

The 'Incomes Policy' Swindle

The Fraud And The Reality Of The Crisis In U.S. Labor Productivity

Treasury Secretary Michael Blumenthal, Council on Wage and Price Stability director Barry Bosworth, and other "British School" economists both in and outside the Carter Administration have pounced on recently released Labor Department data as proof that wages are a primary culprit in the present upsurge of inflation. The Labor Department figures show a sharp plunge in U.S. labor productivity and a marked rise in unit labor costs during the first quarter of 1978.

No Administration official dares openly to espouse mandatory wage-price controls at present, but the Blumenthal-Mondale faction is quietly banking on herding a frightened business community into virtually demanding an "incomes policy" swindle once the inflationary recession engineered by Fed Chairman William Miller's credit-tightening gets underway.

Clearly, the Mondalites believe that, in a period of declining corporate profits, the temptation to "make labor pay" will prove overwhelming. Even Arthur Burns, who was pressured into retiring as Federal Reserve head to make way for Mondale's choice, Miller, and who ought to know the Mondale group's game,

recently blathered about the "high cost of labor and a fall in worker productivity relative to wages."

Yet the cited Labor Department figures—3.3 percent annual rate of decline in labor productivity (defined as output per man-hour) in the manufacturing sector, and a 3.6 percent decline in the private business sector as a whole—are *statistically meaningless*. This is because output in the private business sector also fell 1.8 percent during the first quarter, reflecting the coal strike and the severe winter weather.

As any business economist worth his salt knows, any recession or "pause" in industrial production will result in declining labor productivity, since output tends to fall faster than employment. Employers are reluctant to lay off workers they may have to hire again shortly. Subsequently, industrial production surged 1.1 percent in April over the depressed March level, and now improvement in labor productivity is undoubtedly also underway.

Burns and other conservative business leaders know better. But whether through political spinelessness or sheer cupidity, they are allowing themselves to be set up for major confrontations with labor unions, confrontations that will only damage the U.S. economy.

The Investment

There is a real question involved here—rate of increase of productivity of American manufacturing workers has slackened noticeably since the early 1960s and has fallen well below that of the other leading industrial nations in Western Europe and Japan. This is not a problem of "lazy American workers," but reflects chronic underinvestment in basic plant and equipment in the U.S. since the 1958 recession, as well as declining emphasis on the development and application of new labor-saving technologies.

The three tables presented here drive home the point. *Table I* compares fixed investment (excluding residential construction) as a percentage of Gross National Product in the U.S., Japan, West Germany, and five other leading European industrialized economies. *Table II* shows annual rates of growth of manufacturing output, productivity, hourly compensation (in national currency), and unit labor costs (in national currency) in each country during the period 1960-1977. The third table compares the growth of average *real* wages of manufacturing workers, after

I. Capital Investment, Excluding Residential Construction, As A Percent Of Total Domestic Output 1960-1975 (1)

(Current Prices)

Year	U.S.A.	Japan	Belgium	France	West Germany	Italy	Netherlands	United Kingdom
1960	14.4	28.3	15.3	17.7	21.2	18.4	21.4	15.4
1961	14.1	31.4	16.4	19.2	22.4	19.1	22.1	16.2
1962	14.2	31.3	17.9	19.6	23.1	18.9	22.1	15.7
1963	14.3	29.3	17.7	19.8	22.8	18.8	21.7	15.3
1964	14.7	28.9	17.2	20.4	23.6	16.0	22.4	16.5
1965	15.5	26.3	16.9	20.4	23.1	13.8	21.6	16.7
1966	16.0	26.5	18.5	21.0	22.2	13.9	22.7	16.7
1967	15.7	27.3	18.7	21.3	19.8	14.8	22.4	17.2
1968	15.4	28.6	17.6	20.7	20.0	15.1	23.0	17.4
1969	15.4	29.5	17.5	21.5	21.9	15.0	20.7	17.6
1970	14.9	28.7	19.0	20.2	23.8	16.0	22.8	18.0
1971	14.6	29.1	19.6	20.3	23.6	16.0	22.4	17.6
1972	14.5	28.7	18.6	20.4	22.2	15.4	19.2	17.1
1973	14.8	29.7	17.6	20.2	20.7	16.4	18.3	18.0
1974	15.3	27.7	18.1	20.4	19.3	18.0	18.1	18.3
1975	14.3	24.3	17.6	18.4	18.8	16.1	17.9	17.6

(1) Fixed investment at market prices as a percent of domestic output at factor cost
Source: U.S. Department of Labor

**II. a International Comparison Of
Output Per Man-Hour, Output, Hourly Compensation
And Unit Labor Costs In Manufacturing, 1960-1965**

(Average Annual Percent Change)

	Output Per Man-Hour	Output	Hourly (1) Compensation	Unit Labor Costs (1)
U.S.A.	4.9%	6.9%	3.5%	(1.3)%
Belgium	4.8	6.3	9.6	4.6
France	5.2	6.8	9.2	3.8
Germany	6.0	5.7	9.4	3.2
Italy	6.8	6.6	13.6	6.3
Japan	8.5	11.9	13.2	4.3
Netherlands	5.3	5.8	11.5	5.9
United Kingdom	4.1	3.5	6.4	2.2

(1) In national currency.

**II. b International Comparison Of
Output Per Man-Hour, Output, Hourly Compensation
And Unit Labor Costs In Manufacturing, 1965-1970**

(Average Annual Percent Change)

	Output Per Man-Hour	Output	Hourly (1) Compensation	Unit Labor Costs (1)
U.S.A.	1.4%	2.4%	6.1%	4.6%
Belgium	8.2	7.0	9.3	1.0
France	6.7	6.8	9.3	2.4
Germany	5.5	6.0	8.5	2.9
Italy	5.3	8.6	9.4	3.8
Japan	13.4	16.1	15.3	1.7
Netherlands	9.1	7.4	12.4	3.1
United Kingdom	3.6	3.1	7.5	3.7

(1) In national currency.

Note: Percent changes computed from the least squares trend of the logarithms of the index numbers. Data relate to all employees in manufacturing.

Source: U.S. Department of Labor. Bureau of Labor Statistics. Office of Productivity and Technology. Division of Foreign Labor Statistics and Trade.

adjustments for changes in purchasing power, in each country during the same period.

(A word of caution: official estimates of "real" wages have proved increasingly inaccurate, due to failure to adequately account for rising taxation and other "hidden" factors contributing to the erosion of purchasing power. Thus, real wages in the U.S. have probably been flat-to-declining since 1969. The chart indicates, at least, how U.S. performance stacks up relative to that of other economies.)

Japan, the "miracle" economy of the postwar period, stands out as by far the leading high-investment economy. Fixed investment generally accounts for 28 to 31 percent of Japan's total Gross National Product. But the U.S., with only 14 to 16 percent, ranks lower even than stagnant Britain.

During 1960-77, Japan managed to combine the highest rates of growth of manufacturing output and the highest rates of growth of labor productivity, with the *highest growth in real wages*.

Britain and the U.S. are at the very bottom of the list on all counts. Up until 1975, when the British economy finally collapsed completely under the weight of its turn-of-the-century industrial equipment, the U.S. record was even worse than that of the U.K.!

The Role of Dirigism

Japan's relative success reflects not the arbitrary workings of the "free market" but years of close, "dirigistic" collaboration between its government and private banking and industrial leaders to ensure high levels of capital formation, industrial exports, technological progress. (For details see the ECONOMIC SURVEY in *Executive Intelligence Review*, Vol. V., No.

13). At the same time, Japanese leaders understood that a rapid rise in living standards was required in order to transform a war-ravaged population into a skilled, modern workforce. Otherwise, Japan was doomed to remain a low-wage Hong Kong, exporting textiles and other light manufactured goods to the more advanced economies.

Table II shows that during 1965-70, the productivity of Japanese workers grew at the astounding rate of 13.4 percent per year, much higher than in the other seven countries, and compared with an increase of only 1.4 percent in the U.S. Total manufacturing output in Japan also grew fastest, running at a 16.1 percent annual rate. And hourly compensation rose at a 15.3 percent rate.

Yet unit labor costs rose by only 1.7 percent during this period, reflecting the offsetting effect of rising productivity. During the same period, the period of the Vietnam War, the hourly compensation of U.S. workers grew slowest (6.1 percent), while unit labor costs grew fastest (4.6 percent).

The simple-minded Wall Street view that higher rates of capital formation and rising real wages are two mutually exclusive categories was hereby disproven with a vengeance.

Why the U.S. Stagnated

The U.S. economy emerged from World War II as by far the world's leading industrial power, and possessed a long and proud record of technological achievement. How could it lapse into stagnation as early as 1958? The answer, which can be indicated only summarily here, is that the British oligarchy convinced U.S. policy-makers to accept the British Empire as the model for the postwar "Pax Americana."

The overvaluation of the U.S. dollar relative to

**II. c International Comparison of
Output Per Man-Hour, Output, Hourly Compensation
And Unit Labor Costs In Manufacturing, 1970-1975**

(Average Annual Percent Change)

	Output Per Man-Hour	Output	Hourly (1) Compensation	Unit Labor Costs (1)
U.S.A.	1.8%	1.8%	7.9%	6.0%
Belgium	7.6	4.3	18.0	9.7
France	4.6	4.1	15.0	9.9
Germany	5.5	1.6	13.5	7.5
Italy	5.9	3.6	22.2	15.4
Japan	4.3	3.5	20.3	15.4
Netherlands	7.0	2.9	16.9	9.2
United Kingdom	3.2	1.4	17.8	14.2

(1) In national currency.

Note: Percent changes computed from the least squares trend of the logarithms of the index numbers. Data relate to all employees in manufacturing.

**II. d International Comparison Of Output Per Man-Hour,
Output, Hourly Compensation And
Unit Labor Costs In Manufacturing, 1976**

(Average Annual Percent Change)

	Output Per Man-Hour	Output	Hourly (1) Compensation	Unit Labor Costs (1)
U.S.A.	6.8%	5.1%	8.6%	1.7%
Belgium	11.1	9.2	11.5	0.4
France	9.4	8.0	15.3	5.4
Germany	8.2	7.4	6.0	(2.0)
Italy	7.5	12.4	18.4	10.2
Japan	13.0	13.8	8.8	(3.7)
Netherlands	9.9	5.4	11.6	1.6
United Kingdom	3.5	1.0	18.1	14.2

(1) In national currency.

Source: U.S. Department of Labor. Bureau of Labor Statistics, Office of Productivity and Technology, Division of Foreign Labor Statistics and Trade.

European currencies, insisted on by the British at Bretton Woods, encouraged U.S. multinational corporations to invest in European assets at bargain-basement prices while neglecting investment at home. This was by no means a necessary or "natural" development. In real economic terms, given the devastation of Europe and the higher productivity of American labor, it would have made much more sense to export capital goods produced in the U.S. to Europe and Japan. This would have allowed a much faster pace of industrialization in Europe and Japan, and these countries could then have assisted in the development of Third World regions as well.

With the emergence of a U.S. balance of payments deficit in 1959-60, and the beginning of John F. Kennedy's presidency, Robert Triffin and other "British System" economists spread the myth that the real source of the problem was a "dollar glut"; the dollar's international lending role would have to be reduced. Kennedy Administration "technicians," including Henry Fowler and Robert Roosa (now partners at the British-oriented investment banking firms of Goldman Sachs and Brown, Brothers Harriman, respectively) pushed through capital outflow control measures to "solve" the dollar crisis. In 1963, an Interest Equalization Tax was imposed, effectively shutting off the New York capital market to foreign borrowers. This merely accelerated the growth of an "offshore market" in dollars in London, a speculator's paradise outside the control of U.S. monetary authorities. In January 1968, Lyndon Johnson imposed an emergency ceiling on U.S. multinational investment abroad, invoking the authority of the Trading with the Enemy Act of 1917!

All these measures merely hastened the decline of the dollar. The flow of dollars abroad was never the problem.

**II. e International Comparison of
Output Per Man-Hour, Output, Hourly Compensation,
And Unit Labor Costs In Manufacturing, 1977**

(Average Annual Percent Changes)

	Output Per Man-Hour	Output	Hourly (1) Compensation	Unit Labor Costs(1)
U.S.A.	2.2%	3.1%	8.8%	6.5%
Belgium	N.A.	N.A.	N.A.	N.A.
France	3.8	2.0	12.6	8.5
Germany	4.2	3.2	9.2	4.9
Italy (2)	0.5	2.5	22.6	22.0
Japan	6.1	4.5	9.6	3.3
Netherlands	N.A.	N.A.	N.A.	N.A.
United Kingdom	(1.6)	0.4	10.0	11.8

(1) In national currency.

(2) Estimates for 1977 based on partial year data.

N.A. Not Available.

The problem was how the dollars were used: short-term profit-making based on "buying Europe cheap" rather than the generation of U.S. capital goods exports, which would have easily eliminated the U.S. payments gap.

Bootstrapping

The result was that Japan was forced to "bootstrap" its way into the modern industrial era. The country developed only by assuming huge debts, both external and internal, relative to Gross National Product. The dollar crises of the early 1970s, the sharp rise in the prices of oil and other basic raw materials (most of which Japan must import), a worldwide depression in 1975, combined with the high degree of financial leverage of the Japanese economy, took the wind out of the sails of the Japanese "miracle."

When Japanese output fell to an annual rate of 3.5 percent during 1970-75, its productivity growth fell below that of the other economies while Japanese hourly compensation and unit labor costs grew faster. Although Japanese productivity again showed large gains in 1976 and 1977, the 1977-78 dollar crisis may have tipped the export-based Japanese economy into another major recession.

By contrast to Japan, West Germany, with a lower rate of investment as percentage of GNP and a relatively unenlightened labor policy (a slower rate of increase of real wages and a backward educational system) has hardly had a chance to develop. During 1960-1977, West Germany showed a slower rate of increase of labor productivity and slower growth of overall manufacturing output than Japan.

It is now up to the U.S., still the largest industrial economy, with higher living standards (in absolute terms) than Japan and most of the European economies, to take the appropriately "dirigistic" steps which will lead the way to world economic recovery — but most certainly not the "incomes policy" poison being peddled by the Mondale crowd.

—Alice Shepard

III. Average Real Hourly Earnings (1) Of Production Workers In Manufacturing, 1960-1976

(1967=100)

Year	U.S.A.	Belgium	France	West Germany	Italy	Japan	Netherlands	United Kingdom
1960	90.1	70.0	79.1	68.7	70.4	67.2	64.7	84.5
1961	91.5	72.7	82.5	74.3	73.2	71.0	72.9	87.4
1962	93.2	76.4	85.4	80.3	80.3	75.3	78.2	87.0
1963	94.7	81.4	88.5	83.5	87.2	78.3	80.8	88.9
1964	96.2	87.3	90.8	88.3	91.4	83.8	87.9	92.8
1965	97.6	91.3	92.9	94.0	94.3	87.0	93.0	95.1
1966	96.8	96.2	96.0	97.5	96.0	92.6	95.7	98.6
1967	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1968	102.1	102.4	105.9	102.8	103.1	111.3	104.5	101.9
1969	102.6	107.6	112.1	111.0	110.3	126.2	108.2	104.7
1970	102.1	114.9	120.0	121.1	130.3	137.2	117.2	113.5
1971	104.0	125.0	126.8	128.6	144.2	149.2	125.1	115.8
1972	107.4	134.7	132.0	132.4	152.9	165.5	129.7	123.4
1973	108.3	144.9	140.2	137.7	169.3	184.8	137.1	127.8
1974	105.5	155.2	146.8	143.2	177.7	199.2	147.3	132.5
1975	105.5	163.2	152.8	146.5	192.4	206.5	153.0	133.7
1976 (2)	107.6	167.7	158.7	149.5	203.0	214.0	154.0	127.7
% Change:								
1965 vs. 1960	8.3%	30.4%	17.4%	36.8%	33.9%	29.5%	43.7%	12.5%
1970 vs. 1965	4.6	25.8	29.2	28.8	38.2	57.7	26.0	19.3
1975 vs. 1970	3.3	42.0	27.3	21.0	47.7	50.5	30.5	17.8
1976 vs. 1975	2.0	2.8	3.9	2.0	5.5	3.6	0.7	(4.5)

(1) Average hourly earnings adjusted for changes in purchasing power since the base period.

(2) Preliminary.

Source: U.S. Department of Labor.