

FEDERAL RESERVE POLICY AND LABOR STRIFE

by

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My assignment this morning is the economic outlook. I'm finding it harder these days, however, to approach the economic outlook with the clear, unbiased, analytic detachment which you all associate with economists. The closer I get to some responsibility for the outlook, the less objective I become. Also, the more I see how Federal Reserve policy works in the real world, the more I'm convinced that -- vitally important though it is -- many other very important forces are at work.

One of these, facing us every day in the headlines, is labor strife. In addition to its tremendous social and political impact, this has to be one of the most significant economic developments of 1970. The postmen walked out, the air controllers got sick, and, in Philadelphia, we had a month-long "trash-in." A trucking strike was narrowly avoided and special legislation is now required to prevent a railroad strike. The situation could remain critical because there will be many more major contracts expiring in the next nine months.

It seems likely, therefore, that labor strife will play an important part in determining the over-all performance of the American economy in 1970. The most immediate example I can give you is the result of the postal strike. It now looks as though the pay increases to postal workers and all Federal employees will inject a big dose of spending power into the economy soon. Incomes will be considerably higher than originally estimated and consumer spending will be up accordingly. The result may well be to pull the economy out of its mini-recession sooner and more sharply than most of us expected just a few weeks ago.

I should like, therefore, to talk about three things: (1) the immediate economic outlook as I see it in the Fed; (2) the relationship of Federal Reserve policy to labor unrest in 1970; and (3) the relationship between Federal Reserve policy and labor strife in the 1970's.

The Economic Outlook

The Federal Reserve has been trying for over a year to get inflation under control. We were concerned about mounting inflation well before that, but intensive efforts to do something about it were applied in 1969 and to a considerable extent are still being applied today. The immediate effect has been to produce the tightest money conditions and the highest interest rates most of us have ever experienced.

The secondary effect has been to slow the economy. The main person affected has been the consumer. He has cut down his spending in the stores; after allowance for rising prices, the consumer is buying less today than a year ago. The businessman is also feeling the effects. His profits this year are likely to be considerably below last year. He has been holding down inventories. Although he still plans to spend a large amount for new plant and equipment, I suspect he may soon be scaling down his plans. At the same time, the Federal Government has been cutting defense spending and holding down non-defense spending. State and local governments have postponed millions of dollars worth of projects because they haven't been able to finance them at today's interest rates.

In short, demand for goods and services has been curtailed. Total spending has been rising less rapidly. After adjustment for price increases, it has actually been falling in the past six months.

This, of course, is exactly what the Fed has been trying to accomplish. We have been trying to weaken the pull of demand on prices. Now that we have accomplished this, the pace of inflation should slow down.

The effect on prices is the last link in the chain and no one should be surprised that efforts to weaken the demand pull have not had instantaneous results. We knew when we began that this would be the case and last year at this time I was talking about the need for patience. But I had no idea then how much patience would be needed. I under-estimated the extent to which inflation had become embedded in the thinking of consumers, businessmen, labor leaders, and virtually everyone making economic decisions. This inflation psychology has turned out to be much more difficult to root out than we thought.

In fact, I believe it is still very much a factor in the outlook. It has been weakened somewhat by successful efforts to curtail the demand pull. But consumers and businessmen are still worried about inflation, although they react in different ways. Whenever any of the various outfits that make surveys of consumers comes out with a new report, the finding is that consumers have inflation uppermost in their minds and expect more of it. This makes them cautious in spending. Similar surveys of businessmen reveal a remarkable optimism about profits and big plans to spend for plant and equipment. Businessmen react to inflation by buying capital equipment before it becomes still more expensive.

The way interest rates have been behaving recently also suggests that inflation sentiment is still strong. Rates have come down most sharply in the short-maturity category. One reason is that many investors have not become convinced that inflation is really licked or that interest rates generally are going to be much lower. So they are staying short. At the same time,

corporations and state and local governments jump into the market to borrow large amounts each time rates decline a little bit. They want to get the money while they can.

With inflation psychology still so strong, the Fed, in my opinion must be extremely careful about how fast and how drastically it moves toward easier money. As you know, a modest move has been made away from the very restrictive posture of late 1969. In the last half of 1969 there was no increase at all in the money supply. It was clear to us that if we kept on that path, we would certainly precipitate a major recession. But the move has been modest. It is an attempt to get moderate growth in money and credit. More than this would run a great danger of encouraging the inflation sentiment that still exists.

In looking at immediate prospects, therefore, I am cautiously optimistic that inflation will moderate. My optimism comes from what has already been accomplished to curtail demand. My caution comes from a fear of inflation psychology, particularly as it affects the labor situation. Wage increases have not only stayed high, but there is a possibility that they could take off on a new round at still higher rates following the example the Government sets with salaries of Federal employes.

This brings me to my second point: the relationship of Federal Reserve policy to labor unrest in 1970.

Federal Reserve Policy and Labor Strife

It is natural for a businessman to blame labor for inflation. He feels the pressure of wage costs directly and believes he is simply a passive instrument when he passes these costs along in the form of higher prices.

But the labor leader feels the same way. He feels helpless to do anything about the broad forces pulling up prices -- Government spending, credit expansion, and the like -- and simply is trying to protect his workers against attrition in their purchasing power.

This is the insidious thing about inflation. It blinds us all to the interrelationships in our society. It forces each of us to look to his self-interest regardless of the impact on others. It is divisive. And, unfortunately, there is no workable solution to inflation that does not aggravate the problem.

This is true as well of Federal Reserve policy. It is often said that the Fed can do something about demand-pull inflation but nothing about cost-push inflation. That is, the Fed can curb the demand for goods and services by curtailing growth in money and credit, and this can relieve the pull on prices. But, it is said, the Fed has no direct authority over wages and, therefore, can't prevent the push on prices coming from the wage side. Recent experience would appear to bear this out. As I have said, demand has been slowed down; but wage increases continue to be very strong.

It is wrong, however, to say that Federal Reserve policy has no effect on cost push. As tight money has cut into the spending ability of consumers, businessmen and state and local governments, it has weakened the market for the goods and services businessmen produce. The outlook for sales of automobiles, appliances, houses is bearish. People are protecting

their nest eggs because they are concerned about their jobs and incomes. They are more leery about paying higher prices for the things they do buy. Businessmen, seeing demand weak, are more resistant to wage increases.

But at the same time, money is trying to hold its own as the cost of living keeps rising. The effort to get higher wages continues, even though business is not as good as it was. So labor is insisting; management is resisting. Result: labor unrest.

One cost of curbing inflation by using tight money, therefore, has been more labor unrest. And this unrest comes at a time of turmoil in the universities, militant race relations and (maybe potentially the most bitter conflict of all) the new feminist movement. A logical question is: can we cure inflation by some means that get directly at the wage-price push and thereby avoid this unrest?

There are, of course, many approaches and I shall discuss some of them briefly, ranking them in the order of the teeth they have -- the enforcement power behind them, in other words. The toothiest of all is direct Federal controls over prices and wages. The Government determines what individual prices and wages should be and gives them the force of law. I don't believe this approach would work. It requires a huge administrative machinery which would take a long time to set up, and I don't believe the public would stand for the loss of economic freedom at this present time.

Next on the enforcement scale come controls under which the Government suggests specific prices and wages and relies on voluntary compliance. They combine many of the disadvantages of obligatory controls with a fundamental drawback inherent in all voluntary systems -- the bad

guys who don't cooperate gain a competitive advantage over the good guys who do.

A variant of this is the guidepost principle used in the 1960's. Here the Government determines general, over-all limits to price and wage increases -- based on increases in productivity -- and asks business and labor to observe them. When the economy is not far out of balance, this approach may help, but when labor and management have been under severe inflationary pressure for years, as they have now, they hardly can be expected to exercise enough moderation to have any real effect on prices.

The final category -- the so-called open-mouthpolicy -- may have teeth in it, but they don't have much bite. This method simply involves generalized appeals from the President on down for business and labor to display some restraint in the national interest. Perhaps little is lost by trying, but I am not enthusiastic about the effectiveness of such appeals. It takes a real crisis for most groups to willingly deny self for national interest.

In short, I see no effective way that current inflation could have been curbed except by restraining demand, largely by tight money. And I see no way, under this approach, by which labor unrest could have been avoided. It is a price society is paying for letting inflation get out of hand. This brings me to my third point: what might be the relationship between Federal Reserve policy and labor strife in the decade of the 70's? Can anything be done in the longer-run to minimize unrest?

Labor Strife in the 1970's

This will be an increasingly critical question, if I am at all right about the kind of society we are likely to have. My guess is that society will

be concerned less about how fast our material wealth is growing and more about who is getting it. The trend was already apparent in the 1950's and 1960's. J. K. Galbraith caught the imagination of a great many people when he wrote The Affluent Society in 1958. He helped to spread the impression that this nation has conquered the problem of scarcity and that the question now is who gets what. The war on poverty was another indication of a concern over the distribution of wealth. An issue dividing the generations is whether the accumulation of wealth is the way to the good life. The tax reforms made last year were designed to shift the burden of taxes.

All these are evidences of concern over how various groups share the national income. I see no reason why this concern should diminish in the 1970's. And I see no reason why it should necessarily produce more harmony than it is producing right now. It would be comforting to think that affluence will be so great that everyone will have enough -- the pie will be so big that there will be no conflict over how it is sliced. But this is not the way things seem to be moving. Expectations have been aroused. There is a spirit of activism and assertiveness. There has been an erosion of the authority of the institutions of American society. If this is the kind of environment we can expect in the 1970's, the chances of labor peace would not seem very good.

The Federal Reserve, of course, can do little directly about these strong tides in the public mood. But it can avoid aggravating unrest to the extent it can help avoid major inflation. Inflation brings latent conflicts to the surface; it amplifies those that already exist. If the Fed can help to provide a stable economic environment, decisions about how the pie is to be sliced can be reached in a more peaceful way.

An important key to how much labor strife we are likely to have in the 70's, therefore, is how successful we are in starting the decade off on a

sound basis. The current fight against inflation is not yet won. If we go off on a new round of wage increases, the task of winning it will become much greater. And if the job is not done this time, it will be immeasurably more difficult later. Rigid price and wage controls, despite all their disadvantages, might then be inevitable. The stakes in the current fight against inflation are large indeed.

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