Research Department
Federal Reserve
Bank of
San Francisco
May 7, 1976

Un-Cola?

Wages will go up as prices go up in 1976, in line with the cost-of-living adjustments (COLAs) that are part of most major labor contracts. Even so, COLAs still represent a minor (albeit growing) share of the total wage package resulting from new contract agreements. This year in particular, the bulk of the average increase will result from the hefty first-year gains achieved in multi-year bargaining agreements.

Nonetheless, COLAs remain in the news because of the diverse ways they have affected this year's contract negotiations. The Teamsters were largely successful last month in their attempt to remove the cap (ceiling) on the amounts they could earn under such escalator adjustments. New York's subway drivers have threatened to strike over the State Attorney General's ruling which would freeze their COLA as well as their basic wage. The rubber workers have already gone on strike to obtain a COLA whose lack has cost them dearly in the inflationary period of the last several years; they claim that their average \$5.50 hourly wage now lags about 25 percent behind the average auto worker's wage, after moving closely together in most earlier periods. The auto workers, who started the trend a quarter-century ago, probably will concentrate on job-security issues rather than escalator adjustments in their upcoming negotiations this fall, although some UAW leaders would like to emulate the aluminum workers by gaining COLAs for retirees as well as active workers.

Down the up escalator

Actually, cost-of-living factors have been recognized to some extent in wage negotiations ever since the post-World War I inflation period, when the scientific-management movement supported the principle as a contribution to employee morale. However, the principle lost much of its popularity in the postwar deflationary period, when employers tried to apply it in reverse, cutting wages as prices fell. A notable example was President Roosevelt's action in reducing Federal workers' salaries by 15 percent in 1933, under authority granted him by early New Deal legislation.

The inflation of World War II and the early postwar period generated new interest in cost-of-living adjustments, and this led to the path-breaking 1948 agreement between the United Auto Workers and General Motors, the first major labor contract containing an explicit escalator adjustment. This agreement provided for an "annual improvement factor" in auto workers' standard of living. To insure that the contractual increases stated in nominal terms would translate into real wage gains, the contract stipulated a series of regular reviews whereby wages would be automatically adjusted to changes in the consumer price index. That principle has been maintained (with some liberalizing adjustments) over the past quarter-century. Under the present auto-industry agreement, autoworkers receive a one-cent wage increase for each 0.3 index point (not percentage point) rise in

(continued on page 2)

Research Department
Federal Reserve
Bank of
San Francisco

the CPI. The current agreement is uncapped (open ended), since it sets no maximum on the amount that can be paid out under the escalator clause.

Coverage and formulas

The importance of COLAs has waxed and waned with the rate of inflation. About 4.0 million workers were covered by escalator clauses in major bargaining agreements during the inflationary period of the late 1950s; the number dropped to 1.9 million during the early 1960s, but then accelerated in the 1970s, to 4.0 million in 1972 and 5.9 million in 1975. At one time or another, unions in steel, railways and electrical equipment dropped COLA coverage, but all resumed coverage again during the recent inflation. Those receiving such adjustments account for 58 percent of all workers under major contracts in the private nonfarm sector, and for 74 percent of all workers under three-year contracts.

The impact of escalators reflects not only the number of workers covered, but also the formula used, the frequency of adjustment, and the amount of capping. About 2.4 million workers follow the UAW formula—one cent for each 0.3-point change in the CPI—while another 1.2 million receive one cent for each 0.4-point change in the CPI, and the rest follow other types of formulas. About half of all covered workers receive quarterly wage adjustments, and most of the remainder follow annual adjustment formulas. Meanwhile, more than 2 million operate with capped adjustment formulas.

For all these reasons, wage-rate increases under COLA provisions have lagged substantially behind price increases. For the 1971-75 period as a whole, escalator increases averaged 4.0 percent annually, compared with a 7.0-percent annual rate of increase in the CPI. (For 1975 alone, escalator gains averaged 4.8 percent compared with a 7.0-percent rise in the CPI.) Thus, escalator payments during the first half of the 1970s offset about 57 percent of the increase in consumer prices, although the proportion offset was much higher for those following the auto industry formula.

Impact on wages

Nonetheless, COLAs now account for an increasing share of effective wage increases, as can be seen from a breakdown of the Labor Department's series of total wage-rate adjustments for major bargaining units. The series includes wage changes resulting from current settlements, from prior-year settlements, and from escalator adjustments, with the relative importance of each component determined by the average size of wage increases and the number of affected workers. In 1975, escalator adjustments accounted for one-fourth of the entire 8.7-percent effective wage-rate increase, compared with no more than a one-tenth share throughout the 1968-72 period. The increased number of workers receiving COLA payments explained most of this increased share.

Last year, the 8.7-percent effective wage change was composed of 2.8 percent from current settlements, 3.7 percent from prior settlements, and 2.2 percent from escalator provisions. This year the proportions should be somewhat different. Because of the relatively large number of workers (4.5 million) covered by agreements expiring in 1976, new settlements undoubtedly will play the dominant role in determining the total effective wage increase. Heavy front-loading of long-term contracts, with unions obtaining large first-year gains as a means of recouping inflation-caused reductions in real income, could bolster the importance of this factor even more. Another determining factor will be the deferred raises (averaging 5.4 percent) scheduled for 5.5 million workers under the terms of prior settlements. The number of workers receiving deferred raises is smaller than last year, but their influence is still significant.

Cost-of living reviews are scheduled for 4.7 million workers this year—the same as in 1975. COLAs thus may again account for a significant part of the overall wage package, although their impact will diminish to the extent that the inflation rate falls below last year's 7.0-percent rise in the CPI. Still, it's worth emphasizing, escalator adjustments will represent only one part of the unions' several-pronged drive to keep wages in line with price increases.

Impact on inflation

How much influence have COLAs had on the recent inflationary spiral? Not very much, according to a recent study by the Council on Wage and Price Stability, which cites some of the factors (noted above) that tend to limit the size of the typical adjustment. But if inflation persists, union negotiators may attempt to expand COLA coverage and adopt escalator provisions that move more closely in line with CPI changes—for example, by liberalizing formulas, removing caps, and making more frequent adjustments.

In addition, there is an important demonstration effect, since the escalation principle has spread in the past decade from heavy industry, where productivity gains can partly offset escalated wage increases, to many other sectors where productivity gains are modest or completely lacking. In fact, active workers now account for only about one-tenth of all the individuals who now benefit from cost-of-living adjustments, what with the extension of coverage to federal retirees, social-security beneficiaries and food-stamp recipients. But the solution is not to try to limit the spread of escalator provisions, but rather to attack the underlying causes of inflation.

William Burke

Research Department
Federal Reserve
Bank of
San Francisco
Alaska • Arizona • California • Hawaii
Idaho • Nevada • Oregon • Utah • Washington

FIRST CLASS MAIL
U.S. POSTAGE
PAID
PERMIT NO. 752
San Francisco, Calif.

BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 4/21/76	Change from 4/14/76	Change from year ago Dollar	Change from year ago Percent
Loans (gross, adjusted) and investments*	87,686	− 674	+ 2,416	+ 2.83
Loans (gross, adjusted)—total	64,962	− 807	− 298	− 0.46
Security loans	1,196	− 997	+ 22	+ 1.87
Commercial and industrial	22,854	− 156	− 1,172	− 4.88
Real estate	19,578	+ 44	− 107	− 0.54
Consumer instalment	10,710	+ 22	+ 846	+ 8.58
U.S. Treasury securities	10,063	+ 65	+ 2,520	+ 33.41
Other securities	12,661	+ 68	+ 194	+ 1.56
Deposits (less cash items)—total*	87,823	− 571	+ 3,570	+ 4.24
Demand deposits (adjusted)	24,297	− 736	+ 1,122	+ 4.84
U.S. Government deposits	752	+ 322	+ 480	+ 176.47
Time deposits—total*	61,295	− 19	+ 1,610	+ 2.70
States and political subdivisions	6,853	+ 242	− 613	− 8.21
Savings deposits	25,745	+ 133	+ 6,217	+ 31.84
Other time deposits‡	26,392	− 329	− 2,759	− 9.46
Large negotiable CD's	11,442	− 193	− 4,357	− 27.58

Weekly Averages of Daily Figures	Week ended 4/21/76	Week ended 4/14/76	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves	99	1	40
Borrowings	0	16	38
Net free(+)/Net borrowed (−)	+ 99	− 17	+ 2
Federal Funds—Seven Large Banks			
Interbank Federal fund transactions			
Net purchases (+)/Net sales (−)	+ 1,391	+ 1,338	+ 2,079
Transactions of U.S. security dealers			
Net loans (+)/Net borrowings (−)	+ 288	+ 1,419	+ 659

*Includes items not shown separately. ‡Individuals, partnerships and corporations.

Editorial comments may be addressed to the editor (William Burke) or to the author. . . .Information on this and other publications can be obtained by calling or writing the Public Information Section, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco 94120. Phone (415) 544-2184.