

It is fervently to be hoped, of course, that the future will see improvement, but not matter how earnestly this end is pursued, progress is likely to be slow. In the meantime, we have only recent history to go on, and it would be irresponsible to disregard it. The trade-off between unemployment and inflation must be made on the information we now have.

So much for the *terms* of the trade-off. As we indicated earlier, we do not undertake at this juncture to address the *policy* question of where the balance should be struck. Before we get to that issue there are a number of related questions to discuss, the first of which—how we got into the present dilemma—is considered in the next chapter.

Chapter 2

HOW DID WE GET THAT WAY?

The phenomenon that creates the bitter trade-off dilemma described in the preceding chapter is the responsiveness of labor compensation to low unemployment rates. As our chart indicates, wages and salaries “take off” as the rate declines toward the target figure of 4 percent, and virtually explode if it goes much below that level. Obviously, if we are to understand the dilemma we must address the question: why this hypersensitive response?

It was not ever thus

The first thing to note is that it appears to be a fairly recent phenomenon. While the figures for remote periods are poor, and not too closely comparable with those now available, they are nevertheless suggestive.

In the 30 years following the Civil War, the average hourly compensation of nonfarm employees underwent some substantial swings, but apparently finished the period about where it started.¹⁰ From the midnineties to the outbreak of World War I, it rose at an average rate between 2.5 and 3 percent a year.¹¹ More significant for the present, in the prosperous period of the twenties, 1923–29, the rise averaged between 2 and 2.5 percent.¹² Contrast this with the postwar period 1947–68, when it averaged over 5 percent.

Sharpening the contrast between 1923–29 and 1947–68 is the indication that in the former period the unemployment rate averaged somewhere between 2.5 and 3.5 percent, against an average of 4.7 percent for the latter.¹³ You will recall from chart 1 (p. 3 of ch. 1) that the rise in average hourly compensation now associated with an unemployment rate of 3.5 percent appears to be *in excess of 7 percent* a year. Obviously, something has happened to alter radically the relation between unemployment and wage inflation. What is it?

¹⁰ Stanley Lebergott, *Manpower in Economic Growth*, McGraw-Hill Publishing Company, 1964. We have adjusted Lebergott's estimates of *annual* earnings of nonfarm employees (p. 528) for the decline in hours worked per year.

¹¹ *Ibid.*, pp. 524, 528, similarly adjusted.

¹² *Ibid.*, p. 524, similarly adjusted.

¹³ Lebergott's average for the earlier period is 3.3 percent (*op. cit.*, p. 512). That of the National Industrial Conference Board is 2.5 percent (*Economic Record*, March 1940, p. 78). The postwar average is that of the U.S. Department of Labor.