Chapter 2

Prices and Wages in 1966

Expanding production and fuller employment brought gratifying advances in the incomes of most Americans in 1966. But satisfaction with higher incomes was marred by concern over the first significant rise in prices in 7 years.

The shift away from price stability actually began early in 1965, when sagging farm prices suddenly reversed direction, followed shortly by a climb in food prices, first at wholesale and then at retail. During the course of the year, prices of many other items turned upward. But it was only in 1966 that price movements were sufficiently disturbing to arouse public concern.

The public sensed what every economist knows—that a reasonably stable price level is essential if balanced prosperity and full employment are to be continued at home and if the strength of the dollar is to be maintained abroad. Experience proves that rising prices can generate distortions that can eventually topple an economy from boom to recession. Experience also shows that rapidly rising prices can quickly erode a country's competitive position in international markets. The critical economic problem to be solved in the year ahead is that of maintaining income growth and full utilization of resources without becoming trapped in an inflationary price-wage spiral.

The recent advance in prices was due in large measure to the acceleration in the growth of demand which began in mid-1965 and to the particularly rapid increase in output of capital goods and defense products. The step-up in the rate of price increase cannot be explained by any simple formula. It was a by-product of the complex process by which additional resources are drawn into production and adapted to the changing composition of demand. That process is now largely completed, leaving the economy with a much higher rate of utilization of resources. But in the process of adjustment, forces were set in motion which will continue to push up prices for a time even though the pressure on resources has now relaxed.

Demand had, of course, been rising steadily since 1961. But that rise began when there were abundant supplies of idle labor and unused equipment. In addition, productive capacity was being steadily increased through the installation of new plant and equipment; accretions to the labor force;

and the steady rise of productivity as a result of better management, an increasingly educated and skilled work force, new industrial processes, and increased capital per worker. Thus, throughout the early 1960's production could expand freely to match growing demand. Moreover, the pattern of expansion of industrial capacity was well balanced with the pattern of rising demand, so that few specific points of pressure on the price structure developed.

By mid-1965, prices of farm products and of some industrial raw materials were already rising, partly because of growing demand, but also for such unrelated reasons on the supply side as the stage of the hog production cycle or impediments to minerals production abroad. Moreover, by that time, margins of idle labor and underutilized plant and equipment were shrinking. Under these circumstances, the rapid spurt in demand and production that began in mid-1965 could not fail to affect prices.

The sharp rise in demand for defense products and capital goods imposed special pressures on the metals and machinery industries. In some branches of these industries, the limits of efficient utilization were surpassed, and, in a few, output was close to absolute limitations on capacity.

Even where productive resources were not fully used, it was often difficult to adjust production rapidly enough to keep pace with soaring demands. Time is needed, even when there are no special problems affecting supply, to increase the output of farm products and of industrial raw materials, especially metals. It takes time to hire workers, activate additional machines, or increase the rate at which purchased supplies are delivered. In the second half of 1965 and in early 1966, the expansion of demand for many products and services was pushing against these speed limits on the expansion of output. Moreover, the growth of demand was less balanced than previously, so that pressure points multiplied. For some products and services, production could keep up with demand only at somewhat higher costs—using standby, semi-obsolete equipment, paying overtime rates, mining lower grade ores, and so on.

There were also imbalances in labor markets which created increasing difficulties as unemployment declined. Workers in low-paid occupations could not be retained without substantial upward adjustments of wage scales. Moreover, reduced unemployment strengthened the bargaining position of unions and weakened that of employers. Wages generally began to rise faster at a time when productivity gains were slowing down. Prices of services of all kinds continued to rise, and at an accelerated rate, as wages in many service occupations were increased substantially.

The broad upswing in prices must therefore be explained in terms of a complex interaction between a general increase in the pressure on productive resources and special factors impinging on a limited range of product and labor markets. Had the increase in demand been slower and more evenly balanced, the rise in the price level would certainly have been less, although some increase would still have occurred. Farm products and raw materials would surely have risen in any event, given the supply problems at home and abroad. Wage adjustments for low-paid occupations would still have been necessary, though they could have been more gradual.

Although the pressures that developed in early 1966 have now abated somewhat, they have left their mark on the structure of costs and prices. Prices of most farm products and of many industrial raw materials move more or less freely in both directions. The same is true, though to a lesser degree, of many products at early stages of fabrication. But it is unlikely that past price increases in most other parts of the economy will be reversed so long as the economy remains strong. Moreover, price advances for such items as metals and industrial equipment tend to fan out and become built into the structure of industrial costs. And even temporary increases in farm and food prices, through their impact on consumer prices, materially affect the pattern of wage negotiations. The resulting higher wage settlements also tend to be permanently built into the cost structure.

Consequently, the return to price stability can only be gradual. However, as 1966 drew to a close, there were signs of progress. Prices of farm products and some raw materials had leveled off. Thanks to the enormous strength and adaptability of the economy and the skill and ingenuity of workers and managements, many of the industrial pressure points had been alleviated. With the slower pace of growth in the second half of 1966, much of the necessary adaptation was accomplished. More of it will be accomplished in 1967.

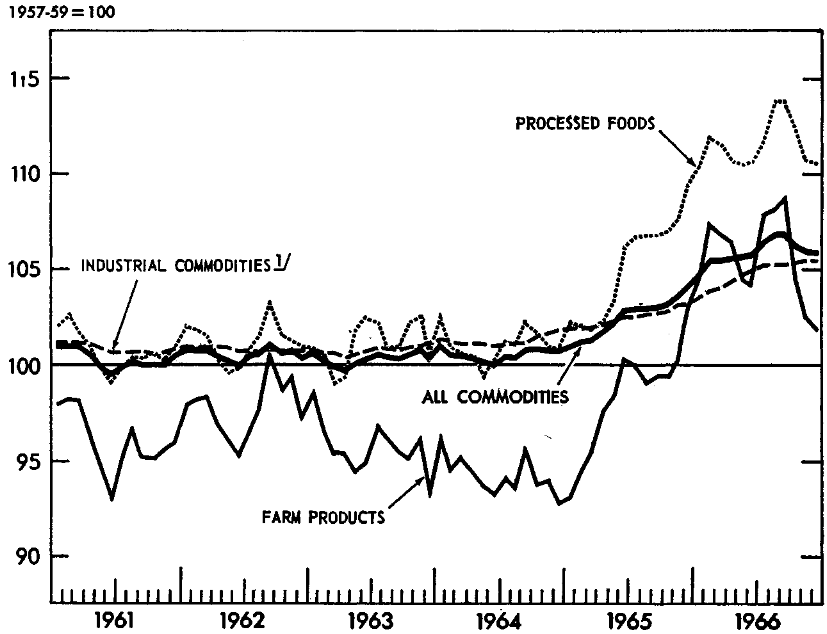
THE RECENT PRICE RECORD

The year 1965 marked the end of a long period of price stability (Charts 6 and 7). After having remained virtually constant since 1958, the wholesale price index rose by 3.4 percent during 1965 (i.e., December 1964 to December 1965) and 1.7 percent during 1966. Consumer prices increased by 2.0 percent during 1965 and by 3.3 percent during 1966.

Between December 1964 and September 1966, the wholesale price index was dominated by a rise of 14½ percent in the average price of farm products, foods, and feeds (Table 6). This group of products accounted for over 60 percent of the total increase in the index over this period. In the fourth quarter of 1966, wholesale prices of farm products and foods dropped sharply and by the end of the year were only 1 percent higher than at the end of 1965. Prices of the other commodities included in the wholesale price index increased by 1.8 percent during 1966 (Table 7). Because of the strong demand for investment goods, the largest price increases came in the machinery producing sector, though prices of metals and metal products also rose appreciably.

Chart 6

Wholesale Prices



1/ COMMODITIES OTHER THAN FARM PRODUCTS AND PROCESSED FOODS.
SOURCE: DEPARTMENT OF LABOR.

TABLE 6.—*Changes in wholesale and consumer prices, 1964–66*

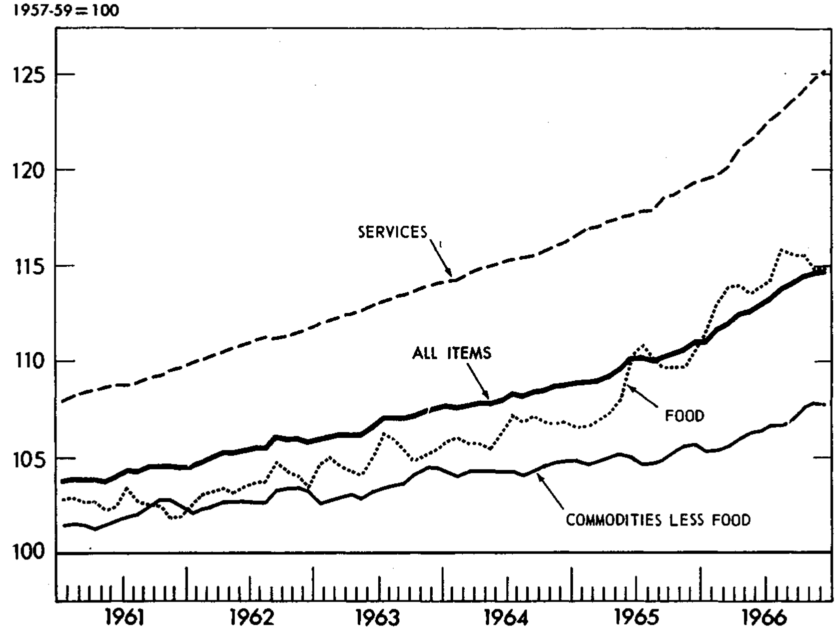
Group	Percentage change			
	December 1964 to December 1965	December 1965 to September 1966	September 1966 to December 1966	December 1965 to December 1966
Wholesale prices:				
All commodities	3.4	2.6	−0.8	1.7
Farm products, processed foods, and manufactured animal feeds	9.0	5.2	−4.1	1.0
Metals and metal products	1.8	1.7	.5	2.2
Nonelectrical machinery	2.3	3.2	1.3	4.6
Electrical machinery and equipment	.3	2.7	2.2	5.0
All other commodities	1.2	1.2	(1)	1.2
Consumer prices:				
All items	2.0	2.8	.5	3.3
All commodities	1.6	2.4	.1	2.5
Food	3.5	4.5	−.7	3.8
Other commodities	.8	1.2	.7	1.9
Services	2.7	3.5	1.4	4.9

1 Less than .05 percent.

Sources: Department of Labor and Council of Economic Advisers.

Chart 7

Consumer Prices



SOURCE: DEPARTMENT OF LABOR.

From 1960 to 1964, the consumer price index rose at an average rate of 1.2 percent a year—with commodity prices rising by less than 1 percent and service prices increasing by about 2 percent a year (Table 8). Much of the acceleration in consumer prices during 1965 was directly attributable to food prices, but, by the following year, prices of all major components had begun to rise more rapidly. Prices of services, especially in the medical and financial areas, increased most and accounted for half of the total rise in the index during 1966. There were further increases in foods and other nondurables, including a 3.7 percent rise in apparel prices. After declining through 1965, prices of consumer durables began to rise in the second quarter of 1966.

Perhaps the most comprehensive measure of price movements is the implicit price deflator for gross national product (GNP). Although consumer prices are its largest component, the deflator also reflects changes in the prices of structures, producers' durable equipment, exports and imports, and government purchases. The over-all GNP deflator rose by 3.6 percent between the fourth quarter of 1965 and the fourth quarter of 1966. Over that same period, prices of structures and of government purchases increased more than the average price of consumer expenditures, prices of producers' durables rose less, and prices of exports and imports remained unchanged.

TABLE 7.—*Changes in wholesale prices, December 1965 to December 1966*

Commodity group	Relative importance in index (percent) [1]	Indexes, 1957-59=100: December 1965	Indexes, 1957-59=100: December 1966 [2]	Percentage change, December 1965 to December 1966 [2]	Contribution to total change in 1966 (percent) [2]
All commodities	100.00	104.1	105.9	1.7	100
Farm products, foods, and feeds	26.19	107.6	108.7	1.0	17
Farm products	10.24	103.0	101.8	−1.2	−5
Processed foods	13.97	109.4	110.6	1.1	11
Manufactured animal feeds	1.99	118.6	132.0	11.3	11
Other commodities	73.81	102.9	104.8	1.8	83
Textile products and apparel	7.83	102.0	101.9	−.1	(3)
Hides, skins, leather, and leather products	1.43	114.6	117.5	2.5	(3)
Fuels and related products, and power	7.71	100.6	102.1	1.5	11
Chemicals and allied products	6.41	97.6	98.2	.6	(3)
Rubber and rubber products	1.38	93.5	95.0	1.6	(3)
Lumber and wood products	2.68	101.9	102.5	.6	(3)
Pulp, paper, and allied products	4.80	100.9	103.0	2.1	6
Metals and metal products	13.01	106.6	108.9	2.2	16
Machinery and motive products	17.70	104.2	107.9	3.6	38
Nonelectrical machinery	7.78	111.9	117.0	4.6	21
Electrical machinery and equipment	4.57	96.6	101.4	5.0	11
Motive products	5.34	100.7	101.8	1.1	6
Furniture and other household durables	3.95	98.2	100.4	2.2	6
Nonmetallic mineral products	2.88	101.6	103.2	1.6	(3)
Tobacco products and bottled beverages	2.60	107.9	110.1	2.0	6
Miscellaneous products [4]	1.46	104.2	104.8	.6	(3)

[1] As of December 1963.
[2] Preliminary.
[3] Less than 0.5 percent.
[4] Excludes manufactured animal feeds.

Note.—Detail will not necessarily add to totals because of rounding.

Sources: Department of Labor and Council of Economic Advisers.

TABLE 8.—*Changes in consumer prices, 1960–66*

Item	Relative importance in index (percent) [1]	Percentage change per year: 1960 to 1964	Percentage change per year: December 1964 to December 1965	Percentage change per year: December 1965 to December 1966	Contribution to total change in 1966 (percent)
All items	100.0	1.2	2.0	3.3	100
Food	22.8	1.2	3.5	3.8	26
Nondurable commodities less food	24.6	.7	2.0	2.8	21
Durable commodities	18.1	.5	−1.0	.7	3
Services: Total	34.5	2.0	2.7	4.9	50
Less rent	29.1	2.2	2.9	5.5	48

[1] As of December 1965.

Note.—Detail will not necessarily add to totals because of rounding.

Source: Department of Labor.

LABOR COMPENSATION AND LABOR COSTS

Compensation of employees increased by $40 billion from 1965 to 1966, more than two-thirds of the increase in GNP. Much of the increase in money compensation represented labor's share of the added output produced by added employment. Some of it represented labor's share of the added output which resulted from the growth of productivity. But some of the gain in employee compensation reflected increases in wage rates in excess of the growth of productivity. That part of the increase in labor compensation served to increase unit labor costs and thereby to push prices up.

Compensation per man-hour grew more rapidly in 1966 than in earlier years. At the same time, productivity grew more slowly than usual. As a result, unit labor costs in manufacturing showed the first significant rise since 1960. For the private nonfarm economy, the rate of increase of labor costs accelerated.

The tight labor markets generated by rising demand were mainly responsible for the rapid rise in hourly compensation, although collective bargaining power was important in a few sectors.

SUPPLY AND DEMAND IN THE LABOR MARKET

The accelerated growth of output that began in mid-1965 was accompanied by record increases in employment throughout the economy. As indicated in Chapter 1, the rising demand for workers also induced an increase in the supply, with nearly 500,000 more workers entering the labor force in 1966 than demographic trends would have indicated. The number of workers on part-time schedules "for economic reasons" dropped sharply for the second year in a row, and the unemployment rate fell to the lowest level since 1953.

Although no general labor shortage resulted, labor markets in almost every industry, occupation, and area tightened appreciably, and shortages appeared at a number of points. The abruptness of the increase in demand itself strained the normal processes of adjustment, and contributed to more pressure on wages and on costs than would have occurred had the same over-all level of employment been reached more slowly.

Pattern of Demand

The gains in employment were distributed unevenly among industries and occupations (Table 9). In many industries, the expansion since mid-1965 simply accentuated long-run employment trends, such as the growth in trade and services and the decline in agriculture. After years of little change, manufacturing employment rose sharply, particularly in the durable-goods sector, reflecting the sharp increase in defense and capital goods spending (Chart 8).

For the same reasons, the increase in the demand for workers in various occupations was also uneven. Many of the occupational labor shortages reported during the past 18 months were an intensification of longstanding imbalances between supply and demand—for example, for teachers, doctors, nurses, and engineers. But new shortages appeared in a number of skilled occupations—machinists, toolmakers, modelmakers and patternmakers, aircraft mechanics, and setup operators for various metalworking ma-

TABLE 9.—*Changes in employment, by industry, 1960–66*

Industry	Percentage change per year		
	1960 to 1964	1964 to 1965	1965 to 1966
Nonagricultural payroll employment: Total	1.8	4.2	5.1
Manufacturing	.7	4.4	5.8
Durable	.9	5.8	7.7
Nondurable	.4	2.5	3.3
Mining	−2.8	−.3	−.6
Contract construction	1.4	4.3	3.1
Transportation and public utilities	−.3	2.1	2.6
Retail trade	1.7	4.4	4.2
Wholesale trade	1.5	4.0	4.3
Finance, insurance, and real estate	2.6	2.1	2.2
Service and miscellaneous	4.1	4.5	5.3
Government	3.5	5.2	7.5
Federal	.8	1.3	7.9
State and local	4.5	6.4	7.4
Agricultural employment [1]	−4.1	−3.7	−8.3

[1] Labor force basis.

Source: Department of Labor.

chines—which clearly resulted from the rapid expansion in durable manufacturing. Until the closing months of 1966, there were, in addition, shortages of skilled construction labor in many parts of the country.

Meeting the Demand for Labor

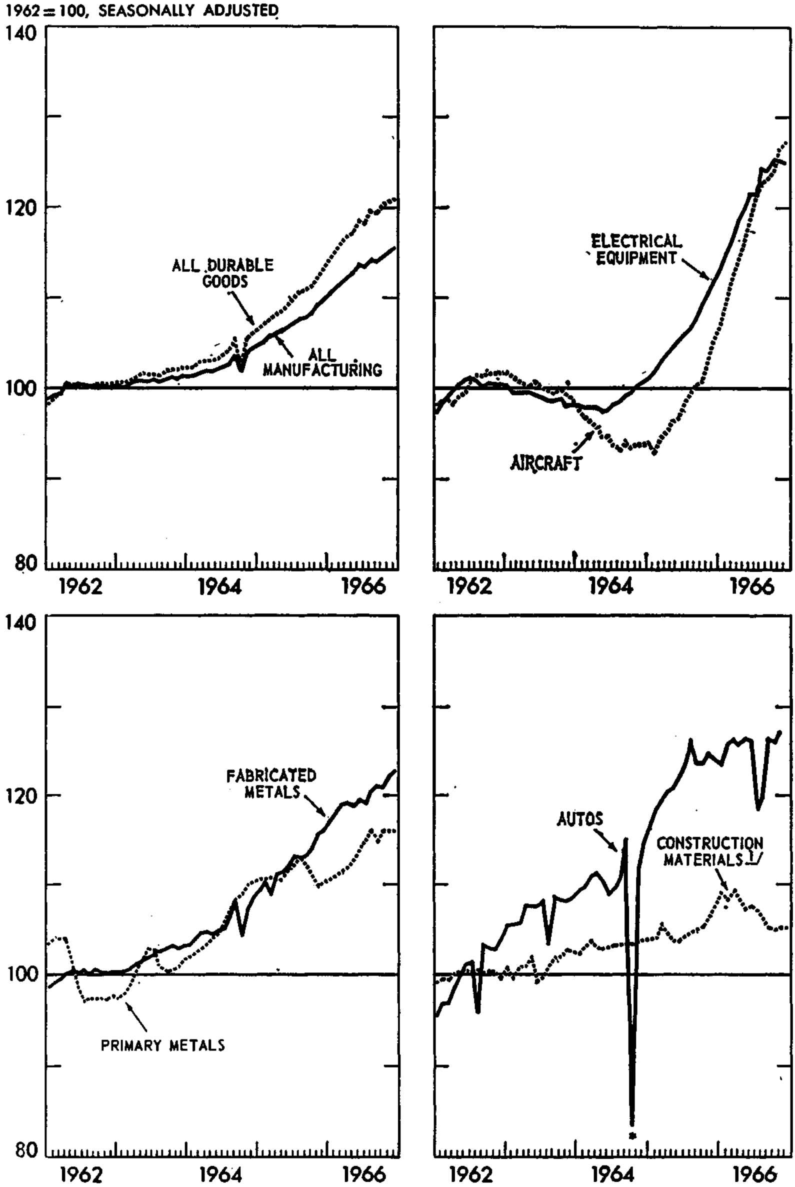
Some of the increase in the demand for labor could be easily met by hiring workers previously unemployed. For the reasons set forth in Chapter 3, however, the pattern of skills and residence of the unemployed did not fully match the pattern of hiring needs. Employers often were forced to make other adjustments. They recruited at longer distances than before—in some cases even abroad; searched their rolls for workers who could be upgraded; redesigned jobs and even altered production methods to make better use of available workers. Hiring standards were lowered, and training programs for both new and previously employed workers were expanded. Particularly in manufacturing, employers lengthened the workweek to meet their production schedules.

But such adjustments become increasingly costly the further they are pushed. Moreover, for highly skilled occupations—at the extreme, professional workers—several years are needed to increase the supply. Employers therefore were willing to increase what they would pay for a worker who already met their preferred specifications. The result was a bidding up of wages for scarce skills and a rapid rise in quit rates.

Competitive market pressures also extended to many low-paid types of labor. Many farm laborers, unskilled or semiskilled service workers, and factory workers in the low-wage industries were attracted by the jobs opening up in higher wage industries and areas, and new entrants to the labor force naturally preferred jobs in the high-wage sectors. Employers in low-wage industries were thus forced to give larger wage increases than other employers in order to hold experienced workers and to recruit new ones.

Chart 8

Employment in Durable Goods Manufacturing



*STRIKE.

1/ LUMBER AND WOOD PRODUCTS, AND STONE, CLAY, AND GLASS.

SOURCES: DEPARTMENT OF LABOR AND BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM.

Collective Bargaining

Moreover, tight labor markets enhanced the bargaining power of organized workers and reduced that of employers. When prices and profits are rising throughout the economy, workers expect to receive larger increases than before. Also, workers are more willing to strike when jobs have been and are expected to remain plentiful. On the employers' side, wage increases are less vigorously opposed at a time when they can easily be recovered in higher prices. In addition to the market forces that put pressure on wages, the rise in consumer prices associated with the strong expansion of demand—as well as the high profits of many employers—understandably strengthened organized labor's demands for larger wage increases generally.

As a result of the changed bargaining situation and of workers' more militant attitudes, more workers struck in 1966 than in any year since 1959. Also, the available information on mediated contracts indicates that in 1966 union members voted down a higher proportion of tentative agreements made by their representatives than in other recent years.

Only a limited number of contracts were negotiated during 1966, but they provided for wage increases substantially higher than those obtained in earlier years (Table 10). Moreover, the size of wage and fringe benefit gains tended to increase as the year progressed. A number of important negotiations in the second half of the year resulted in compensation gains well above those typical of earlier contracts.

As a result of deferred wage increases and cost-of-living escalator adjustments, wages paid under existing contracts also rose. But these wage gains were substantially lower than the increases obtained from contracts newly negotiated in 1966. The median 1966 union wage increase (excluding fringes) in all nonconstruction contracts, new and existing, was

TABLE 10.—*Wage changes in major collective bargaining situations, 1961–66* [1]

Type of wage change	Changes in wage rates as percent of straight-time hourly earnings					
	1961	1962	1963	1964	1965	1966 [2]
Median of first-year changes negotiated during specified year:						
All industries	2.8	2.9	3.0	3.2	3.8	4.4
Manufacturing	2.4	2.4	2.5	2.0	4.0	4.2
Nonmanufacturing	3.6	4.0	3.4	3.6	3.7	5.0
Median adjustment effective during specified year, regardless of date of negotiation: [3]						
All industries	2.7	2.8	2.9	2.7	3.4	3.3
Manufacturing	2.7	2.6	2.7	2.0	3.4	3.0
Nonmanufacturing	2.6	3.5	3.2	3.5	3.4	3.4

[1] All contracts affecting 1,000 or more workers in all industries except construction, services, finance, and government.
[2] Based on preliminary data available in early January 1967.
[3] Includes changes in wage rates negotiated during specified year, plus increases decided upon in earlier years, cost-of-living escalator adjustments, and no wage changes.

Source: Department of Labor.

3.3 percent, about the same as in 1965, although higher than in other recent years.

Construction workers obtained considerably larger increases in both wages and fringe benefits than did other workers. The available information indicates that the average annual increase in hourly compensation (wages plus fringe benefits) in major construction settlements was over 6½ percent in both 1965 and 1966.

Compensation

The pressures on the labor supply in areas other than manufacturing during the past year resulted in a sharp acceleration in wage rates. As shown in Table 11, the increases in average hourly earnings in the manufacturing industries were exceeded by the gains in most other sectors.

The substantial wage gains outside manufacturing extended through the whole spectrum of occupations though, as noted above, the intensity of wage pressures varied widely. Professional and semiprofessional workers were in continued short supply. In fact, there was a general shortage of persons with a college education. The salary offers made to graduating college students in 1966 increased by about 6 percent, compared with an increase of 3½ percent in 1965. There were also notable wage increases for nurses in many areas in the last half of the year. At the other end of the spectrum, wage rates rose rapidly in low-wage service occupations; and agricultural wages, which are generally low, rose by a spectacular 8.3 percent.

For the entire private economy, average hourly compensation, including fringe benefits, increased 6½ percent (Table 12). About 0.8 percent was due to increased employer contributions for social insurance. And a significant part of the increase reflected a shift of workers from the farm

TABLE 11.—*Changes in average hourly earnings, by industry, 1960–66*

Industry	Percentage change per year		
	1960 to 1964	1964 to 1965	1965 to 1966 [1]
Manufacturing:			
Durable goods	2.8	3.0	3.6
Nondurable goods	2.8	3.1	3.8
Bituminous coal mining	1.3	5.8	4.3
Contract construction	3.6	3.9	4.9
Transportation and public utilities:			
Telephone communication	3.8	3.1	3.0
Electric, gas, and sanitary services	3.5	4.3	3.8
Local and suburban transportation	2.9	3.6	3.1
Wholesale trade	3.0	3.6	4.6
Retail trade [2]	3.7	4.8	4.1
Finance, insurance, and real estate	(3)	3.9	3.8
Service and miscellaneous:			
Hotels, tourist courts, and motels	4.3	4.7	5.9
Laundries and cleaning and dyeing plants [4]	3.8	5.6	5.3
Agriculture	2.5	5.2	8.3

[1] Preliminary.
[2] Excludes eating and drinking places.
[3] Not available.
[4] Prior to January 1964, data relate to production workers.

NOTE.—Data are for production workers in manufacturing and mining, for construction workers in contract construction, and for all nonsupervisory employees in other industries (except as noted).

Sources: Department of Labor and Department of Agriculture.

TABLE 12.—*Changes in compensation, productivity, and unit labor cost in the private economy since 1947*

Item	Percentage change per year			
	1947 to 1965	1960 to 1964	1964 to 1965	1965 to 1966 [1]
Total private, all persons:				
Average hourly compensation [2]	5.0	4.3	3.7	6.5
Output per man-hour	3.4	3.8	2.8	2.8
Unit labor cost	1.6	.4	1.0	3.6
Private nonfarm, all persons:				
Average hourly compensation [2]	4.8	3.9	3.3	5.6
Output per man-hour	2.8	3.5	2.1	2.4
Unit labor cost	1.9	.3	1.0	3.2
Manufacturing, all employees:				
Average hourly compensation [2]	5.1	3.8	2.5	4.8
Output per man-hour	3.5	4.0	3.4	3.1
Unit labor cost	1.5	−.2	−.9	1.7

[1] Preliminary; based on averages of quarterly data; not strictly comparable with changes for prior years.

[2] Wages and salaries of all employees and supplements to wages and salaries such as employer contributions for social insurance and for private pension, health, unemployment, and welfare funds, compensation for injuries, pay of the military reserve, etc. For total private and private nonfarm, also includes an estimate of wages, salaries, and supplemental payment part of the income of the self-employed.

Sources: Department of Commerce, Department of Labor, Board of Governors of the Federal Reserve System, and Council of Economic Advisers.

to the nonfarm sectors. Because wages are generally higher in the nonfarm sector, this shift of workers raises the average level of wages in the private economy. In fact, it is the main reason why the over-all gain is so much higher than the gain in the nonfarm sector alone.

Compensation per man-hour for manufacturing workers rose by 4.8 percent in 1966—a significant increase over the 3.5 percent average annual gain from 1960 to 1965—but considerably less than the 5.7 percent gain for other nonfarm workers. Furthermore, much of the acceleration in manufacturing compensation was due to the increased employer contributions for social insurance, the rise in overtime work, and the relative shift of workers into the higher-wage durable manufacturing sector. In spite of some skill shortages and the rapid increase in general employment, manufacturers generally had less difficulty in recruiting than employers in some other sectors, because manufacturing wages are relatively high. Of course, the small proportion of new union contracts in manufacturing negotiated during 1966 also served to hold down wage increases.

Productivity and Unit Labor Costs

Output per man-hour has shown a long-term upward trend but annual advances in productivity often deviate significantly from the trend. The trend rate of growth of productivity largely determines the long-term trend in real wage rates. And the changes in unit labor costs which result from the movements of employee compensation in relation to the movements of productivity play a major role in determining price level movements.

The long-term advance in output per man-hour is attributable to several factors: an increase in the abilities of the average worker; additional capital per worker; technological progress; and improved management and organization. A major element underlying the increased average quality of the work force has been a steady gain in educational achievement. The expansion of private and Government training programs, better health, and improved working conditions have also contributed to the efficiency of workers.

Gains in labor skills have been accompanied by additions to the economy's stock of productive capital. Business investment has continually provided the average worker with more and better machines to increase the speed, accuracy, and ease of his production. The rapid pace of technological progress has been made possible through large and increasing investments in research and development.

Over any reasonably long period of time, these changing characteristics of the labor force and the capital stock are the basic determinants of the economy's total productive capacity and of the productivity of its workers. But, in the short run, much of the fluctuation in productivity is due to cyclical variations in business operating rates. During an expansion, as operating rates pick up, firms utilize their capital and labor more efficiently. Until full capacity is reached, output can be increased with little or no increase in overhead labor (supervisors, clerical and maintenance workers, etc.). Furthermore, since it is difficult and costly to adjust the work force in response to each fluctuation in demand, changes in employment tend to lag somewhat behind production. For these reasons, productivity gains are generally higher than average during periods of rising utilization rates. However, once output begins to press against capacity, less efficient equipment is brought into use, less skilled labor is hired, and employment begins to catch up with output. Productivity gains drop back to, and temporarily drop below, their long-run rate of increase.

The substantial, and sometimes erratic, short-run movements in productivity make it impossible to provide a single, unambiguous estimate of the trend in productivity. But a variety of statistical techniques has been used to adjust as completely as possible for the effects of the short-run factors. The results for the private economy as a whole consistently indicate a trend rate of increase in real output per man-hour of somewhat over 3 percent a year. The comparable trend for the private nonfarm economy is about half a percentage point lower. Of course, the trends themselves are likely to change slowly over time.

Because of the technological advances in agriculture, productivity gains in that sector far exceed those in the nonfarm sector. This accounts in part for the fact that productivity grows faster in the total private economy than in the nonfarm sector alone. An even more important factor is the continuing shift of workers from farming into nonfarm occupations. Although productivity is growing faster in the farm sector, average output per man-hour is appreciably higher in the nonfarm sector. When a worker shifts from a farm to a nonfarm occupation he generally increases his productivity and, thus, the average productivity in the private economy.

From 1960 to 1965, as the economy moved toward full utilization of resources, it made more efficient use of its productive plant and overhead labor. As a result, output per man-hour rose at a faster rate than the long-term trend (Table 12). By 1965, however, productivity gains in some sectors began to weaken despite the very rapid growth in output. After some 5 years of rapid expansion, the deferred adjustments in employment began to catch up with output. Furthermore, in some industries, production began to press against capacity and firms were forced to use semi-obsolete equipment, run extra shifts, hire untrained workers, and struggle with supply bottlenecks.

As output grew at a more moderate pace in 1966, firms continued to make adjustments in their work force. Productivity gains remained somewhat below trend in all sectors, and there was a further slowdown in manufacturing productivity. After showing strong gains in the first half of 1966, manufacturing productivity remained virtually unchanged after midyear. For the year as a whole, output per man-hour increased by 3.1 percent—somewhat below the average annual increase in the postwar period.

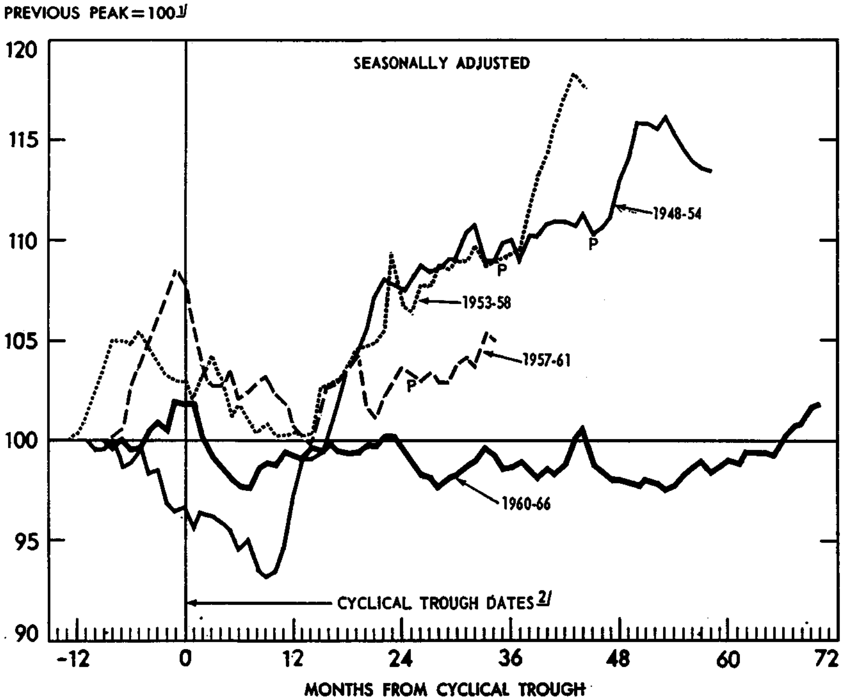
Unit Labor Costs

Because productivity gains between 1960 and 1964 were above normal, and compensation gains relatively moderate, unit labor costs remained essentially stable in that period. Then as productivity gains began to slacken in 1965, unit labor costs were held to a modest increase by the slowdown in the growth of compensation per man-hour. For the entire private economy, unit labor costs in 1965 averaged only 2 percent higher than in 1961. In 1966, however, tight labor markets pushed compensation up more rapidly, and there was no surge in productivity to maintain stable costs. As a result, unit labor costs rose an average of more than 3½ percent in the private economy and nearly 2 percent in manufacturing, the first appreciable increase during the entire period of expansion.

Although the rise in unit labor costs in 1966 in the crucial manufacturing sector represents a serious break with the earlier record of stability, it was well below the increase experienced in every other postwar expansion (Chart 9). Hourly compensation in manufacturing grew steadily and quite rapidly throughout the entire year. From the fourth quarter of 1965 to the fourth quarter of 1966, compensation per man-hour increased by nearly 6 percent. Because of the uneven rates of growth of output and productivity, most of the rise in unit labor costs in manufacturing was concentrated in the second half of 1966. During the first half of 1966, unit labor costs rose at a rate of about 2 percent, but then accelerated to an annual rate of nearly 5 percent in the second half of the year. Since this sharp upturn was in part a reflection of the very uneven pattern of growth of output during the year, it should be regarded as temporary in nature.

Chart 9

Unit Labor Costs in Manufacturing Since 1948



P=CYCLICAL PEAK: JULY 1953, JULY 1957, AND MAY 1960.

1/ PREVIOUS PEAKS ARE NOVEMBER 1948, JULY 1953, JULY 1957, AND MAY 1960.

2/ CYCLICAL TROUGHS ARE OCTOBER 1949, AUGUST 1954, APRIL 1958, AND FEBRUARY 1961.

NOTE.–PERIODS COVERED ARE NOVEMBER 1948–AUGUST 1954, JULY 1953–APRIL 1958, JULY 1957–FEBRUARY 1961, AND MAY 1960–DECEMBER 1966 (LATEST DATA AVAILABLE).

SOURCES: DEPARTMENT OF COMMERCE AND BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM.

In summary, all major sectors of the economy experienced higher unit labor costs during 1966, particularly in the latter half of the year. This upswing broke a long record of relative stability. Productivity gains, which had been above trend during previous years, slowed down in 1965 and 1966 while the rise of compensation accelerated. The trend of prices, described in the following sections, could not be insulated from the resulting rise in unit costs.

PRICES IN MAJOR SECTORS

In view of the critical significance of prices in the 1966 economic record and in the outlook for 1967, a fuller review than usual of the price situation in major sectors is called for in this Annual Report. This review concentrates on four sectors: farm and food products; raw materials; manufactured products; and consumer services.

FARM PRODUCTS AND FOOD

As indicated earlier, farm prices rose sharply in 1965 and continued to rise during the first three quarters of 1966. Prices declined sharply in the final quarter of the year and by December showed little change from a year earlier. However, they remained well above the levels of early 1965. These increases were reflected at wholesale in the prices of processed foods, and at retail in the consumer price index.

The rise in farm prices was due to the strong expansion of domestic and export demand, combined with only slightly increased or in some cases reduced supplies of important farm commodities. Given adequate time for the adjustment of production, America's farmers are capable of expanding total farm output to meet any foreseeable expansion of domestic demand and to provide substantial surpluses for export, in most instances at essentially constant costs. To be sure, for some highly labor-intensive products—particularly dairy products and some fruits and vegetables—rising prices may be necessary to attract or hold the necessary labor services. But this is the exception rather than the rule. However, an expansion of farm output necessarily takes time—ranging from a few months for broilers, at least a year for most field crops, 1 or 2 years for hogs, and even longer for cattle or tree crops. To expand production of some of these commodities also requires changes in Federal farm programs.

Because of relatively long production cycles, supplies of some farm products reflect past rather than current prices. In 1965, hog supplies were declining in response to the low prices of 1963 and 1964. The resulting rise in livestock prices was intensified by strong consumer demand. The price rise which began in 1965 continued into early 1966. After February supplies began to expand, and by December wholesale livestock prices were 12.5 percent below the unusually high levels of December 1965.

Meanwhile, however, grain prices began to rise. At the beginning of 1966, grain prices stood 2.2 percent above their levels of a year earlier. During 1965, demand had expanded sharply but so had production. In 1966, strong domestic demand was supplemented by a jump in exports but total production was essentially unchanged from 1965 levels. Export demand was particularly buoyant for wheat, as reduced supplies from Argentina and Australia led to a rise in the volume of U.S. exports estimated at about 20 percent.

Prices for wheat, feed grains, and soybeans rose sharply during the late spring and summer. The rise was accentuated by speculation based on uncertain crop prospects and the strength of export demand. In the fall, harvests having proved somewhat better than had been expected, prices for grains and soybeans declined sharply. However, grain prices averaged 12.6 percent higher for December 1966 than a year earlier.

In contrast to both grain and livestock prices, dairy prices moved up sharply in the second half of 1966 as growing demands were matched with a decline in production. This decline in turn was related to general economic conditions as high beef prices induced farmers to cull and sell dairy cows while excellent off-farm employment opportunities encouraged some farmers to abandon dairying altogether.

Thus the major factors involved in rising farm product prices in 1966 were:

(1) the hog production cycle which led to reduced marketings until mid-1966 when numbers shipped began to increase;

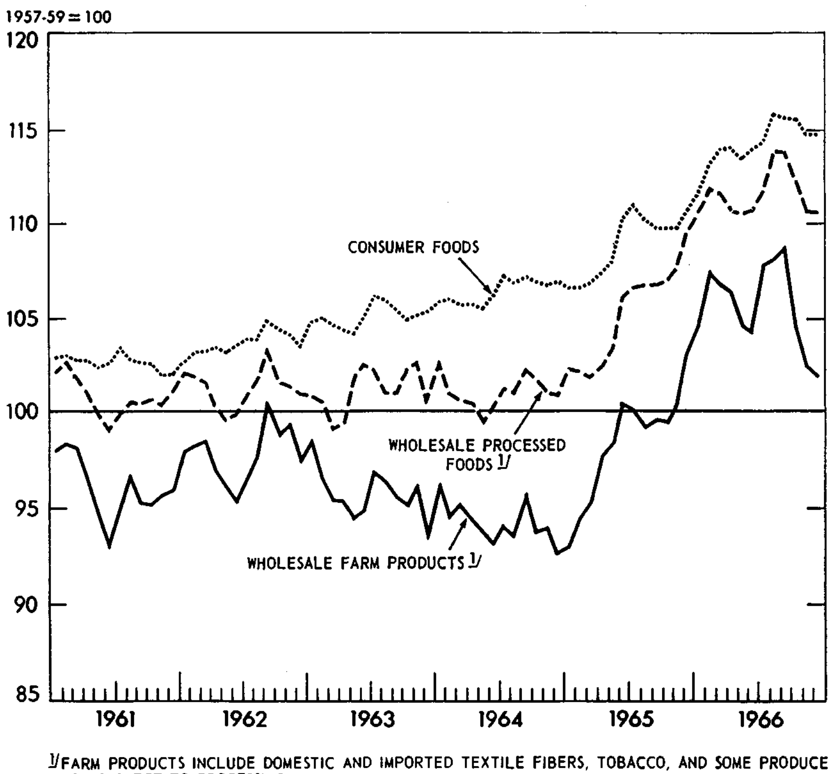
(2) poor weather here and abroad which caused some decline in U.S. production and increased the demand for U.S. wheat exports;

(3) high cattle prices which resulted in reduction in dairy herds and good employment opportunities which induced farmers to leave dairying;

(4) strong demand for food based on rising consumer incomes.

Chart 10

Farm and Food Prices



1/ FARM PRODUCTS INCLUDE DOMESTIC AND IMPORTED TEXTILE FIBERS, TOBACCO, AND SOME PRODUCE NOT SUBJECT TO PROCESSING.
SOURCE: DEPARTMENT OF LABOR.

Processed Foods and Foods at Retail

Changes in food prices at subsequent levels of processing and distribution generally follow changes in the costs of raw farm products. These costs, however, account for only about 40 percent of the price of delivered foods with the remainder reflecting costs of transportation, processing, distribution, and marketing. Over time these latter costs have risen steadily reflecting, in part, increases in labor costs and, in part, higher quality and better packaging. As a result, even when farm prices are stable, food prices, especially at retail, tend to rise.

Chart 10 shows the relation between farm and processed food prices and retail food prices. As expected, changes in farm product prices are more directly reflected in processed food prices. Changes in retail food prices tend to lag behind farm prices and fluctuate with less amplitude.

Following the decline in farm prices, processed food prices ended the year only slightly above the levels of December 1965. But retail prices remained 3.8 percent above the level a year earlier. The spread between farm and retail food prices narrowed during 1965, but then widened late in 1966. On the average, there is little evidence of an increase in processing and distribution margins. In the months ahead there may be some further decline in retail prices, but the rising trend in intermediate costs suggests that a full reversal cannot be expected.

RAW MATERIALS

The rise in raw materials prices which began in 1965 continued through 1966, although the prices of hides, secondary copper, and softwood lumber, which had risen rapidly during 1965 and early 1966, declined in the last half of the year. Prices rose for a wide range of mineral products, including sulphur, nickel, vanadium, and a number of other alloy metals. Some nonmineral raw materials used in industry—such as tobacco and wool—also rose.

Over long periods, the relative price of mineral products reflects a race between the improvement of the technology of discovery, mining, and refining and the gradual deterioration in the quality of available ores. Despite the fact that use is now made of ores which would have been discarded 30 years ago, the average price of minerals has not generally risen relative to other commodities.

In the short run, however, sharp increases in demand almost always mean higher prices for both ores and metals. Since it takes several years to develop new mines, increased requirements can only be met from inventories, and by stepping up output from existing capacity and from an expansion of capacity which is already under way. Once these limits are exceeded, as they have been for many of the minerals, pressures on price become severe. Even when primary producers do not raise their prices, or do not raise them enough to balance the market, secondary market prices will rise. The initial advance is likely to be accentuated by inventory speculation. Correspondingly, a relatively small improvement in the supply and demand balance can reverse the speculative movement and produce a sharp decline in price. These characteristics are shared by many nonmineral raw materials.

The upward pressure on raw materials prices in 1965 and 1966 reflected the slow response of supply to a sharp increase in demand. It was accentuated by the fact that the increase in demand was heavily concentrated in defense and capital goods which use large amounts of mineral raw materials.

Random factors such as strikes and interruptions in foreign supplies always influence raw materials prices. Copper and hides were particularly affected by changes in foreign markets. However, in 1966 the strength of demand and the basically tight supply situation magnified the impact of fluctuations in supplies.

In the case of copper, strong demand drove domestic consumption up by more than 200,000 short tons from the first half of 1965 to the first half of 1966. Foreign supplies were reduced by strikes and political disturbances in the principal producing nations. While this loss was largely offset by sales from the government stockpile, prices in the United States were influenced by changes in the outlook for foreign supplies. The price of primary domestic copper was not raised significantly until early 1967, but the price in the secondary market, which supplies about one-third of domestic consumption, rose sharply to a peak of nearly $1.00 a pound early in 1966, compared with 36 cents for the primary refined metal. It then eased to a range of 50 to 60 cents during the summer and fall.

The influence of demand pressures was also clearly shown in the case of softwood lumber prices, which rose rapidly early in the year under the pressure of rising defense and construction demand, and then sank as residential construction declined.

As indicated below, the rise in raw material prices played a significant role in the increase in prices of manufactured products during 1966.

MANUFACTURED GOODS

In contrast to some farm products and raw materials, price changes in most manufacturing industries do not reflect an automatic balancing of supply with demand through the operation of impersonal market forces. Producers in many industries have some degree of discretion in setting prices, although the range of discretion varies with competitive conditions from industry to industry.

Firms with considerable market power are often able to maintain markups over unit costs that are largely independent of changing market conditions. In other industries, the effectiveness of market power is more limited. When utilization rates are low, markups often have to be shaded. By the same token, when demand and capacity utilization rates are high, competitive pressures are weakened, presenting the opportunity to restore temporarily depressed markups to desired levels or even to raise sights on what is desired. In a few industries, market power is insignificant and markups over cost vary widely with demand conditions.

On the whole, the markup of prices over "standard costs" (based on assumed or standardized capacity utilization) appears to have been relatively stable in the past few years. Actual costs tend to decline as capacity utilization rises. The general improvement in capacity utilization between 1961 and 1965 would have produced very substantial increases in profit margins even if prices had been adjusted only enough to maintain a constant markup over costs calculated on a fixed volume. But as markets strengthened, some prices were raised even though costs had not increased. And some firms failed to reduce prices even when standard costs were falling.

After remaining stable from 1961 to 1964, prices of finished nonfood manufactures rose by 1.2 percent during 1965 and then moved up by 2.5 percent during 1966. Some part of the increase in prices was, of course, directly attributable to the rise in raw materials prices and unit labor costs. But the basic factor underlying the general price rise was the strength of demand and, in particular, the sharp increase in demand in late 1965 and early 1966.

Though demand pressures cannot be measured precisely, the relation between capacity utilization and the preferred rate of operation provides a crude measure. Capacity utilization in manufacturing has been increasing since 1961 and the average rate in 1966 was exceeded only in 1951 and 1953 in the postwar period. At the end of 1966, manufacturing industries were operating at an estimated 89 percent of capacity, compared with an average preferred rate of 93 percent (Table 13). The end-of-year capacity utilization was lower than the average for the year as a whole. Even so,

TABLE 13.—*Manufacturing capacity utilization, 1965–66*

Industry	Output as percent of capacity [1]		Preferred rate (percent) [2]
	December 1965	December 1966	
Total manufacturing [3]	90	89	93
Iron and steel	75	80	91
Nonferrous metals	99	95	95
Machinery	90	92	93
Electrical machinery	89	89	90
Autos, trucks, and parts	96	84	99
Other transportation equipment	95	102	93
Fabricated metals and instruments	87	89	92
Stone, clay, and glass	86	80	92
Chemicals	84	83	90
Paper and pulp	96	94	97
Rubber	96	98	93
Petroleum and coal products	94	97	98
Food and beverages	85	85	90
Textiles	99	96	96
Miscellaneous manufacturing	90	85	93

[1] Data for 1965, except iron and steel, from McGraw-Hill; estimates for iron and steel for 1965 and all industries for 1966 by Council of Economic Advisers after consultation with McGraw-Hill.
[2] From McGraw-Hill survey of *Business Plans for New Plants and Equipment, 1966–69, April 1966.*
[3] Not comparable with data in Table B–35 because of differences in methods of computation.

Sources: McGraw-Hill, Board of Governors of the Federal Reserve System, and Council of Economic Advisers.

operations were close to or above preferred rates in 9 important sectors: nonferrous metals, nonelectrical machinery, electrical machinery, "other" transportation equipment (aerospace and railroad equipment), fabricated metal products and instruments, paper and pulp, rubber, petroleum and coal products, and textiles. Furthermore, in 6 of these 9 sectors (all except nonferrous metals, paper, and textiles), operating rates either increased or held steady between December 1965 and December 1966.

The pressure of demand for finished goods is in itself a major element contributing to the rise in wages and in raw materials prices. Translated into a demand for labor, it can create shortages which bid up wages, or at least strengthen the bargaining power of unions. And, after being transmitted through a chain of suppliers and processors, the increased production requirements can pull up the prices of raw materials. Thus, by forcing up wages and raw materials prices, an increase in demand in one sector can raise production costs in other sectors. If aggregate demand is strong, producers in these latter sectors will tend to increase their prices to cover the higher costs. Thus, while it may at times be useful to describe a price increase in terms of cost factors only or demand factors only, in general both elements will be present.

The direct impact of materials costs is, of course, most evident for products requiring relatively little fabrication. For example, in 1966, copper pipe, brass fittings, and wire prices rose sharply in response to increased copper prices. But the effect of higher costs continued to spread, though somewhat more slowly, to products at more advanced stages of fabrication. Ultimately, increased raw materials prices exercised a pervasive influence on industrial prices, although their direct impact was notable in only a few cases. Similarly the rise in unit labor costs in manufacturing eventually influenced prices over a wide range of manufactured goods. But, without strong demand conditions, the rise in prices and costs would not have spread so quickly nor, of course, been so large.

Most manufacturing industries were affected to a greater or lesser degree by all these factors—rising unit labor and materials costs and pressures on capacity. However, in a few cases where demand pressures were conspicuously absent, prices did not rise or actually declined. Thus prices of synthetic fibers dropped during 1966 because capacity had outrun demand by a considerable margin.

The machinery industries afford the outstanding example of the problems involved in operations at rates close to full capacity and their reflection in the price movements. The demand for machinery grew rapidly while output was limited by shortages of skilled labor and some types of equipment, in part because the machinery sector had to compete with expanding defense production for labor, materials, and components.

Spurred by the capital boom of the past 5 years and the sharp rise in defense demands, production of machinery expanded by 67 percent between 1961 and 1966, an average annual growth of more than 10 percent. For the first time in many years both the electrical and the nonelectrical machinery industries were operating in 1966 at about their preferred rates and, in each segment, order backlogs grew by about one-quarter.

In the nonelectrical sector, there appears to have been sufficient plant capacity and manpower to meet the growing demand without much strain until early 1965. Then, beginning around mid-1965, some segments of the industry, especially machine tool producers, began to report increasing difficulties in recruiting and training skilled labor. After rising at an average annual rate of only 1.1 percent between 1961 and 1964, prices of nonelectrical machinery rose by 2.3 percent during 1965 and then 4.6 percent during 1966. Similar strains on capacity developed in the electrical machinery industry and prices, which had been declining for a number of years, changed little in 1965 and then rose by about 5 percent during 1966.

Summary

The moderate but persistent upward trend in manufacturing prices reflected the interaction of many factors, of which the most pervasive was the rapid increase in demand at a time when the economy was operating close to capacity. The actual course of prices varied considerably from industry to industry, depending upon the degree to which each was affected by changes in costs of materials, supplies, fuel, and labor, the balance between demand at prevailing prices and the capacity to meet that demand without undue strain, and the extent and exercise of discretion in the pricing policies of leading concerns.

On the average, the 2½ percent increase in manufacturing prices during 1966 was probably about commensurate with the average percentage increase in all elements of cost. This seems a reasonable inference from the over-all profit record in manufacturing. During the first three quarters of 1966, after-tax profits for all manufacturing averaged 5.6 percent of sales, the same as in the first three quarters of 1965. As a percentage of equity, however, they were higher—13.4 percent for the first three quarters of 1966 against 12.7 percent a year earlier.

CONSUMER SERVICES

Since 1947, the cost of consumer services has risen at an average rate of about 3½ percent a year, more than twice as fast as for commodities at retail; between 1960 and 1964, the rate of increase was a little over 2 percent a year; and in 1965 it was about 2½ percent.

Between December 1965 and December 1966, the rate of increase jumped to 4.9 percent, accounting for half the total rise in the consumer price index. This acceleration reflected partly an intensification of existing long-run trends and partly the appearance of new factors.

The services included in the index are a highly diversified group, but they can be regarded as comprising three very broad and somewhat oversimplified categories: (1) rents and utility rates, (2) labor intensive services, and (3) financial charges.

The behavior of prices in the first of these categories differed little during 1966 from earlier trends, and increases were relatively small (Table 14).

The second group—labor intensive services—is quite heterogeneous; but in most cases the scope for significant improvements in productivity is limited, and therefore costs and prices are sensitive to changes in wage rates. This is true whether the labor involved is relatively highly skilled (as for professional services, repair mechanics, barbers, and beauticians) or relatively unskilled (as for domestic services, hotels, motels, or laundry and dry cleaning).

As already indicated, wage increases in the service industries accelerated during 1966. This was also true of fees for professional services. The resulting rise in personnel costs was aggravated, in some instances, by increases in other cost elements, such as commercial rents and hospital equipment.

While prices for virtually all these services had been rising for years, the advance was particularly sharp during 1966. Examples are shown in Table 15.

The third category of services—financial costs—had received relatively little attention in the past, though property taxes had been rising slowly and property insurance rates more rapidly. Both accelerated considerably during 1966, and a major new element was added: mortgage interest rates, which had remained quite stable in preceding years, rose by 12.4 percent.

As shown in Table 14, these higher financial costs accounted for over one-third of the total advance in prices of services during 1966. A large part of this advance reflected increased mortgage costs. The fact that the increase in mortgage interest rates had such an impact on prices reflects

TABLE 14.—*Changes in consumer prices for services during 1966*

Type of service	Percentage change, December 1965 to December 1966	Contribution to total change in 1966 (percent)
All services	4.9	100
Interest and property insurance, and taxes	7.4	36
Public transportation and labor-intensive services	6.5	51
Public transportation	6.4	5
Medical services	8.1	22
Skilled labor services [1]	5.2	15
Other [2]	5.9	9
Rent and utilities	1.0	5
Rent	1.6	5
Utilities	.1	(3)
All other services [4]	4.4	8

[1] Includes repair and maintenance services, barbers, and beauticians.
[2] Includes hotels and motels, domestic services, babysitters, laundries, drycleaning, and shoe repair.
[3] Less than 0.5 percent.
[4] Includes postal charges, recreational services, legal and banking services, etc.

NOTE.—Detail will not necessarily add to totals because of rounding.

Source: Department of Labor.

TABLE 15.—*Changes in consumer prices for typical labor-intensive services since 1959*

Type of service	Percentage increase per year	
	1959 to 1965	December 1965 to December 1966
Physicians' fees	2.7	7.8
Daily service charges in hospitals	6.4	16.5
Men's haircuts	2.8	7.7
Dry cleaning	1.6	6.0
Local transit fares	3.2	9.1
Housing maintenance services	[1] 3.0	6.8

[1] Data for 1959 not available; increase from December 1963 to December 1965 used.

Source: Department of Labor.

the system of measurement used in constructing the index. The index is designed to measure the change in prices associated with *commitments currently entered into,* rather than the change in the cost of *current expenditures* related to commitments entered into in the current and past periods. Had weighting been based on current expenditures rather than commitments entered into during the year, the increase in the over-all consumer price index would have been about 0.4 percentage points less.

There are other difficulties in measuring service prices. Changes in the quality of services are difficult to assess. This is particularly true of medical services because of the progress in medical techniques. It is impossible to make a statistical correction for the changing quality of medical care, but it is clear that the cost of a given standard of health care has risen less than the indexes indicate.

PRICES AND THE DISTRIBUTION OF REAL INCOME

The significance attached to price movements varies with the perspective of the observer. A trade association usually reports a price rise for the products of its members as an improvement in prices. But the firms in another industry using those products describe the same price increase as an unfortunate rise in costs. A rise in the price of haircuts is a rise in the cost of living to most of us, but it means an increase in income to barbers. Wages are incomes to workers but costs to employers.

In 1966, wages, profits, and farm incomes all rose rapidly in money terms. But the gains in money income could not have been so large without price increases. Those increases turned very large money gains into smaller, though still substantial, increases in real income.

In 1966, the nominal increases in hourly compensation were unusually large—4.8 percent for manufacturing employees and 5.7 percent for other nonfarm workers. Farm wages rose by 8.3 percent and net income per farm by 10.3 percent. But after adjustment for price increases, hourly compensation in the nonfarm sector increased by only 2.6 percent and net income per farm rose by 7.0 percent. In manufacturing, real hourly compensation rose by less than 2 percent. Because some of that gain represented increased employer contributions to social security, real hourly take-home pay for manufacturing workers increased even less for the year as a whole and actually declined between the end of 1965 and the end of 1966.

The disparity between the large nominal gains in hourly compensation and the very moderate increase in real compensation per man-hour in 1966 emphasizes again the fact that more cannot be taken out of the economy than is produced. On the average, labor productivity in the private economy can be expected to increase by somewhat over 3 percent a year. Real hourly compensation cannot rise more rapidly than that except at the expense of other incomes. In conditions of strong demand and full utilization of resources, a general increase in money wages in excess of productivity growth is more likely to result in a rise in prices than in a corresponding increase in real wages.

When producers pursue pricing policies designed to increase the share of income going to profits or to maintain that share at excessively high levels, this too is likely to be self-defeating. Despite sizable short-run fluctuations due to changing utilization rates, the profit share of income has shown no perceptible trend over the long-run (Chart 11). When profits are unusually high, they encourage workers to demand higher wages. By pushing up the cost of living, the price increases necessary to sustain a high profit share provide further incentive for increased wage demands.

Thus, in 1966, price increases were no more successful in raising the profit share than nominal wage increases were in accelerating real wage gains. The share of gross profits in corporate gross income had been rising steadily throughout the expansion. This was of course a normal response to the rise in capacity utilization. The profit share reached a peak in the first quarter of 1966 and then, despite rising prices, began to decline slowly.

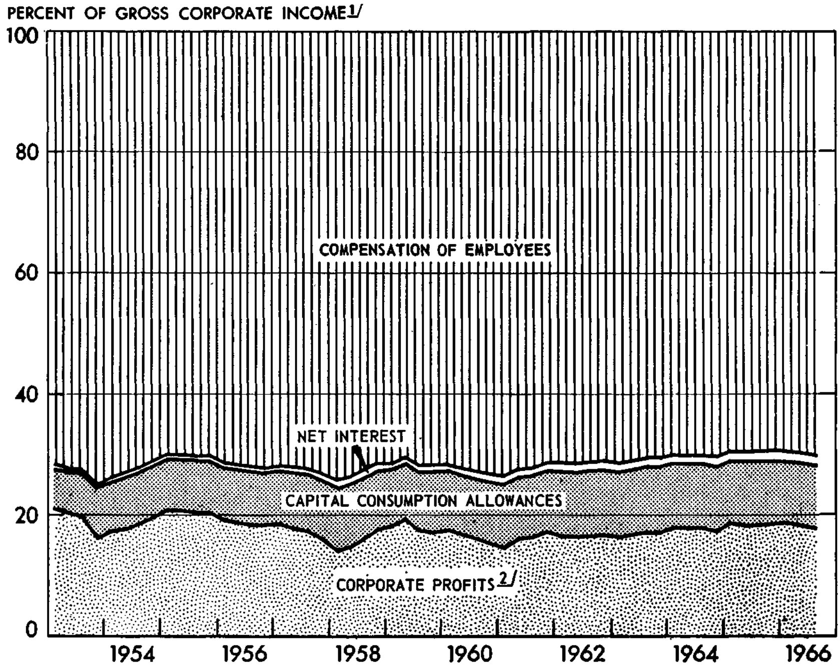
Within the manufacturing sector, the decline in profits after the first quarter of 1966 resulted in a decline of 1½ percentage points in the profit share of gross manufacturing income. Nonmanufacturing corporations experienced a similar though less pronounced decline in share.

The decline in the profit share reversed the upward movement which had continued since 1961. That movement was, as noted earlier, primarily due to the improvement of capacity utilization from the low levels ruling in 1961. In spite of the small decline during 1966, the corporate profit share remained substantially above the post-Korean average, though somewhat lower than in 1955.

The relatively minor change in the aggregate share of labor income was accompanied by significant differences in the wage gains in particular sectors. In general, wages increased more rapidly in the nonmanufacturing sectors than in manufacturing. Construction workers made notable gains, as did medical workers from the professional level on down. Other professionals, such as teachers, enjoyed sizable increases in compensation, and trade and service wages continued to advance relatively rapidly.

Chart 11

Shares of Gross Corporate Income



1/INCOME ORIGINATING IN BUSINESS PLUS CAPITAL CONSUMPTION ALLOWANCES; BASED ON SEASONALLY ADJUSTED DATA.
2/CORPORATE PROFITS PLUS INVENTORY VALUATION ADJUSTMENT.
NOTE.–DATA RELATE TO DOMESTIC ACTIVITY OF NONFINANCIAL CORPORATIONS.
SOURCES: DEPARTMENT OF COMMERCE AND COUNCIL OF ECONOMIC ADVISERS.

Of course, the most dramatic income movement was the 7 percent gain in real income per farm. The relative improvement in farm income was largely a result of the sharp rise in prices of farm products in 1965 and early 1966. By the last quarter of 1966, farm prices had begun to fall and income per farm declined substantially from the peak in the first quarter. However, for 1966 as a whole, real income per farm still showed a gain of more than one-third over 1964.

OUTLOOK FOR PRICES

While forecasts of price trends are even more hazardous than other forms of economic prediction, there is good ground for anticipating that 1967 will witness progress toward greater price stability. That view is based on the expectation, reviewed in Chapter 1, that the growth of the real GNP in 1967 will not exceed the growth of productive resources.

Average wholesale prices in the farm and food sector should be relatively stable, if weather is normal, with advances for some items approximately balanced by reductions for others. However, retail food prices will probably continue to rise, although more slowly than in 1966.

The sharp increase in mortgage interest rates, which significantly affected the average level of consumer service prices in 1966, should not be repeated in 1967. Costs for medical care will continue to increase and prices of other labor intensive services may also rise, although less rapidly.

Demand pressure on manufacturing prices should be significantly reduced in 1967. With capacity increasing by an estimated 7 percent, there will be a slight reduction in average capacity utilization as well as a better balance among industries. A small decline in manufacturing capacity utilization may have an adverse effect on productivity in some industries, but, in others, such a decline will reduce the need to use obsolete facilities. Moreover, the large amount of new capital coming into use should improve productivity.

The movement of employment costs will be affected by a number of conflicting factors. The pressure of demand on wages in unorganized labor markets will be somewhat weaker. Although employment will grow in pace with the growth of the labor force, the balance between the skills in demand and those available will improve. However, there will be continued upward pressure on the compensation of some groups of professional and technical workers. At the other end of the scale, the scheduled increase in minimum wage rates will raise employment costs in some sectors.

During 1966, negotiated wage settlements had only a limited influence on the over-all movement of employment costs. In 1967, the average size of negotiated wage increases will tend to increase and the number of workers affected will also be larger. These increases will have a significant influence on the costs of the particular industries involved. However, only about 7 million workers—less than 10 percent of all private employees—will be involved in this year's wage negotiations. Consequently, taken by itself, the direct and immediate effect of higher union wage settlements will be relatively small. However, increases obtained by organized workers tend to pull up the wages of unorganized workers in the same labor market. This process will broaden the impact of union settlements on wages and costs in 1967 and will continue to affect wage costs for a much longer time.

The increase in employer contributions for social security in 1967 will be much smaller than in 1966. That will more or less offset other factors tending to push up the rate of increase of hourly employment costs.

Unit labor costs will doubtless continue to rise this year. But with greater stability in the farm and food sector, and with less acute demand pressures in product markets, the rise in the general price level in 1967 should be more moderate than in 1966.