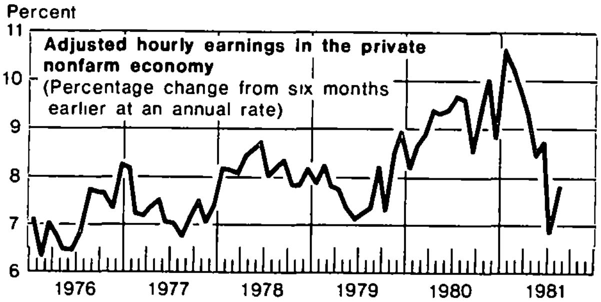
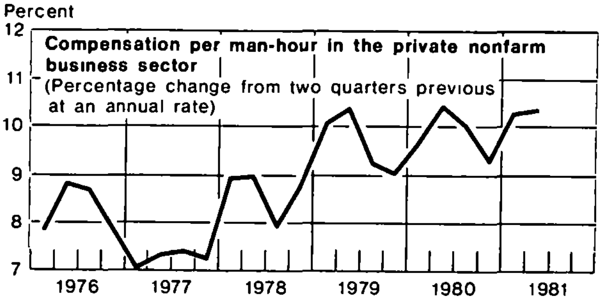
# The business situation
## Current developments

Chart 1

**Measures of wage and compensation changes are giving mixed signals. Increases in adjusted hourly earnings in the private nonfarm economy appear to be moderating . . .**




**. . . while increases in average hourly compensation show no sign of slowing.**




Source United States Department of Labor, Bureau of Labor Statistics

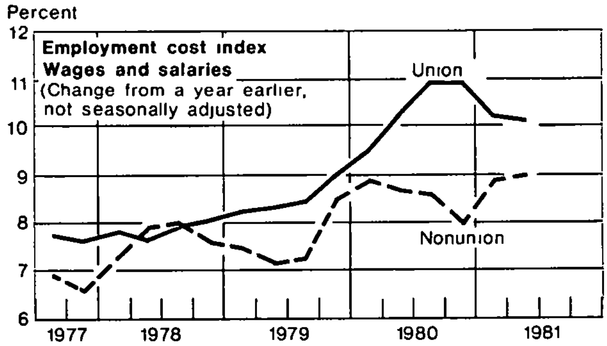
Economic activity leveled off during the summer months, following the mild downturn in the spring. Industrial production in August was essentially unchanged from what it had been last spring and, indeed, was still running slightly below the peak attained in March 1979. Auto sales, after languishing for most of the summer, strengthened in August and early September largely in response to the various merchandising incentives. At the same time, domestic auto production tapered off, with further cutbacks scheduled for later in the year. In the face of the high interest rates, construction activity continued to drop. Modest gains elsewhere in the economy, however, counterbalanced the weakness in construction, and the unemployment rate has held fairly steady.

The one bright spot in the economic situation has been the slowdown in inflation thus far in 1981. During the first eight months of the year, the consumer price index rose at an annual rate of 9.4 percent, in contrast to a 12.4 percent increase in 1980. The slowdown in price increases at the producers' level was even greater. The producers' price index for nonfood finished goods rose at an annual rate of 9.6 percent over the first eight months of the year as compared with a 13.4 percent increase in 1980. Looking ahead to the longer term, the extent to which the price slowdown is maintained will depend critically on what happens to wages and productivity.

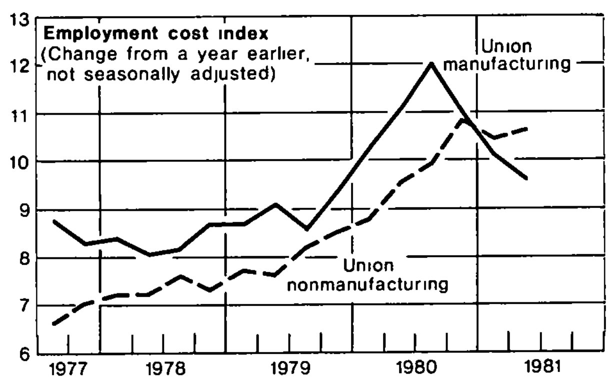
The various measures of wages and compensation have been giving off mixed signals (Chart 1). Many of the series do tend to be fairly erratic, which makes it difficult to interpret them over short time periods. Over the six months ended in August, average hourly earnings in the private nonfarm economy rose at an annual rate of 7.8 percent, compared with a 10.3 percent rate of increase in the previous six-month period.

Chart 2

**Union wage increases appear to be leveling off . . .**




**. . . with the slowdown concentrated in manufacturing.**




Source: United States Department of Labor, Bureau of Labor Statistics

(The earlier jump in wages reflected in part the 8.1 percent increase in the minimum wage effective in January.) This moderation follows nearly two years of accelerating wage advances. A sharp rise in hourly wages occurred in August, but this could be a result of some bunching of pay raises that was not corrected by the seasonal adjustment process.

In contrast, no clear-cut sign of moderation has yet appeared in average hourly compensation (which includes wages, salaries, and fringe benefits). Hourly compensation in the nonfarm business sector rose at an annual rate of 10.6 percent over the first half of 1981, compared with a 9.5 percent rate of increase in the previous two quarters. The first-quarter 1981 compensation increase was inflated in part by the January 1 increase in social security taxes paid by employers. Nevertheless, since growth of compensation in the second quarter of 1981 was at an annual rate of 9.6 percent, there is little sign of any marked slowing.

Union wage increases appear to be leveling off (Chart 2). In the second quarter of 1981, wages of all unionized workers covered in the employment cost index rose at an annual rate of 10.1 percent from twelve months previous, down slightly from the increase in 1980. This flattening-out of union wage increases follows a two-year acceleration that reached a plateau toward the end of 1980. Industry detail shows that the moderation is concentrated in the manufacturing sector. Wages of unionized workers there rose in the second quarter of 1981 at an annual rate of 9.6 percent from year-earlier levels, the smallest increase since the fourth quarter of 1979.

Data on effective wage adjustments in major collective bargaining agreements also point to some slowing of union wage advances. For the union sector as a whole, total effective wage adjustments (which reflect first-year increases negotiated in the quarter, as well as increases under earlier contracts and cost-of-living increases under current and prior contracts) were at an annual rate of 11.7 percent in the second quarter, down from the 13.9 percent rate of the second quarter of 1980. Wage and benefit increases in newly negotiated contracts ran a bit higher during the first half of 1981 than they had over the same period last year. However, the larger wage and benefit increases negotiated so far this year partly reflected the fact that comparatively few of these agreements contained cost-of-living adjustments (COLAs).[1] Wage increases have tended to be higher for settlements without COLAs. In any case, 1981 is a light bargaining year, so that these larger settlements will have only a modest impact on the overall trend in union wages.

Recent collective bargaining activity has been influenced by severe economic difficulties in a number of industries. Since the end of 1979, an unusual surge of plant closings and wage concessions under existing contracts have affected a total of nearly 300,000 workers (over a third of whom were auto workers). Revisions of collective bargaining agreements before expiration because of adverse business conditions had been relatively rare. The wage concessions that have occurred since 1979 have taken many forms and have affected both union and nonunion workers. For example, under the much-publicized Chrysler agreement, the current COLA and future COLAs, as well as a

[1] Only 21 percent of the workers under these settlements were covered by COLAs, whereas 57 percent of all workers under major collective bargaining agreements are covered by COLAs.

scheduled wage increase, were to be foregone for the duration of the contract. The Firestone Company, which had announced the closing of seven plants, obtained a 14 percent wage cut for certain workers as well as COLA concessions by both union and nonunion employees.

By and large, the impact of these concessions on total effective adjustments has been small. Nevertheless, the proliferation of such concessions may influence the tone of future negotiations. Similarly, it is not possible to measure the extent to which the climate for collective bargaining has changed in the aftermath of the recent air-traffic controllers' strike. But this, too, has the potential for affecting future settlements.

The Federal Government is bringing strong pressure for wage moderation for its own employees. President Reagan recommended that Federal white-collar workers receive a 4.8 percent pay increase in October.[2] If the Congress concurs, this would be the smallest average increase for Federal white-collar workers since their 1973 raise. The Congress had already passed a statute limiting the wage increases for Federal blue-collar workers for fiscal 1982 to 4.8 percent as well. Reducing wage increases for Federal workers may also induce a slowing in the private sector by moderating the wage increases necessary to attract workers to comparable private-sector jobs.

Additional downward pressure on wages, it has been suggested, could come from the recently enacted personal income tax cuts, the first of which took effect on October 1. Because the tax cuts increase take-home pay, workers may feel under less pressure to push for wage increases just to maintain their purchasing power. Moreover, the tax cuts strengthen work incentives Some people will be encouraged to enter the labor force, whereas their take-home earnings under the previous tax system would not have been large enough to make it worth their while to work. Others who do have jobs will find it advantageous to work longer hours or even to take a second job. The resulting increase in workers and work effort will also lessen overall pressure for wage increases. At the same time, however, much of the tax cuts will be used by households to buy additional goods and services. Within a short period of time, the initial wage moderation associated with the tax cut could be offset in part by the influence of these demand pressures. Thus, it is unclear what the net effect of the tax cut on wages would eventually be.

[2] The President's recommended increase for white-collar workers earning less than $50,112 a year is less than one third of the 15 1 percent increase that would be called for under the provisions of the Pay Comparability Act of 1970 The President's recommendation automatically takes effect in October unless overridden by the Congress President Reagan also recommended that Federal executives, whose pay has been frozen since 1979, receive a 4 8 percent annual increase Included in this group are middle- and senior-level executives However, on September 30, the Congress rejected any immediate increase in pay for these positions Military personnel, in contrast, will receive the full 15 1 percent increase