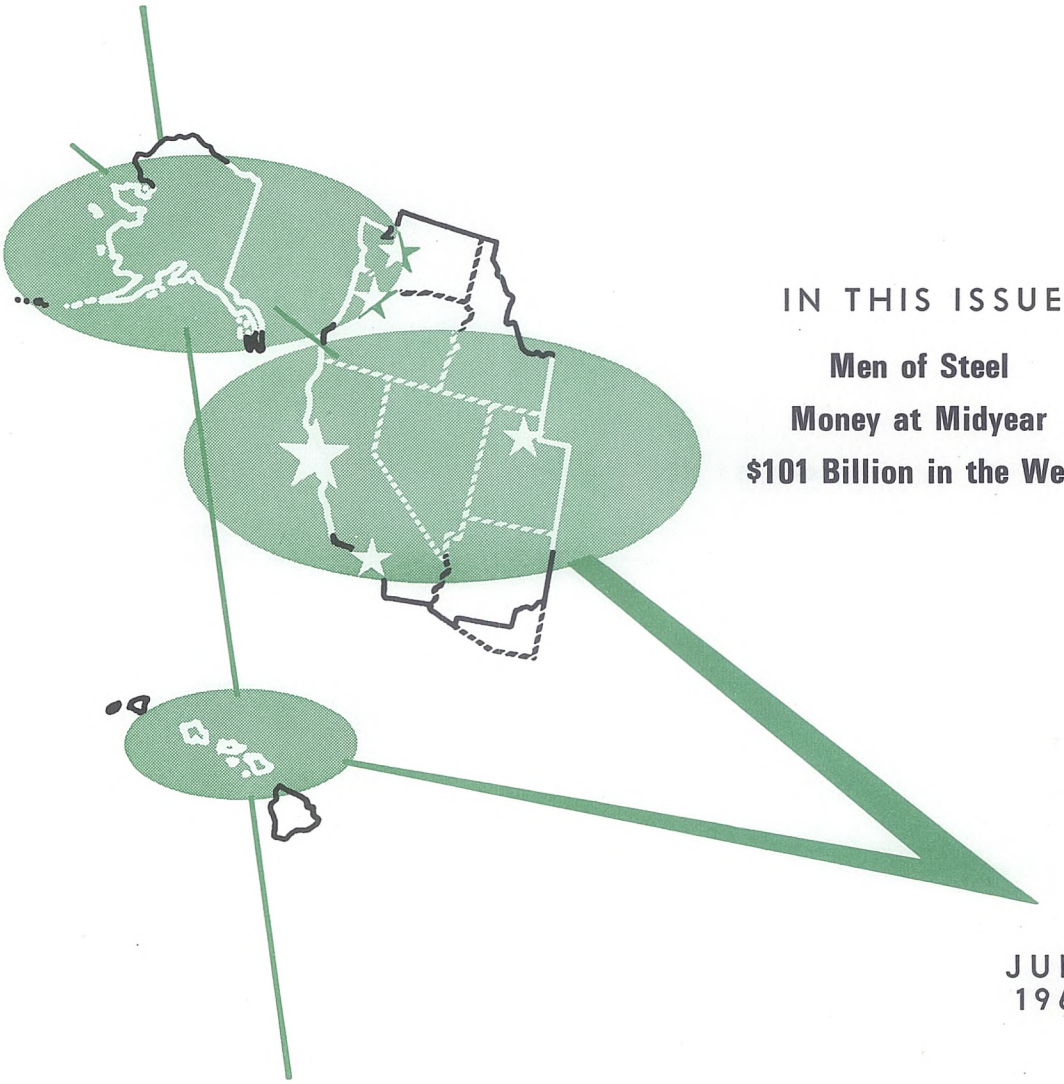
FEDERAL RESERVE BANK OF SAN FRANCISCO

MONTHLY REVIEW



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JUNE
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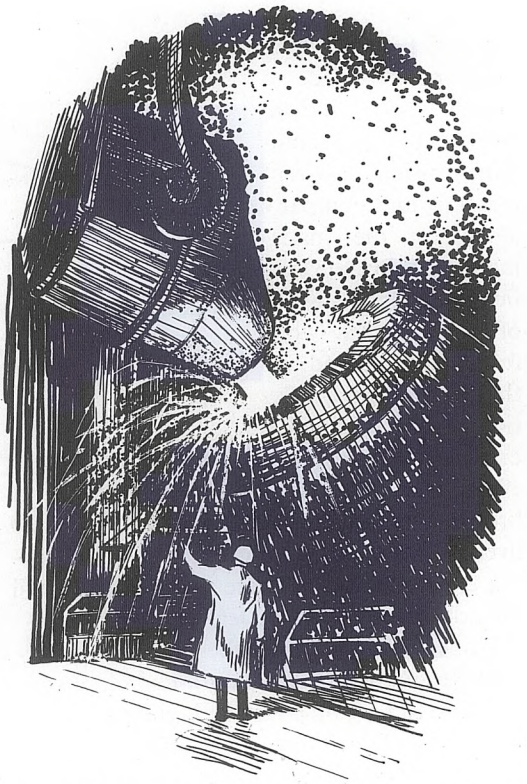
. . . The regional market, after doubling in size within a decade, is now larger than any nation in the Western world except the U.S. itself.

Editor: William Burke

Men of Steel



Steel, which in 1968 provides the skeletal frame and sinews of American industry, may well play the same basic role in the year 2000 that it does today. Despite the continued competitive inroads of substitute materials and foreign steel, the domestic steel industry hopes to triple its production over the last third of the 20th century. And despite the great advances of technology, hundreds of thousands of workers will still be required to produce the steel frame of the growing national economy—which means that negotiations between the United Steel Workers (USW) and the major steel companies will continue to provide newsworthy copy in the 21st century.

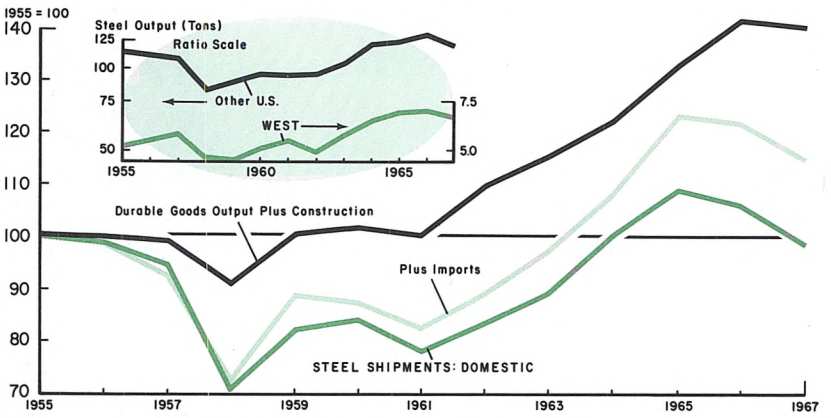
Workers in primary-metals manufacturing (the basic constituency of the USW) number about 1.3 million, with roughly half working in iron and steel and the other half in nonferrous metals and metal fabrication. Most of these workers are concentrated in the Great Lakes States and the Eastern Seaboard, but they are also heavily represented in California's steel works, the Northwest's aluminum mills, and the Mountain States' copper smelters. In the West, primary-metals employment has risen almost 10 percent over the past decade to 95,000—two thirds of the total being employed in California—while employment elsewhere has returned to the decade-ago level of 1.2 million after a significant dip in the early 1960's.

New contracts signed earlier this year in the copper and can-making industries have affected the regional and national economies, but this summer's negotiations in aluminum and in steel will exert an even greater impact on future wage-price developments. In view of the crucial nature of the steel negotiations, the industry's past record of labor negotiations and its present economic environment merit a review.

Pre-war bitterness

Since the late 19th century, steel negotiations have been marked by a number of bitter strikes, several ending in violence, but they have also led to substantial advances in wages and working conditions for the industry's work force. The first important event in the industry's annals was the Homestead strike of 1892, wherein a skilled-worker group (the Amalgamated Association of Iron, Steel, and Tin Workers) fought against wage reductions by calling a strike, which was defeated when the state militia intervened after a pitched battle between strikers and Pinkerton agents.

Steel provides skeletal frame of national economy, although shipments lag behind output of major users



In later decades, a paternalistic management policy made it possible for skilled workers to obtain company pensions, low-rent housing, and company stock on the instalment plan. But the less-favored circumstances of the unskilled work force, accentuated by the World War I inflation, led to a massive organizing strike in late 1919. This strike was broken after 3½ months with the loss of 20 lives and $100 million in wages, and unionizing efforts thereafter were unsuccessful until the advent of the New Deal.

Under Section 7A of the National Industrial Recovery Act, which granted employees the right to bargain collectively through representatives of their own choosing, and under the stronger language of the National Labor Relations Act (Wagner Act), organizing activity began again under the auspices of the Steel Workers Organizing Committee. These efforts met with partial success in "Big Steel" in 1937, with the top-level agreement between John L. Lewis and Myron W. Taylor, but they met with failure in "Little Steel" until the War Labor Board forced that group of firms to recognize the union in 1941. Incidentally, the Little Steel formula devised in those negotiations provided the basis for all wartime wage increases in industry, essentially by tying wage awards to the rise in living costs since the outset of the war.

Postwar gains

In the postwar period, a nation-wide pattern of wage increases followed by price increases was set by the steel and auto agreements of 1946. Between 1946 and 1965, steel labor and management representatives have engaged in a number of major wage negotiations, but most of the agreements in the early postwar period were accomplished only at the expense of prolonged strikes (1946, 1949, 1952, 1956, and 1959). The contract gains of the present decade, however, have been achieved without the use of the strike weapon.

The first postwar round, in 1946, occurred when the union obtained an 18½-cents-an-hour wage increase and the industry responded with a $5.00-a-ton price increase. The second and third rounds, in 1947 and 1948, provided the union with smaller packages of wages and fringe benefits, but led to the institution of annual wage re-openers. Until 1956, steel negotiators utilized this system rather than the auto industry's escalator system, which tied wage increases to changes in the consumer-price index. (But steel, unlike autos, has dropped the escalator clause in recent years.)

In 1949, a settlement was obtained only after the intervention of a presidential fact-finding board, and in 1952, only after presidential seizure of the mills and the eventual use of Taft-Hartley Act procedures. But more important, these and later negotiations rounded out a complete package of job-security measures, such as pensions, insurance, extended vacations, and supplementary unemployment benefits.

Human relations: post-1959

At the end of the bitter 116-day strike of 1959, the union got no more than a 3.5-percent package increase—considerably less than the 8-percent annual average of the earlier postwar period—and management got no satisfaction in its attempt to revise local work practices. To protect against a repetition of that experience, both sides agreed to set up the Human Relations Committee to find solutions to their mutual problems, especially those generated by technological progress.

Later, under the Kaiser Plan of 1962—a notable Western innovation in labor-management relations—a method was devised for sharing the savings resulting from improvements of productivity. Under this plan, technologically unemployed workers are not laid off but rather are retrained and reassigned to other work, and workers get roughly one-third of all dollar savings created by technological improvements.

In the 1962 negotiations, the union obtained only a small increase, with no straight-time wage increase in the package, and management was forced to get by without any price increase after a traumatic confrontation with the White House. In 1963, as in 1962, improvements in fringe benefits made up the entire package. But in both these and the 1965 negotiations, overall increases conformed fairly closely to Administration guidelines, with a major part of the contract improvements going to meet the union's job-security demands —for example, through 1963's extended-vacation plan, which provided 13 weeks' vacation every five years for the senior half of the union-represented work force.

Aluminum Settlement

Major aluminum producers settled with the United Steelworkers union but failed to reach an agreement with the Aluminum Workers union prior to the June 1 strike deadline. The pact with the Steelworkers, which should set the final pattern for the aluminum industry—and perhaps for the steel industry as well—contained a 6.5-percent annual package increase for the three-year contract period.

The basic package calls for average wage boosts of 55.9 cents over three years, including 45 cents for straight wage increases, 8.2 cents for increased differentials between job classes, and 2.7 cents for upgrading jobs to higher classifications. The pact also contains significant improvements in fringe benefits, including bonus vacation pay, increased pension benefits, and (in the third contract year) increased supplemental unemployment benefits. The 97-cents pricetag for the hourly package increase puts it above the 90-cents package negotiated by the Steelworkers and the can industry earlier this year.

Following the settlement, one major producer immediately raised prices from 25 to 26 cents a pound on unalloyed ingot, the primary form of the metal, and similarly added 4 percent to the prices of most fabricated products. Ingot prices had been as high as 26 cents in 1961 and as low as 22½ cents the following year.

Aluminum prices were last raised in January 1967, when they went up by one cent on ingot and ½ cent on fabricated products. The industry was unsuccessful in an earlier try, in November 1965, when the Administration forced a rollback by threatening to dump aluminum from the Government stockpile.

Job security: perennial

The drive for job security reflects the relatively stagnant growth of the USW membership rolls and of primary-metals employment in general. Union membership jumped from 125,000 in 1937 to 858,000 a decade later, and to 1,086,000 at the 1957 peak. After a decline to below 900,000 in the early 1960's, membership again is back to its peak level, but primarily because of the union's absorption last year of the mine-mill-smelter union. Moreover, employment in all primary-metals facilities amounts to no more than 7 percent of total manufacturing employment today, as against a 9-percent share two decades ago.

In steel especially, the core of the industrial-relations problem is the shrinking workforce required to meet the economy's needs for the metal. The union leadership throughout the postwar period has thus worked to cushion the required workforce adjustments, through such means as shorter hours, longer vacations, and expanded pension, insurance, and employment benefits. Yet, as each of these costly goals is achieved, management is forced to intensify its cost-cutting (and job-reducing) efforts in order to remain competitive in the face of the challenge posed by domestic substitutes and foreign imports.

Conflicting goals

Management's negotiating problems will be increased this year by the discrepancy between two conflicting union goals: a veteran leadership's perennial drive for future job security and a younger rank-and-file's inflation-fueled drive for higher take-home pay right now. Whereas the USW a generation ago represented a relatively old work force drawn from all the ends of the Austro-Hungarian empire, today it also represents a younger element drawn from all segments of American society, including suburbia. Press reports of an unpublished yet widely quoted AFL-CIO survey indicate that roughly half of all union members live in middle-income suburban communities, and that they are far more concerned with local community issues of schools, highways, and garbage collection than with such traditional union issues as improved social-security benefits.

The 1966 USW convention, reflecting the conflict in goals between the old and the new union members, adopted a "decentralization" policy to give the rank-and-file greater participation in bargaining. The 163-member wage-policy committee continues to be responsible for general policy, but special industry problems will henceforth be delegated to separate policy committees in steel, aluminum, nonferrous metals, and can-making. The general committee will no longer settle the overall contract for the entire jurisdiction; instead, the separate industry committees will participate in setting contract goals and will themselves vote on contract ratifications and strike authorizations.

Future negotiations thus will see some extension of present special agreements across a wider range of negotiating topics. But even with greater decentralization, the bargaining scene may not be so complicated as in 1965, when union policy was set by the 163 members of the wage-policy committee, 700 presidents of union locals—and two candidates for the USW presidency.

More money?

Basically, however, the USW and its rank-and-file simply want "more" this year than they achieved in 1965. The package increase negotiated last time averaged 3.5 percent annually for the three-year period, or little more than was called for by the Administration's then-current wage guidelines. But unions in the auto, rubber, and can industries have recently obtained 6-percent package increases, so that the 6-percent figure effectively represents the minimum desired by USW negotiators in aluminum and steel. The union also is

asking for liberalized pensions and shorter work periods, along with further progress in the direction of a guaranteed annual wage.

Steel bargaining began at the plant level in mid-April, when 15,000 individual demands were introduced for discussion, while bargaining on the economic package was set to begin in mid-June, only about five weeks before the contract deadline. In contrast, negotiations began at least four months prior to the deadline in each of the strike-free years, 1962-63-65.

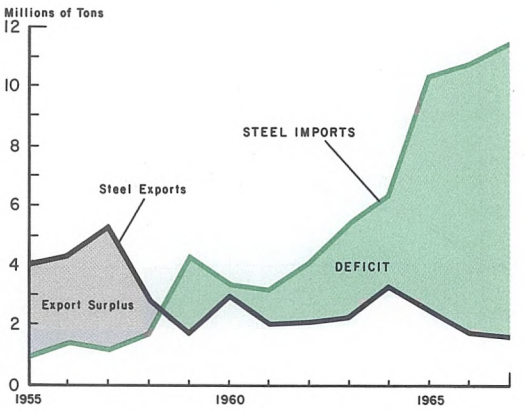
Bargaining this year is taking place against a backdrop of rising production, rising productivity, rising prices, and also rising imports. Negotiators on both sides of the bargaining table are especially conscious of the challenge to the industry—and the challenge to the balance of payments—generated by a modern, efficient, low-cost foreign steel industry. With world steel capacity doubling over the last decade to more than 600 million tons, the U.S. share has dropped to not much more than one-quarter of the total, and U.S. plants have dropped behind European and Japanese plants in terms of efficiency.

More imports?

Steel imports, which totaled only about 1.0 million tons in 1955 (as against exports of 4.0 million tons), first made serious inroads in the American market during the prolonged strike in 1959. Imports totaled 4.4 million tons that year, and the import challenge has increased during each of the four strike-hedge negotiating periods of the 1960's. Imports reached 11.5 million tons in 1967, and may well climb to 17 million tons this year. With exports meanwhile declining, the steel industry's balance of trade has shifted over the past decade from +$650 million to −$900 million.

But the import challenge is due to more than just the demands of a booming U.S. economy and the relationship of steel costs here and abroad. This challenge also reflects the fact that foreign producers developed almost all

Foreign invasion of U.S. market leads to widening export deficit



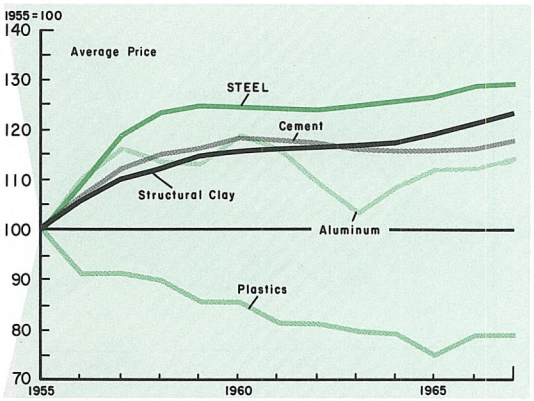
the basic technological breakthroughs of the postwar period. The Austrians first used the oxygen-injection method in blast furnaces and steel converters; the French and Swedes perfected the electric furnace to make pig iron; the French pioneered the efficient use of low-quality coke, and the British and Japanese first developed ways of concentrating, pelletizing, and sintering low-grade ore.

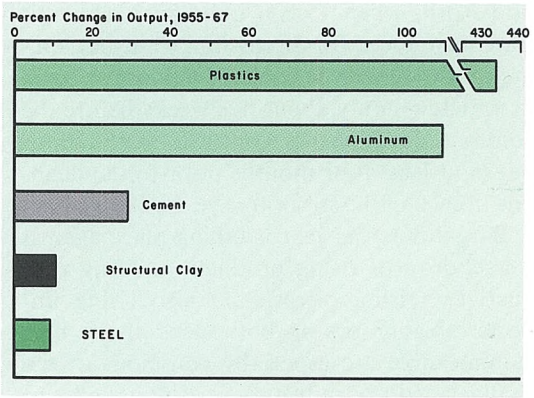
Production and prices

Yet, with all that, the domestic industry has in recent years posted a creditable production and productivity record, and, until recently, a record of stable prices as well. (Some steel puddlers recently even began to peddle steel, quoting discounts of 15 percent or more on flat-rolled stainless, but most of the industry greeted this heretical notion with dignified silence.) On the strength of the booming 1968 economy, steel consumption may exceed 100 million tons this year, as against totals of 95 million tons in both 1967 and the last contract year, 1965.

Imports, as indicated, are siphoning away a major part of the expanding American market, but the industry has managed to avoid 1965's severe supply problem through the expansion of finishing capacity and through smoother

Steel loses markets to substitute materials, reflecting sharp price advances of late '50s and late '60s





scheduling of orders. Steel mills this year have not only added new rolling capacity but have also built up mill stocks of in-process and semi-finished steel, and in addition, they have offered to store steel orders or give users 120 extra days to pay. Inventories of finished steel jumped 20 percent over the fall and winter period alone, so production in the second half of 1968 should decline even if a strike is avoided. But since output in the January-May period exceeded the year-ago figure by at least 15 percent, 1968 as a whole should still wind up with a quite respectable record.

The price outlook is another major element in the 1968 environment. Despite improvements in productivity and despite the import challenge, steel prices rose about 5 percent over the 1962-67 period, and have risen about 2 percent since last summer alone. This performance is not nearly so bad as the 25-percent increase of the 1955-59 period—the increase which caused steel to be branded as the major culprit for the inflationary push of the late 1950's—but it creates substantial problems for the economy in the present inflationary year.

The rising price trend for steel products, moreover, has helped to account for steel's loss of markets to substitute materials over the past dozen years. Between 1955 and 1967, steel output increased 9 percent, as against a 109-percent increase for aluminum and a 434-percent increase for plastics. Largely because of the legacy of the 1950's, then, steel production has increased only about 50 percent for the entire postwar period, as against a 150-percent expansion for all manufacturing.

More productivity? more pay?

Productivity, however, is now the key to the domestic industry's prospects for stable prices and international competitiveness—and to labor's demand for an expanded wage package. On the basis of a strong technological performance in recent years, output per man-hour in steel manufacturing last year was about 30 percent above the 1957-59 base, roughly in line with the productivity increase in all manufacturing.

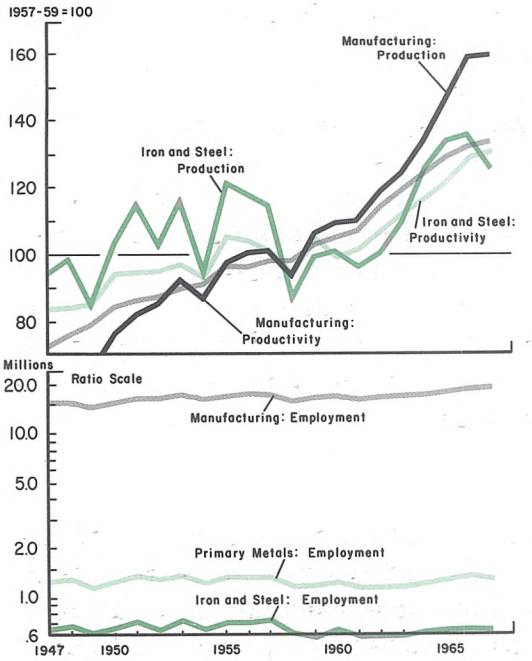
The American industry is now beginning to benefit from the innovations developed abroad in the early postwar period. The basic-oxygen furnace, which is some four to six times faster than the open-hearth process and is also substantially cheaper in terms of capital and operating costs, has increased its share of total

capacity from roughly zero a decade ago to about one-fourth of the total today. The continuous-casting process, which converts molten steel directly into semi-finished shapes, has also stimulated large productivity gains.

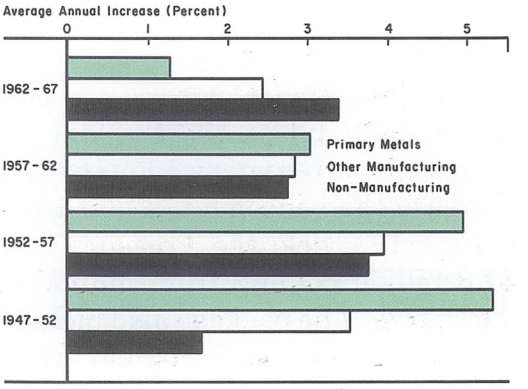
Labor, of course, hopes to benefit from these and future productivity savings, especially since the trend of real compensation in steel and other primary metals has lagged behind the metals industry's productivity trend in recent years—in contrast to the situation in the earlier postwar period.

Moreover, average real compensation per full-time worker—wages plus fringe benefits, adjusted for changes in consumer prices—increased only about 1 percent annually in primary metals in the 1962-67 period, as against a 2-percent average gain in other manufacturing and a 3-percent average gain

Rising productivity permits rising output with stable workforce



Primary-metals workers set pace in earlier postwar periods, but now lag in growth of compensation



outside manufacturing. Yet, productivity gains have been somewhat higher in the metals industries than elsewhere over this recent timespan. Nonetheless, because of the sharp advances in compensation in the earlier postwar period, primary-metals workers still earn significantly more than other workers—in 1967, average total compensation per full-time employee was roughly $9,200 in primary metals, as against roughly $7,800 in other manufacturing and $6,700 in nonmanufacturing industries.

In the light of these favorable developments in production and productivity, and in the face of the steel import challenge, USW negotiators will strive hard to restore earlier inter-industry differentials and to gain a larger share of the savings generated by technological progress. Management negotiators, however, will bargain with an eye on the heavy costs of technology, along with the inroads made into steel's markets by foreign steel and by domestically produced substitutes. Interested onlookers meanwhile will remain concerned with the impact of the price of this key industrial material on both the domestic price level and the nation's trade balance.

William Burke

Money at Midyear

Tax Bill: The Surcharge

In late June, Congress responded to the President's invitation to "bite the bullet" and passed the long-delayed tax bill. The surcharge, which is retroactive to January 1 for corporations and to April 1 for individuals, will increase their income taxes at the rate of 10 percent a year. . . . The bill is expected to yield the Treasury $15.5 billion by the end of fiscal 1969, with $7.8 billion coming from individuals and $3.8 billion from the corporate surcharge. The package also includes $1 billion from a speed-up of corporate tax payments and $3 billion from the extension of automobile and telephone excises.

Tax Bill: The Cutbacks

The bill incorporating the revenue increases also included several budget restraints, 6-8-10 being the relevant numbers. Actual spending for fiscal 1969 was reduced $6 billion below the total in the President's January budget, to $180.1 billion. Moreover, cutbacks of $8 billion from old obligational authority must be shown in next January's budget document, while a reduction of $10 billion from last January's request for new obligational authority must be recorded for fiscal 1969. (These figures refer to commitments for disbursements over more than one fiscal year.) . . . The spending cutbacks are still only target figures, and do not apply to four major budget areas—Vietnam, debt interest, veterans' benefits, and social-security expenditures. But the bill requires a reduction of almost 10 percent in Federal employment. Besides, a number of normal appropriations bills already showed the effects of the economy drive as they wound their way through Congress, as the ax fell on NASA's space hardware purchases, the AEC's 200-billion-electron-volt proton accelerator, and even on usually sacrosanct rivers-and-harbors appropriations.

Monetary Environment

Monetary policy continued tight in the inflationary atmosphere of late spring. During May, member-bank net borrowed reserves averaged about $380 million, or somewhat above the April average. Member-bank borrowings continued to increase, while excess reserves showed little further

change. . . . Yields on most Treasury notes and bonds rose to their highest levels in a century around mid-May, but they then declined sharply over the following month. Yields on new corporate and municipal bonds also declined in early June. Treasury bills generally moved in the same direction as Treasury bonds over this period. The three-month bill was bid at around 5.70 percent in mid-June, but then dropped as the market reflected expectations of less monetary tightness in the tightening fiscal atmosphere.

Curbs on Speculation

The Federal Reserve Board, expressing concern over the "excessive" amount of credit fueling the nation's stock markets, in early June raised the minimum down payments for listed stocks and convertible bonds bought on margin. The Board increased margin requirements on loans for listed-stock purchases from 70 to 80 percent of the purchase price, and also raised the margin level on convertible-bond credit purchases from 50 to 60 percent. . . . Wall St. authorities took several steps of their own to curb the speculative upsurge, which created severe difficulties for the exchanges and "sheer pandemonium" in over-the-counter trading. Among other steps, the industry began to eliminate trading for one day a week over a four-week period, as a means of clearing up the logjam in back-office paperwork, and major firms reduced their advertising for new accounts and cut back their dealings in low-priced securities and margin transactions.

$101 Billion in the West

A booming regional economy lifted personal income in the West to $101 billion in 1967—up from $93 billion the year before. With the District economy now twice the size of a decade ago, this region boasts a larger consumer market than any nation in the Western world outside the U.S. itself.

By the second half of 1967, the District economy accounted for 16.3 percent of the national market, according to recently released Commerce Department data. This was up strongly from the 14.9-percent share of a decade ago, but was a notch below the level of several years ago. The District share had drifted down from 16.4 to 16.1 percent of total personal income between early 1964 and late 1966, partly because of sluggishness in California's aerospace and construction industries and partly because of the defense boom's relatively greater impact elsewhere during the early Vietnam period.

A decade's growth

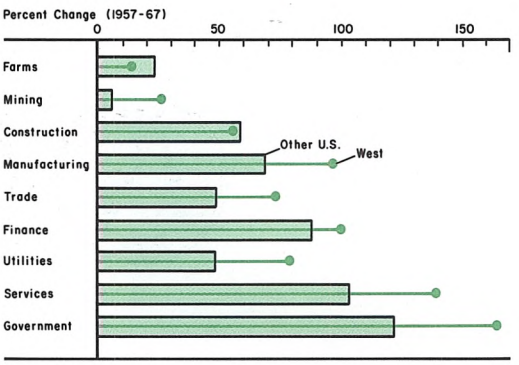
The rest of the national market expanded by 75 percent in the 1957-67 period, with rising per capita income accounting for 54 percent of that increase and rising population for the remainder. All but one of the nine District states recorded increases of over 75 percent in total income, but most did so only because of a faster-than-national pace of population growth. Only Hawaii, Washington, and Alaska —with per capita increases of 71, 60, and 56 percent, respectively—outdistanced the non-Western states in terms of per capita growth.

The states boasting the fastest growth of *total* income over the decade—Nevada, with 139 percent, and Arizona, with 116 percent—were helped along by their very sharp population gains. The state accounting for the vast bulk ($35 billion) of the dollar increase in income—California—also found over half of its 98-percent increase attributable to population growth.

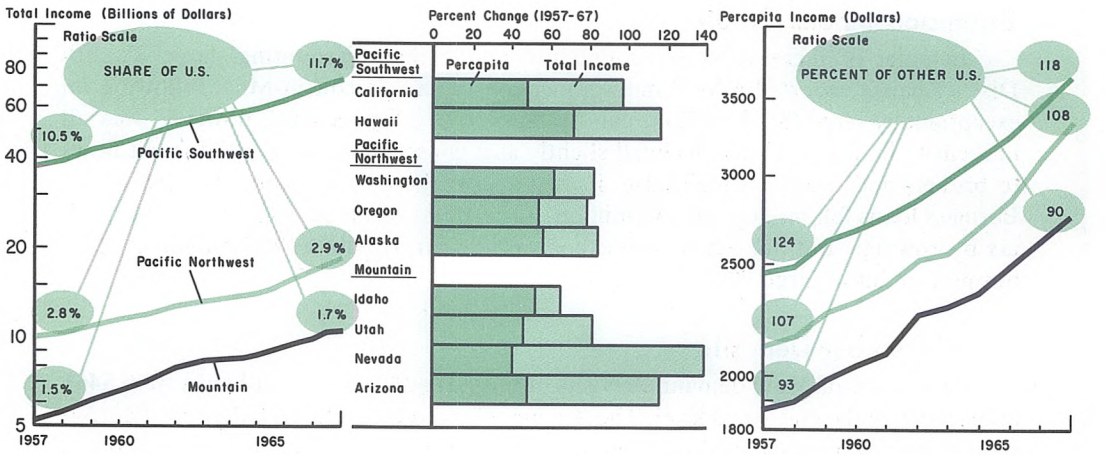
Per capita: shifting margins

Between 1957 and 1967, per capita income outside the District rose from about $2,000 to almost $3,100. The Pacific Southwest region (California and Hawaii) maintained a 24-percent margin over the non-District figure over most of the decade, but the margin slipped from 24 to 18 percent in the 1964-67 period because of the stepped-up growth elsewhere. Even so, in 1967 only New York and Illinois among the major states recorded a higher per capita income than the Pacific Southwest's $3,640 figure.

Government, finance, services post largest increases in income



Western states outpace nation in terms of total income, but mostly because of faster rate of population growth



Per capita income in the Pacific Northwest (Washington, Oregon, and Alaska) ranged between 6½ and 7½ percent above the non-District figure during most of the past decade, but the boom in "Pugetopolis" has widened the margin from 7 to 8 percent over the last three years. With the boom reaching ever-higher levels, the Northwest's per capita income rose to $3,320 last year.

Per capita income in the Mountain region (Idaho, Utah, Nevada, and Arizona) remained consistently below the figures recorded elsewhere over the 1957-67 period, although this was offset in some measure by the lower level of living costs in this area. The Mountain region's per capita income was about 6 percent below the non-District figure in both 1957 and 1964, but the margin widened to 10 percent last year because of the impact of the prolonged copper strike on mining communities.

Total income: shifting industries

The strongest growth sectors over the past decade, in the West as elsewhere, were government, services, and finance: in District states, income from those sources expanded by 167, 141, and 101 percent, respectively, over the ten-year time-span. These gains were larger even than the substantial gains reported elsewhere, and the West thus expanded its share of the national total in each category. In 1967, this region accounted for almost 20 percent of the (civilian) government sector, 18 percent of services, and 16½ percent of finance.

Personal income from manufacturing, the West's single largest industrial sector, increased by 98 percent over the 1957-67 period —a faster pace than elsewhere—and Western manufacturers thus increased their share of total manufacturing income. But in two other major District activities, construction and farming, the pace was considerably slower—slower even than in the comparable national industries. Personal income from Western construction activity increased by 57 percent over the period, while income from Western farming rose less than 15 percent, and the regional industries' income shares thus slipped somewhat.

Western Digest

Expansion in Bank Credit

In spite of increased reserve pressure and higher discounting, large Twelfth District banks reported a $173-million increase in bank credit in May, following an exceptionally large ($808 million) gain in April. The May increase, however, was all in security holdings. Loans declined slightly as a consequence of reduced credit flows to brokers and dealers, which offset increases in real-estate and consumer loans. . . . Business loans fell moderately ($7 million) as corporations repaid some of their April tax borrowings. But this small decline contrasted sharply with a $885-million drop in business credit at large banks elsewhere.

Mixed Trends in Deposits

At the end of May, demand deposits (adjusted) at large District banks were $465 million below the end-April level. The decline reflected the reduced balances of corporations and individuals resulting from debiting of April income-tax checks. . . . May's $56-million increase in time and savings deposits, like the April increase, was about one-third below the gain recorded in the comparable year-ago period. The attrition in large negotiable CD's, which had been particularly heavy in April, tapered off in the following month.

Decline in Aerospace

California aerospace-manufacturing employment, with a decline of 3,900 in May, fell to a level 4 percent below last December's peak of 618,000. Aerospace jobs in Washington meanwhile increased slightly over the month, to a point slightly below January's peak figure of 111,000. . . . The sluggishness in employment in these key states—in contrast to the strength in defense employment elsewhere—reflects the recent downtrend in defense contracts awarded to Western states. The volume of contracts received by District firms during the January-March period roughly equalled the preceding quarter's volume but was off 25 percent from the first-quarter '67 figure.

Western Sentinel Sites

Four Western areas—Los Angeles, San Francisco, Seattle, and Salt Lake City—were among the first sites chosen by the Pentagon this spring for Sentinel antiballistic missile installations. About 15 to 20 sites will eventually be included in this "thin" missile defense system, which is designed to counter the potential Chinese threat of the mid-1970s. . . . The four Western sites will be operated by the Sixth Region of the Army Air Defense Command, headquartered at Colorado Springs. Each of the installations is scheduled to cost about $50 million and to produce an annual payroll of $2-3 million.