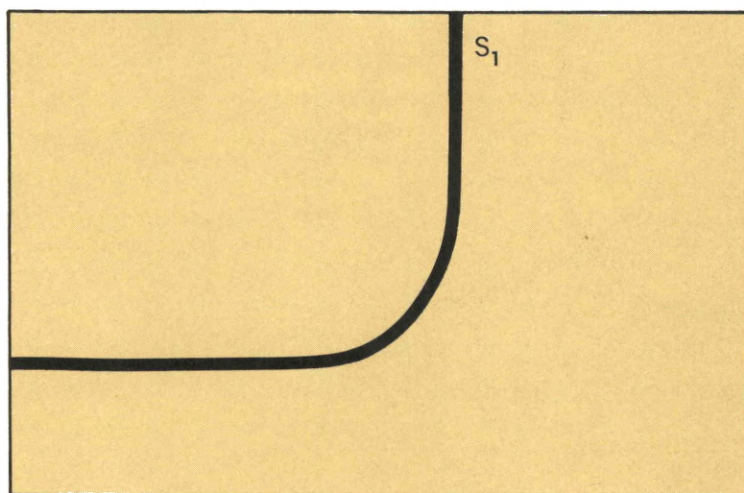
Put It All Together. If we put these few facts together into a unified framework, we can go a long way towards explaining why it is so hard to stop inflation without causing an increase in unemployment. We can also show what an incomes policy is designed to

¹ Threats of additional, more onerous measures can also be used to persuade people to consider the public interest in their price and wage decisions.

CHART 1

AS THE ECONOMY'S TOTAL SUPPLY OF GOODS AND SERVICES INCREASES, THERE COMES A POINT WHEN PRICES RISE AS THE LAST OF THE ECONOMY'S RESOURCES ARE PRESSED INTO USE.

PRICES



OUTPUT

do and what some of the risks might be.

Chart 1 reflects the fact that given sufficient demand for their products and holding other things—especially wages—constant, producers will increase their output of goods without raising the prices they charge so long as there is a fair amount of excess machine capacity, raw materials, and labor available. Beyond some point, however, they will only produce additional output if they can sell it at a higher price. As the economy comes closer to using all of its available labor and other resources, less skilled workers and older and less efficient machines must be used, and materials supply and production bottlenecks begin to appear. These factors make it more expensive to produce additional goods and services, so producers will only do so if they can sell their products at higher prices. Once

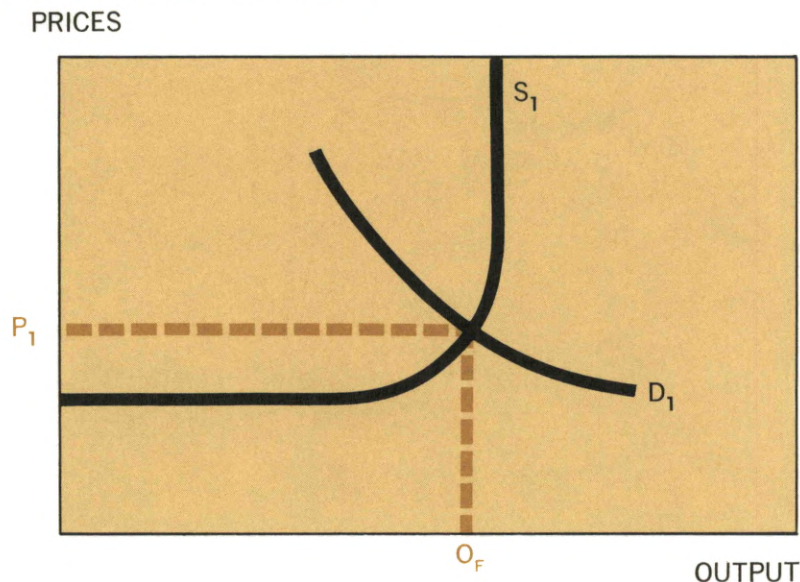
all labor and other resources are in use, the amount of output produced in any given period cannot be increased further. (Producers merely bid against each other for the same resources.) This is shown by the vertical portion of the curve in Chart 1. This S_1 curve is the aggregate or total supply curve for the economy.

In addition to the aggregate supply curve, Chart 2 shows the economy's total demand curve (D_1). This demand curve reflects the fact that abstracting from other influences, as the prices for goods fall, people will want to buy more of them. For example, more new cars will be purchased if the price per car is \$2,000 than if it is \$3,000.

The point where the aggregate supply and demand schedules cross shows what prices and output would be once the economy were in equilibrium (which simply

CHART 2

THE AMOUNT OF OUTPUT PRODUCED AND THE PRICES AT WHICH IT IS SOLD IS DETERMINED BY THE INTERSECTION OF TOTAL SUPPLY AND DEMAND



means that no pressures are operating to change prices or output).

Suppose that the economy is in equilibrium as shown in Chart 2, and that prices and output have been stable for a long time.² Assume also that this equilibrium is at a point where the demand for goods and services is sufficiently large that the economy is operating at its full employment level (O_F).³ In this case, prices might well stay at

the level indicated by P_1 , and we would have both full employment and stable prices.

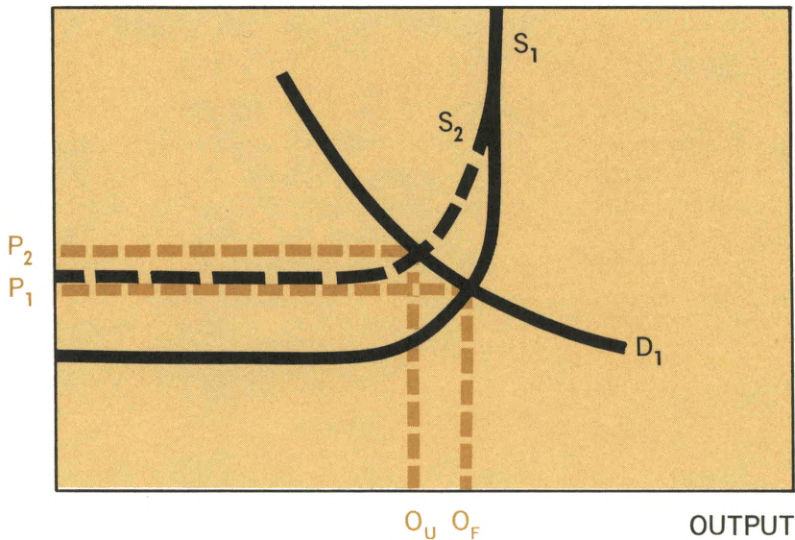
Cost Push and The Barebone Approach. Now suppose that the economy is at the point given by the intersection of D_1 and S_1 in Chart 2, but it got there only after experiencing a sharp and sustained increase in prices (as was the case for the U. S. economy in the late 1960's). In this case, the equilibrium is probably temporary, and the economy is unlikely to stay put. Many workers and businessmen, having seen the value of their income eroded by inflation, may well expect more of the same in the future. Consequently, they will want to protect themselves against future price increases. Labor will bargain for wage increases in excess of productivity gains, and businessmen will seek higher profit margins. If either is successful, the economy's supply curve will shift upward (to S_2) as shown in Chart 3. This

² It is obvious that the whole analysis in this article abstracts from economic growth. This simplification is made to keep the exposition as manageable as possible. The major conclusions of the analysis would not be significantly altered if growth were incorporated.

³ As indicated on the chart, "full employment" is usually considered to be at some point below the complete utilization of all resources, which is represented by the vertical portion of S_1 . In the definition of full employment, some allowance is always made for certain amounts of frictional unemployment. Similarly, some unused plant capacity would exist at that point as well.

CHART 3 A SHIFT IN THE SUPPLY CURVE MEANS UNEMPLOYMENT

PRICES



OUTPUT

is because, at any level of output, producers will now ask a higher price, either because their wage bills (per unit) have gone up, or they have increased the profit they require on each unit sold. This is what is meant by cost-push inflation, because, as can be seen in Chart 3, aggregate supply and demand now intersect at a higher level of prices (P_2).

But cost push may lead to more than an increase in prices. It may also lead to a decline in output and, therefore, an increase in unemployment. As shown in Chart 3, given a cost-push shift in the total supply curve, unless total demand is allowed (or prodded) to increase correspondingly, the economy goes to a new point where output is less than it was before (O_U). This is because as prices rise, if income and other things do not change,⁴ people will buy

fewer goods and services. As a consequence, producers will not be able to sell as much as before, so they will not need as many workers and will, therefore, lay some off.

It is just this softening of demand and increase in unemployment that advocates of the barebone approach to policy count on to bring inflation in tow. If demand is slack enough for a long enough period, businessmen will stop raising prices for fear of suffering still further erosion in their markets and, hence, profits. And with trimmed-down profit margins and little, if any, room for price increases, employers will be tough at the bargaining table because they will know they can't afford excessive wage increases. This resistance will make it

increase in income and a simultaneous shift in the demand curve. The analysis at this point assumes offsetting policy actions are taken so that income and, therefore, demand remain at the same level as before the increase in wages and prices.

⁴ The increased wages and prices resulting from the cost-push shift in the supply curve would lead to an

difficult for workers to improve their position, but they may be more willing to settle for less, since the alternative might be to lose their jobs. Once inflation is squeezed out of the economy, so the argument goes, you can then move back towards full employment. If you don't try to go too fast or too far,⁵ you can get there and remain there with essentially stable prices.

Cost Push and Full Employment. If the

⁵ It is not clear exactly how far it is desirable to go. Presumably, you would want to use monetary and fiscal policy to push unemployment down to its "natural" rate—the lowest rate consistent with stable prices. Beyond that point, reductions in unemployment could best be made by structural or selective policy approaches. A problem would arise, however, if the natural rate were higher than the rate desired by the public. No one knows what the natural rate for the United States is, but recent evidence suggests that it is higher than 3.5 per cent, cited as a target by many. If that is the case, attempts to push unemployment down to that level would set off inflation all over again.

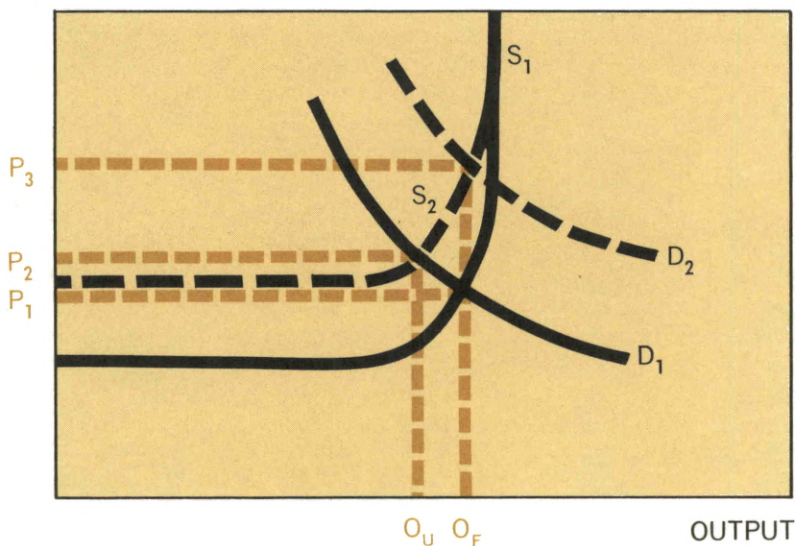
economy faces cost-push pressures, but society decides that it does not want to tolerate a temporary increase in unemployment in order to stop it, two choices are available. The cost-push pressures can be validated by permissive or expansionary monetary and fiscal policies, or attempts can be made to hold those pressures in check through persuasion or legislation.

The first choice is shown in Chart 4. Cost-push pressures shifted the aggregate supply curve up (from S_1 to S_2), so monetary or fiscal policies allowed or encouraged a boost in aggregate demand in order to get the economy back to full employment. This is shown by the shift in the aggregate demand curve from D_1 to D_2 .⁶

⁶ Whether monetary and fiscal policies would need to be stimulative or merely permissive would depend on what happened to aggregate demand as a consequence of the increased income flowing from the higher wages and profit margins which caused the shift in the supply curve.

CHART 4 IF DEMAND IS INCREASED TO KEEP FULL EMPLOYMENT, THEN PRICES WILL RISE

PRICES



OUTPUT

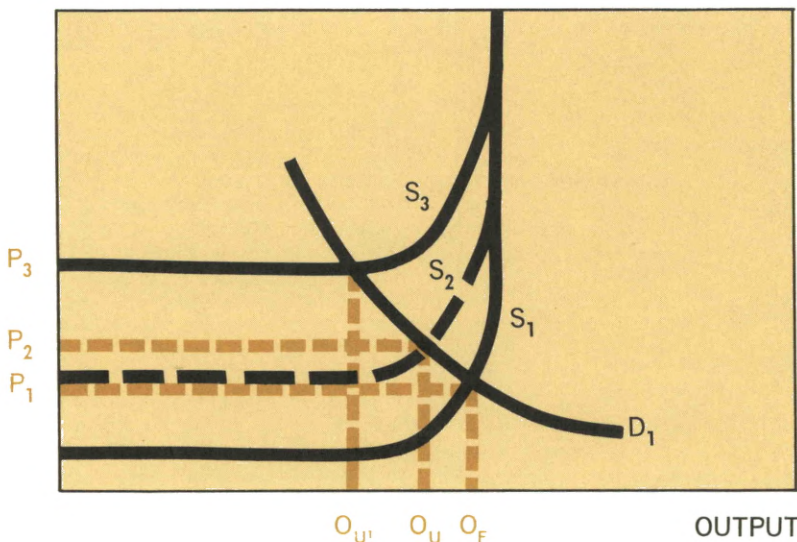
But opting for this approach to the problem is unlikely to make things better. In fact, it could make them worse. While it is true that wages and profits have gone up, it is clear from Chart 4 that prices have gone up as well (from P_1 to P_3). So labor and business are no better off than they were before. They have failed to make gains in purchasing power, and in the process of trying, prices have been driven up even faster. In the absence of soft markets and unemployment, this round of price increases could well lead businessmen and workers to expect similar or even faster price boosts in the future.

Given this situation, business and labor might well demand even larger price and wage increases as they try to keep ahead of inflation. If their demands are met, the total supply curve of the economy will shift up by a larger amount than it did the first time. If this shift were again validated by monetary and fiscal policies (which would again

shift the total demand curve up) in order to keep unemployment from rising, prices would rise even faster than before. Escalating prices could lead to even greater cost-push pressures, and, in the end, what could happen is that it would take accelerating rates of inflation to keep the economy at full employment. That is, in order to hold unemployment at the full employment level, we might see prices rise by 5 per cent, then 6 per cent, then 7-8-9 per cent and more. The longer the process were allowed to run, the greater the increase in unemployment it might take to finally bring inflation under control. This is because the aggregate supply curve would be shifting up by larger amounts each time. And, as shown in Chart 5, if demand is held in check, the higher the shift in the supply curve, the greater the increase in unemployment.

Cost Push and Incomes Policies. The other approach to the problem of cost-push

CHART 5
GREATER COST-PUSH PRESSURES MEAN HIGHER
UNEMPLOYMENT
PRICES



pressures is to jaw- or law- them down. In effect, an attempt is made through the use of moral or legal suasion to prevent price and wage hikes which shift the aggregate supply curve up. If such attempts are successful, and the economy is at full employment but does not suffer from excess demand, then we will be in the situation shown in Chart 2. Prices will be stable (at P_1) and output will not drop, so unemployment will not rise.

Although the lawbone approach might be effective in holding down wage and price increases, few people have the stomach for this method on a permanent basis. Bad memories of bureaucratic price fixing, gray markets, and misallocation of resources when such a procedure was last tried on an extensive basis make almost everyone shy away from such drastic measures. Moreover, to many, this alternative seems inconsistent with the basic freedoms upon which our form of government and society are founded.

A growing number of people do advocate the lawbone approach as a *temporary* measure, however. Freeze wages and prices for six months, they urge, and then the problem will be solved.

No one can really say what the effects of a temporary freeze would be. It might work. Or it might merely delay the effects of cost-push pressures.

And there is some possibility that it might even backfire. Recognizing that if a freeze can be imposed once, it can be imposed again, once the initial freeze thawed, labor and business might press even harder for wage and price increases so that they could get as much as possible before the next freeze were clamped on.

Many who steer clear of the lawbone approach advocate the jawbone as an alternative. The main question is whether or not it would work. Perhaps the main difficulty with jawboning is that people generally bargain for what is good for them, not for society, since they feel they have some control over

their own situation but very little effect on the state of the economy. With the past record of inflation, most people anticipate future inflation. It is, therefore, likely that workers and businessmen will ask for hefty increases in wages and prices, since they know any individual action by itself will have little direct effect on the overall price level, and each bargainer can legitimately claim that he should be able to forestall expected losses in purchasing power. Unfortunately, with everyone trying to get ahead, they may only have to work harder to stay where they are.

The challenge of jawboning is to change people's attitudes so that they include the public interest. The evidence is not encouraging. No outstanding success story for this approach can be found anywhere in the world. Recently, Britain and Canada have suffered serious setbacks in their jawbone campaigns. Earlier, in this country, a voluntary guideposts policy collapsed when inflationary expectations (and losses) were much lower than they are now.

FRYING PAN OR THE FIRE?

Inflation is difficult to contain. The longer it goes, the more rapidly it may grow.⁷ If it is not dealt with quickly and decisively,

⁷ A number of scholars would disagree with this statement. Recent theoretical and empirical work, however, suggests that it may be more correct, especially in the current context, than most of us would like to believe. The argument is essentially one as to the stability and/or shape of a Phillips-type curve which relates the unemployment rate to the rate of change in prices. Recent theoretical work is providing a more rigorous basis than has been available up until now for the notion that attempts to keep unemployment below its "natural" rate will require increasing rates of change in prices. While empirical verification of this theory is still meager, past estimates of fairly stable and nicely shaped Phillips-type curves do not provide strong evidence against it. Most of those curves were fit over periods when the unemployment rate probably was not below the natural rate, at least not for very long. In addition, inflation has now been more severe for a longer period than it was when these earlier studies

more radical and painful procedures might be required to bring it in tow. Consequently, those who argue that moderating inflation now requires the payment of too high a price may be confusing the frying pan with the fire. Failing to pay the price to lower inflation now may actually mean that a higher price will have to be paid to do it later.

Unfortunately, we have a bad inflationary problem for which there are no cheap solutions. Imposition of rigid quotas or controls—the lawbone approach—might involve misallocation of resources, inequities, and reduction in individual freedom. The costs of such an approach would probably increase the longer the controls were in force. Yet, as already noted, if controls were only temporary, they might not be effective and might even be perverse.

A jawboning approach could also run some serious risks. The most significant of these is the possibility that it would not work.⁸ Should that be the case, time taken to implement and evaluate an incomes policy might allow inflation to grow that much worse. It would then be even more

difficult and costly to stop. In addition, introduction of a jawboning policy might make policymakers feel they could follow a somewhat more expansionary policy than they otherwise would. If policy were eased, and then jawboning failed, inflation would be much worse than before, and the cost of reining it in would be significantly greater than if the jawbone approach had not been used in the first place.

The barebone approach is a costly alternative as well. The loss of output is high. The personal and social suffering is tragic.

Many observers have suggested that better job training and job matching, reduced concentrations of economic power in business and labor, and many other measures could help reduce the level of unemployment that triggers and fuels inflation. But those are long-run solutions. As important and necessary as they are, they will provide little help for the current problem.

In the short run, prices must either be lawboned, jawboned, or bareboned into line. The task of policymakers is to choose that policy or combination of policies to hold down inflation that will hurt the least.⁹ The challenge is to base the decision on careful analysis of long-run risks and costs, as well as the pressures of the moment. ■

were made. Moreover, because of past events and Government pronouncements, more people than ever before are convinced that unemployment will not be allowed to rise very high or for very long. These and other factors make it seem likely that people's expectations about aggregate demand, unemployment, and prices might be quite different than in times past. This makes the use of parameter estimates of the relation between unemployment and inflation based on historical experience of questionable value in the current situation. Conditions are certainly ripe for the kind of developments predicted by those theories which suggest only a fleeting tradeoff between inflation and unemployment.

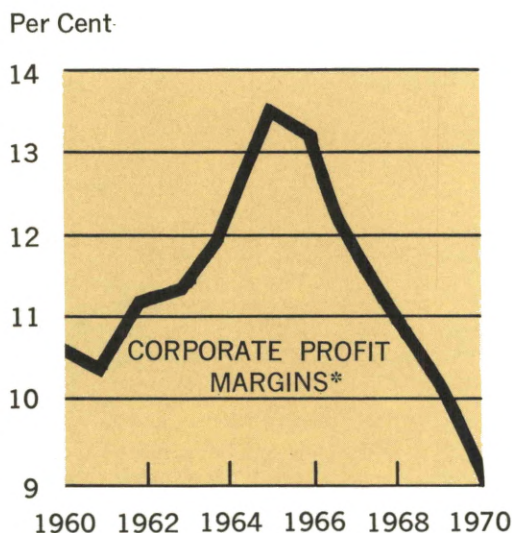
⁸ And, as in the case of lawboning, problems of resource allocation and equity might be severe.

⁹ Perhaps some additional thinking about the barebone approach is needed. Unemployment is undesirable because it hurts people. Unemployment compensation and other programs help. But there might be ways to put some additional meat on the bone and still provide a damper on prices. Some form of graduated negative income tax is one such possibility. If rates were set correctly, people would have an incentive to work, because they could earn more if they did; but if a job were not available, they would still have enough income to feed and house their families. No one knows exactly what the effects of such a plan would be, but they seem worth exploring.

The Wage-Profit Battleground

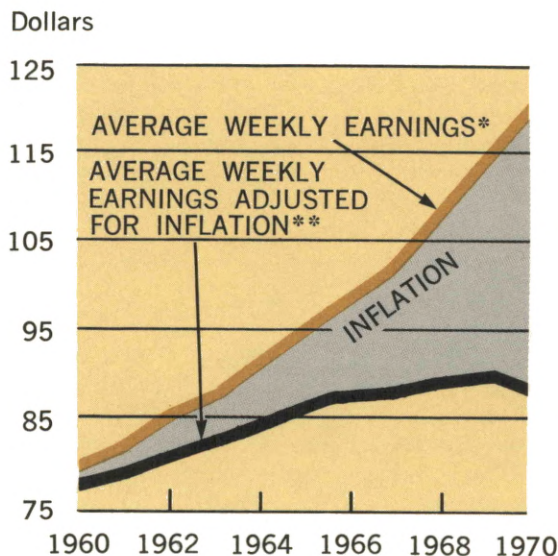
by Kathleen C. Holmes

Although paychecks have become fatter and fatter, prices have risen faster and faster. Consequently, workers have gained little over the last several years in terms of the amount of goods and services they can actually purchase.



*Ratio of after-tax profits to income originating in the corporate sector.

Source: U. S. Department of Commerce, Bureau of the Census.



*Earnings of production or nonproduction workers on private nonagricultural payrolls.

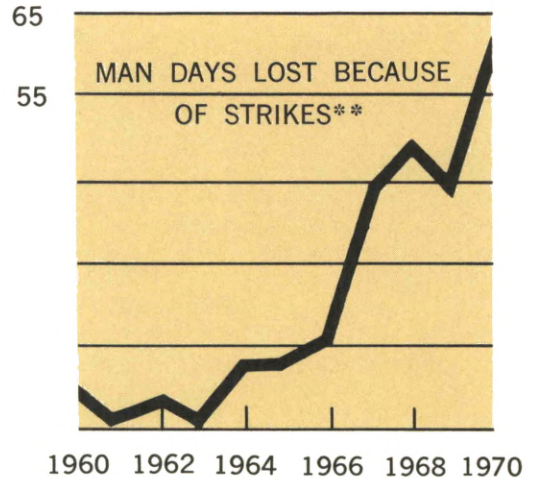
**Average weekly earnings divided by the Consumer Price Index (1957-59=100).

Source: U. S. Department of Labor

At the same time, corporations have also been caught in a squeeze. Soaring costs and sluggish sales have reduced profit margins to their lowest level since World War II.

Because the purchasing power of their members has remained at a standstill for so long, unions sought big wage boosts in 1970. But, with shrinking profit margins, business attempted to put a tight lid on rising costs. With both sides battling for opposite ends, the outcome has been a surge in strike activity resulting in lost wages and sales, as well as aggravation and hardship for consumers.

Man Days Idle*

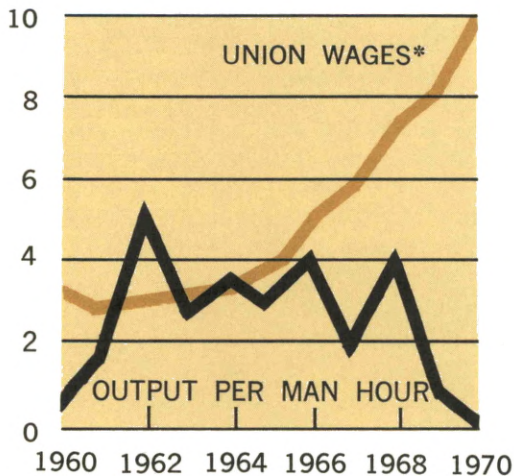


*In thousands.

**All known strikes or lockouts involving 6 or more workers and lasting a full day or longer.

Source: U. S. Department of Labor

Percentage Change



*First year wage changes in contracts negotiated during year involving 1,000 or more workers, manufacturing and selected non-manufacturing industries.

Source: U. S. Department of Labor

Yet the wage-profit battleground in 1970 was only a symptom of the underlying problem—four years of rapid inflation. During this period, organized labor won wage boosts well in excess of labor productivity gains. Narrowing this gap between gains in labor productivity and wage hikes in 1971 would go a long way towards taking the steam out of inflation. If that doesn't happen, we may expect even bigger and more socially disruptive labor-management shoot-outs in the future.

Services: Bridge Over Troubled City Waters?

by Elizabeth P. Deutermann

"The problem of the cities is perhaps the most critical domestic issue with which this country has been confronted since the Civil War, if not since the founding of the Republic." . . . Senator Edmund S. Muskie.

To most Americans, the city is a problem. For physically separated suburbanites, the impact of the urban dilemma looms in proposals for revenue sharing and metropolitan government. For millions of *other Americans* who cannot readily move from problems of crime, high unemployment, racial tensions, poverty, and fiscal bankruptcy, the urban crisis dominates daily living.

Yet, for a few optimists, the city holds some promise as well as problems—promise worthy of investment. Hence, they are bidding up prices of apartments and townhouses on Beacon Hill, in Georgetown, and around Rittenhouse Square. Some are investing in downtown office towers, while others continue to fork over rising rentals for commercial space within. What economic rationale is there for this disparate behavior

on the part of a small minority of urban Americans?

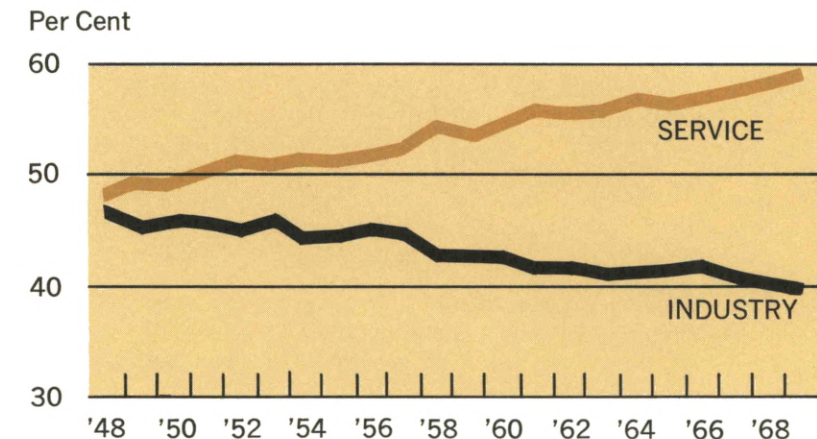
Perhaps the justification is that the city can do best what the nation is doing most. This is the essence of a popular argument for the future economic viability of large urban centers. The idea is that problem-beset cities are not likely to benefit from growth of most kinds of economic activity—particularly heavy industry—because they cannot compete with more spacious parts of the country. Urban centers can, however, offer competitive advantages for service industries. And since underlying trends in the national economy favor growth of services, they will continue to stimulate future economic vitality in the urban core.

STICKING WITH WINNERS

Certainly, national trends do reverberate in regional economies. When a basic industry declines nationally over a long period of time, regions heavily dependent on that industry often become depressed areas. For-

CHART 1 THE NATION SHIFTS TO A SERVICE ECONOMY

SECTOR EMPLOYMENT AS A PERCENTAGE OF TOTAL EMPLOYMENT, 1948-1969, U.S.



Source: U. S. Department of Commerce

tunately, the opposite is also true. For example, Cape Kennedy and Route 128, around Boston, boomed with a national upsurge in space and electronics. Similarly, growth prospects of cities have brightened with the emergence of the U.S. as a service economy.

The shift from an industrial to a service economy took place shortly after World War II, as shown in Chart 1. Prior to that time, over half of the employed population was producing tangible goods—food, clothing, houses, and automobiles. But shortly after the war, the U.S. became the first nation in the world to employ most of its labor force in the production of services—education, health, government, advertising, and trade—for people and for other businesses. And since 1947, six out of seven new jobs added in this country have been service jobs.

This dramatic shift in how the nation is employed, delineated in the Table, does not imply the advent of an industrial decline. On the contrary, the output of both goods and services has grown at almost the same speed

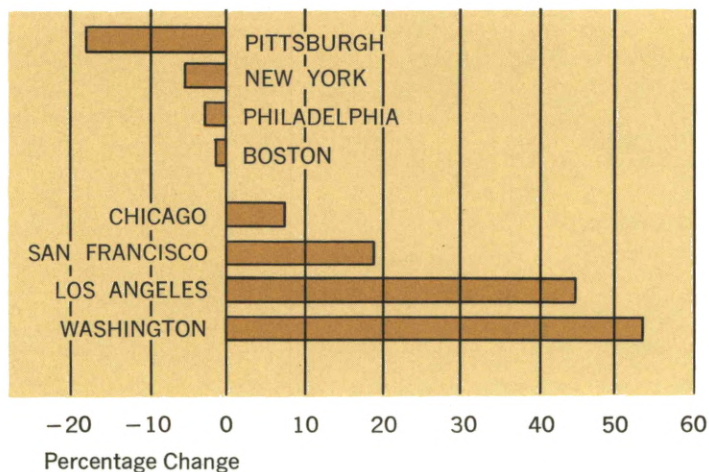
since 1929. The increase in output per man, however, has not been nearly as rapid in services as in industry.¹ Consequently, for each new dollar spent, more jobs have been added in services than in commodity production.

The expansion of service employment has been even more pronounced in large metropolitan areas than in the rest of the country because of a migratory trend of manufacturers towards rural locations. In eight such areas, which together employ a fourth of the nation's workers, nine out of ten new jobs generated in the past two decades have been in noncommodity production. Furthermore, in half of the regions shown on Chart 2, where industrial jobs are contracting, services have become the mainstay of local economies. Employment opportunities continue to expand in regions such as Philadelphia only as service jobs proliferate in excess of industrial declines.

¹ Victor R. Fuchs, *The Service Economy* (New York: Columbia University Press, 1968).

CHART 2 INDUSTRY NO LONGER EXPANDS IN SOME METROPOLITAN AREAS

PERCENTAGE CHANGE IN INDUSTRIAL EMPLOYMENT, BY
METROPOLITAN AREA, 1952-1969

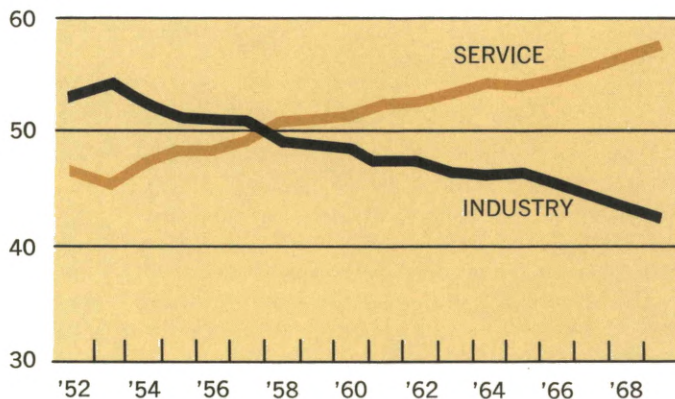


Source: U. S. Department of Labor

CHART 3 THE PHILADELPHIA AREA JOINS THE SERVICE ECONOMY

SECTOR EMPLOYMENT AS A PERCENTAGE OF NONFARM
PAYROLL EMPLOYMENT, 1952-1969, PHILADELPHIA SMSA

Per Cent



Source: U. S. Department of Commerce

CATCHING UP IN THE DELAWARE VALLEY

The Delaware Valley was somewhat slower than the nation to surface as a service economy. Throughout the Korean War, job opportunities in the area's large manufacturing complex continued to lure in-migrants as they had for over a century. As late as 1952, 54 per cent of the region's labor force was still employed in goods production. (See Chart 3.) But in the ensuing 20 years, industrial attraction of the region diminished with the loss of over 20,000 jobs.

Growth of service employment more than compensated for industrial contraction. Following a late start, service jobs in the Philadelphia metropolitan area mounted even more rapidly than in New York, Boston, or Pittsburgh. Employers primarily accountable for the rapid expansion are those producing business and personal services—including advertising agencies, hospitals, and colleges and universities. Offices of state and local governments added the second largest cadre of new workers, followed closely by wholesalers and retailers catering to the booming suburban population. Finance, insurance, and real estate offices are the fourth major source of the region's total service expansion—325,000 new jobs since 1952.

Clearly, the Delaware Valley has emerged as a service economy, as shown on Chart 4. Of all workers employed in the area today, 57 per cent produce services, and fewer than one in three are employed specifically by manufacturers. But even within manufacturing, employment is shifting towards white-collar, labor intensive, and intangible production. For example, hidden in head counts of manufacturing employees are a growing number of workers performing service jobs in offices and laboratories located away from production facilities. Indeed, there has been a 50 per cent increase over the last 15 years in advertising, marketing, and other "intangible personnel" in manufacturing. When added to those working specifically for service industries, a more

complete picture of the new noncommodity orientation of the regional economy develops.

BUCKING ODDS IN THE CITY

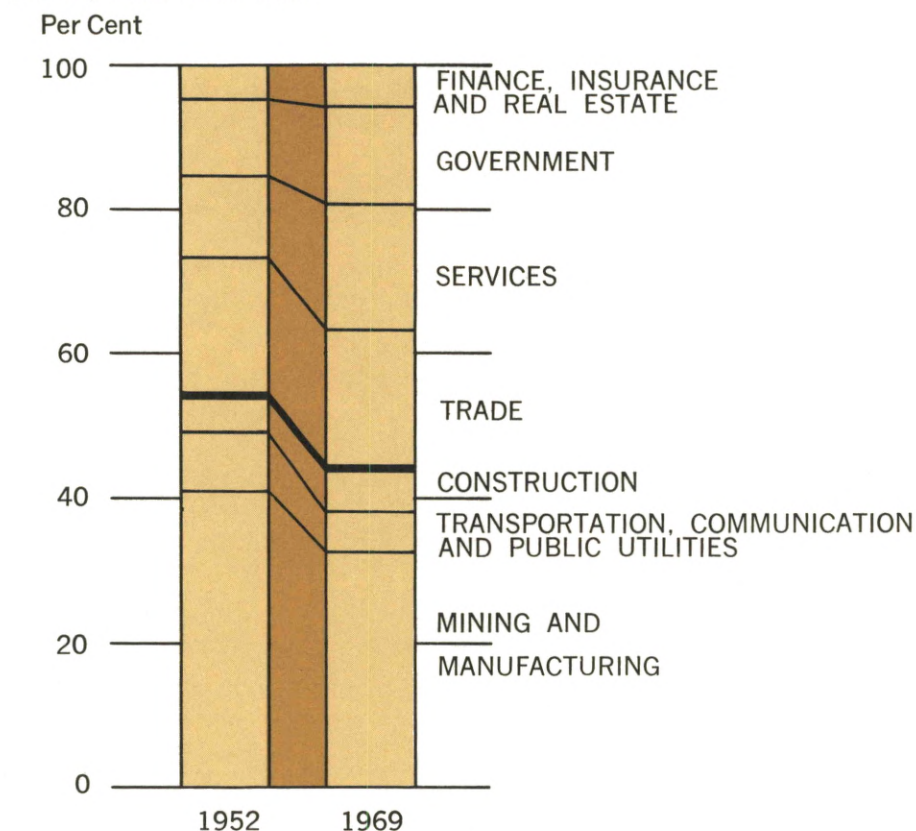
The industrial decline of the Delaware Valley took its toll in the core city of Philadelphia, where the only jobs that increased in recent years were those with service employers. Along with other large cities of the Northeast—Boston, New York, and Pittsburgh—Philadelphia's industrial complex began to shrink drastically following World War II. The trend continued throughout the sixties as 50,000 industrial jobs—primarily in manufacturing—were moved, phased out through technological change, or wiped out in company cutbacks. In contrast, service employment pushed upward, adding 25,000 jobs over the past decade.

Why do services continue to provide strength in an otherwise sagging city economy? Perhaps less dramatic technological change among services—in contrast to other industries—makes it unnecessary for them to seek open space for one-floor, acreage-eating operations. Hence, services can more readily build up, making them promising occupants for high-rise—and high-priced—office towers. Nevertheless, available space would remain available—and low-priced—unless the city offered service producers an economic advantage sufficient to outweigh the heavy costs deterring other employers from in-town expansion.

One likely advantage is the congestion of the city. In spite of its industrial decline, the City of Philadelphia continues to be the most concentrated center of business activity in the region, as shown on Chart 5. This concentration, rather than repelling services, may attract them and facilitate their growth. A large number of business establishments squeezed into a small area may make it more efficient for lawyers, auditors, architects, computer consultants, and assorted executives to meet readily, on a

CHART 4 EMPLOYMENT GROWTH IN THE DELAWARE VALLEY IS SERVICE GROWTH

PERCENTAGE SHARES OF EMPLOY-
MENT BY TYPE IN THE PHILADELPHIA
SMSA, 1952 AND 1969



Source: U. S. Department of Commerce

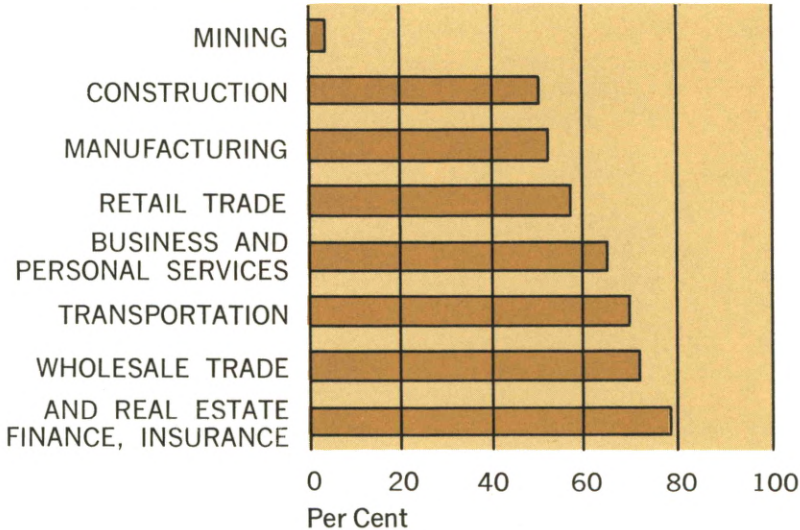
face-to-face basis, and transact necessary business that can be handled only in person.

Indeed, this appears to be the case in Philadelphia. On one hand, a number of services not very dependent on confronta-

tions between executives have been rippling into the rest of the region in the same fashion that heavy industry did. These are services which are clearly responsive to growing residential markets, not transac-

CHART 5 AREA BUSINESS ACTIVITY CONCENTRATES IN THE CORE OF THE REGION

EMPLOYMENT IN PHILADELPHIA COUNTY AS A PERCENT
OF FIVE-COUNTY SOUTHEASTERN PENNSYLVANIA EM-
PLOYMENT, BY TYPE OF BUSINESS, 1969



Source: Pennsylvania Bureau of Employment Security

tions over conference tables. On the other hand, services which aim primarily at business markets—and place a premium on personal negotiations—have been manifesting a strong inclination to expand in the core city.

Not to Serve Residents. At first glance, the city does not seem to offer any special advantage for service employers. Moreover, suburban areas of southeastern Pennsylvania appear more attractive.² Of the 93,000 service workers of all types added to the region

over the past decade, the great majority—63 per cent—located outside the City of Philadelphia. This includes the bulk of the region's growth in retail trade. It also includes wholesale operations, which indicated a decided preference for the less congested portions of the region by expanding only in the suburbs and contracting within the urban core.

Furthermore, the city has not been exerting much of a pull on certain types of business and personal services. For example,

² While it would be desirable to examine detailed service growth for the entire metropolitan area, comparable data are not available for New Jersey counties.

The discussion which follows applies to the Pennsylvania counties of Bucks, Chester, Delaware, Montgomery, and Philadelphia and excludes New Jersey counties of Burlington, Camden, and Gloucester.

regional growth of the following services took place entirely outside the central city: personal services—such as laundries, barber shops, and crematories; miscellaneous repair services; amusements and recreation; motion pictures; and nonprofit membership organizations—including Boy Scouts, labor unions, and United Funds. Within Philadelphia, these services all experienced employment declines. And even though the five service producers shown at the top of Chart 6 continued to expand in the city, over 50 per cent of their regional employment growth located in the suburbs.

But To Serve Other Businesses. In contrast, services which do business primarily with other businesses, and not with the residential population, have demonstrated a preference for space in Philadelphia. Miscellaneous business services—so named by the U.S. Department of Commerce—is one of these. Of all new employees added to the region over the sixties by producers of miscellaneous business services, 58 per cent went to work in the city. Although this is a diverse group of services—including advertising, consulting, bird proofing, and window cleaning—producers have in common their need for close geographical proximity to business markets.

Slightly more prone to settle in the city over the past decade were services drawn not only to business markets, but also to executives at the top. The so-called “elite business services,” which operate most efficiently in a milieu that affords multiple opportunities for face-to-face communication between executives, indicated a very strong preference for in-town expansion, as shown on Chart 6. Of all regional growth in the legal fraternity, for example, 75 per cent was in the central city. Of all regional growth in professional services—engineering consultants, architects, accountants, and auditors—76 per cent was in Philadelphia.

One group of services, which obviously

caters to the residential population, appears more attracted to business contacts when locating and expanding offices. It is the finance, insurance, and real estate sector of the local economy that evidenced the greatest inclination to cluster in the city during the sixties—accounting for 12,000 jobs. Of all new area employees in this sector, seven out of ten went to work in Philadelphia. Among employers who placed the lion's share of their area job openings in the city were banks, security and commodity brokers, insurance carriers, credit agencies, and holding and other investment companies.

Although the attraction of the city for business services is strong, the pull does appear to be waning. As shown on Chart 6, all business-oriented services except the professional group have recently located a smaller proportion of their new employees in the city than they did in the past. That is, the relative attraction of Philadelphia's concentrated opportunities for face-to-face contacts is slipping as the size of the suburban business community grows. Nevertheless, in the foreseeable future, no suburban center will outweigh Philadelphia as a magnet for business services.

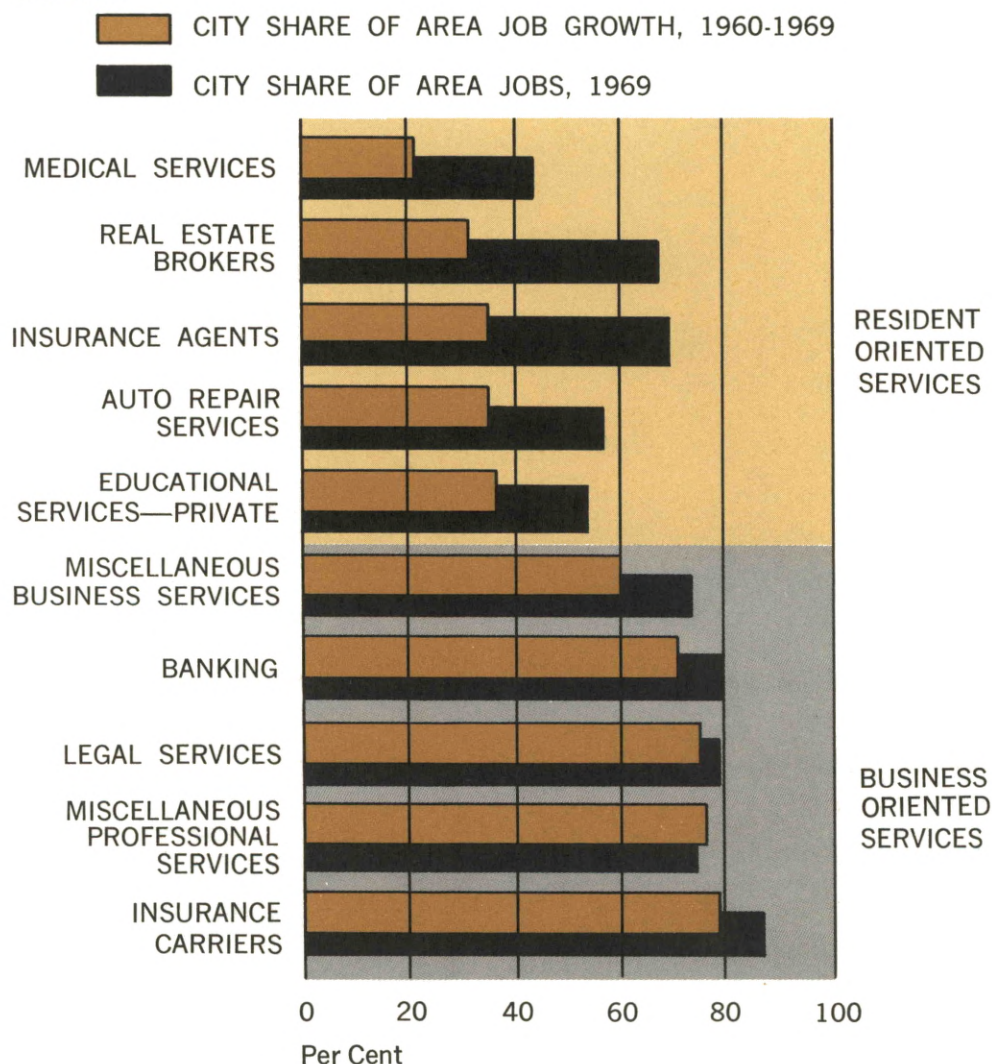
ROUND-UP

Economic growth of Philadelphia—along with other large urban centers—has depended, of late, on the growth of services. National demand and comparatively slow productivity gains have favored mounting service employment throughout the country. In the Delaware Valley, large business and residential markets, combined with a labor force the fourth largest of any metropolitan area, stimulated rapid regional growth of service jobs. Of these, 25,000 were attracted to the central city by some competitive advantage of a relatively disadvantageous location.

Clearly, over the past ten years, the services that spread out most to the suburbs were those keenly attuned to residential

CHART 6 **THE ATTRACTION OF THE CITY IS STRONGEST** **FOR BUSINESS-ORIENTED SERVICES**

JOBS AND JOB GROWTH IN PHILADELPHIA COUNTY AS A PERCENT OF FIVE-COUNTY SOUTHEASTERN PENNSYLVANIA JOBS AND JOB GROWTH, BY TYPE, 1969, AND 1960 TO 1969



Source: Pennsylvania Bureau of Employment Security

markets. In contrast, services favoring in-town locations were those most dependent on face-to-face contacts with a large number of businessmen for efficient operation. Because the greatest absolute market of this type is in Philadelphia—and not likely to be challenged in the near term—business services, particularly of the “elite” variety, have provided a bit of filling in the proverbial doughnut.

Since this market advantage is slipping, the importance of improving the living and working environment of the city is more crucial if business services are to continue to grow. Any list of basic necessities must include more efficient inner-city transportation, first-rate commercial renewal, cleaner and safer streets, and a school system at least responsive to labor requirements of a service economy. Unless positive action is pursued to alleviate the most pressing costs—real and psychic—which have discouraged other industries from in-town expansion, business services also will tow a rapid path to suburbia.

Even with growth, services are a slim reed

on which to lean for support in revitalizing the urban core. In fact, among the uncounted problems which haunt the city, some may be exacerbated by a growing economy of business services. As one example, most of the city’s hard-core unemployed will not be helped by new jobs for lawyers, commodity brokers, and bankers. In fact, since these are the primary kinds of jobs on the upswing, the unemployment problem could become more painful by the penchant of business services to cluster in the hub of the region.

Nevertheless, service growth does have a bright side for the city. Surely a rising demand for office space has followed, resulting in a firmer base for real property taxes. Similarly, any increase in employment—which is coming only from services—adds to revenue from the wage tax. Furthermore, growth of elite business services is likely to encourage a return to the city of upper-income, highly educated heads of households. When the details of the 1970 Census are available, they may reveal that this trend is already underway. ■

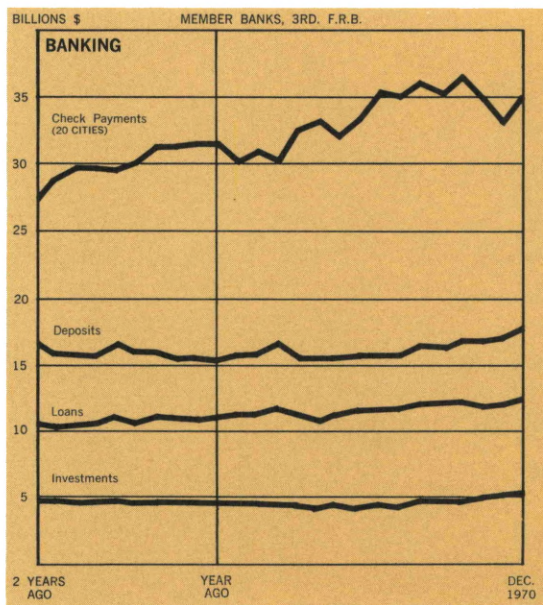
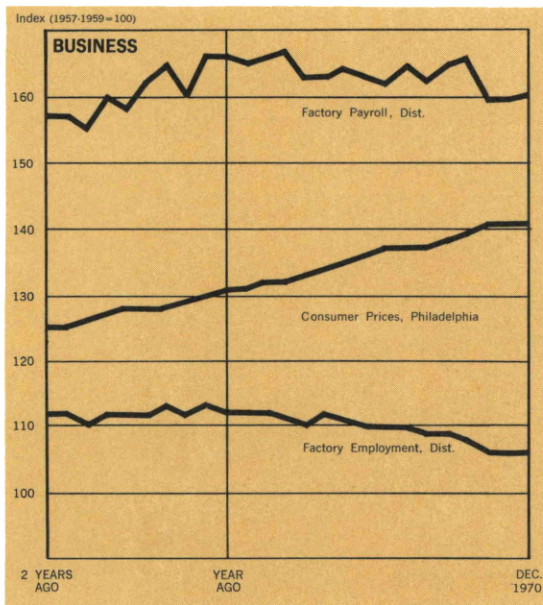
TABLE
CHANGING EMPLOYMENT STRUCTURE OF THE U.S.
ECONOMY

Full-time Equivalent Employees in the U.S. by Industrial Share
of Total U.S. Employment, 1948 and 1969

Industrial Classification	Share as a Per Cent of Total Employment	
	1948	1969
All Industries	100.0	100.0
Goods	52.1	41.7
Agriculture	5.0	1.9
Industry (Mining; Contract construction; Manufacturing; Transportation, communication, and public utilities)	47.1	39.8
Services	47.8	58.3
Trade (Wholesaling and Retailing)	17.5	17.6
Finance, Insurance, and Real Estate	3.5	4.5
Services—Business and personal	12.7	16.0
Resident-oriented services (Amusements and recreation; Motion pictures; Personal services; Hotels and lodging places; Nonprofit membership organizations; Private households)	8.2	6.7
Business-oriented services (Miscellaneous business services; Legal services; Miscellaneous professional services)	1.2	3.1
Other services (Auto repair; Miscellaneous repair services; Educational services—nonpublic; Medical and other health services)	3.3	6.2
Government	14.1	20.2

Sources: U.S. Department of Commerce, *National Income and Product Accounts for the U.S., 1929-65*, Table 6.4, pp. 102-105, and *Survey of Current Business*, July, 1970, Table 6.4, p. 40.

FOR THE RECORD ...



SUMMARY	Third Federal Reserve District			United States			Manufacturing				Banking			
	Per cent change			Per cent change			Employment		Payrolls		Check Payments**		Total Deposits***	
	Dec. 1970 from		12 mos. 1970 from	Dec. 1970 from		12 mos. 1970 from	Per cent change Dec. 1970 from		Per cent change Dec. 1970 from		Per cent change Dec. 1970 from		Per cent change Dec. 1970 from	
	mo. ago	year ago	year ago	mo. ago	year ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago
	mo. ago	year ago	year ago	mo. ago	year ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago
MANUFACTURING														
Production .....	.....	.....	.....	- 1	- 6	- 4	.....	.....	.....	.....	.....	.....	.....	.....
Electric power consumed	- 1	- 4	+ 1	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Man-hours, total*	- 1	- 9	- 5	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Employment, total	0	- 6	0	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Wage income*	+ 1	- 4	0	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
CONSTRUCTION**	+ 7	+ 1	+19	- 3	- 5	- 1	.....	.....	.....	.....	.....	.....	.....	.....
COAL PRODUCTION	-12	-10	- 1	- 4	+ 9	+ 7	.....	.....	.....	.....	.....	.....	.....	.....
BANKING														
(All member banks)	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Deposits	+ 4	+ 7	+ 2	+ 6	+ 8	+ 3	.....	.....	.....	.....	.....	.....	.....	.....
Loans	+ 4	+ 8	+ 7	+ 4	+ 6	+ 5	.....	.....	.....	.....	.....	.....	.....	.....
Investments	+ 6	+16	- 2	+ 5	+17	+ 2	.....	.....	.....	.....	.....	.....	.....	.....
U.S. Govt. securities	+ 5	+ 9	- 7	+ 6	+13	- 3	.....	.....	.....	.....	.....	.....	.....	.....
Other	+ 7	+21	+ 2	+ 4	+21	+ 6	.....	.....	.....	.....	.....	.....	.....	.....
Check payments***	+ 5†	+15†	+13†	+ 3	+14	+11	.....	.....	.....	.....	.....	.....	.....	.....
PRICES														
Wholesale .....	.....	.....	.....	0	+ 2	+ 4	.....	.....	.....	.....	.....	.....	.....	.....
Consumer	0‡	+ 7‡	+ 7‡	+ 1	+ 5	+ 6	.....	.....	.....	.....	.....	.....	.....	.....

LOCAL CHANGES

Standard Metropolitan Statistical Areas*

	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago
Wilmington ..	+ 5	- 5	+12	+ 3	- 5	- 2	+14	+ 3
Atlantic City ..	.....	.....	.....	.....	+ 2	+18	+ 2	+23
Trenton	+ 7	- 4	+ 9	- 3	- 1	+10	+ 1	+14
Altoona	- 1	- 4	+ 2	+ 2	- 1	+ 2	- 2	+ 5
Harrisburg ...	0	- 5	+ 1	- 5	+ 4	+ 8	+ 4	+45
Johnstown ...	+ 1	-11	+ 3	-13	+ 2	+20	+ 4	+15
Lancaster	- 1	- 2	- 2	0	+10	+15	+72	+60
Lehigh Valley ..	- 1	- 5	- 1	- 4	+ 5	+ 2	+ 2	+13
Philadelphia ..	0	- 8	+ 2	- 3	+ 7	+22	+ 3	+ 5
Reading	+ 2	- 9	+ 3	- 9	+ 8	+18	+ 1	+13
Scranton	- 2	- 9	- 2	- 5	+ 5	+10	+ 3	- 1
Wilkes-Barre ..	+ 1	- 1	+ 2	+ 6	- 3	- 2	+ 2	+ 4
York	- 2	- 5	- 1	- 7	+19	+ 7	-45	-49

*Production workers only
 **Value of contracts
 ***Adjusted for seasonal variation

†15 SMSA's
 ‡Philadelphia

*Not restricted to corporate limits of cities but covers areas of one or more counties.
 **All commercial banks. Adjusted for seasonal variation.
 ***Member banks only. Last Wednesday of the month.