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Did Nixon's wage and price controls set in motion the post-1970s decline in real wages?

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Abstract

This paper argues that President Nixon's wage and price controls, in affect from August 1971 to April 1974, laid the groundwork for the post-1973 decline in U.S. production worker real wages.
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1. Decline of production worker real wages

Fig. 1 shows real hourly wage for production workers in the United States. The real hourly wage grew from 1947 until 1973 when it reached $14.78 (in 1999 dollars). It then fell for a couple of years, but then rose to $14.54 in 1978. After that, the real hourly wage for production workers trended downward for almost two decades until 1996, when it once again started to rise. By 1999 the real hourly wage reached $13.24. While the rise in the real hourly wage represents a gain for workers compared to the recent past, it should be pointed out that over thirty years before—in 1967—the real hourly wage stood at a higher level, $13.37.

Mainstream economists have offered a number of explanations for the decline in real wages. One favorite explanation is that the decline is a statistical artifact of an inaccurate, and upward biased, measure of inflation. Nilsson (1999) shows that even when a more accurate measure of inflation is used, a decline in real wages and compensation for production workers still did occur.

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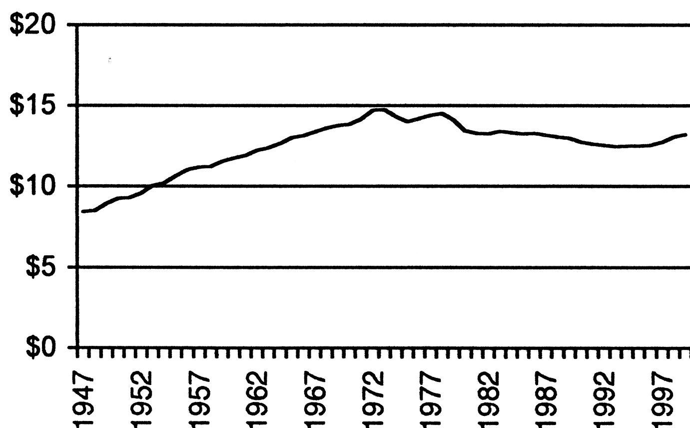

Fig. 1. Real wages of production workers, 1999 dollars.

Other mainstream explanations for the decline in real wages are that the oil price shocks of the 1970s disrupted productivity growth in the United States and, as a result, wages for production workers suffered. More recently many have claimed that technological changes and a concomitant failure of many workers to gain the skills demanded by this new technology caused the post-1973 real wage decline.[1]

This paper offers a new hypothesis about the decline of the real wages of production workers. It argues that Nixon's wage and price control program created the conditions for the post-1973 decline in real wages.

2. Wage and price controls: the standard view

The wage and price controls in effect from August 1971 to April 1974 were the most extensive federal government intervention into the U.S. economy during the post-WWII years.

The two questions asked most often about the 1970s wage and price control program are: (1) did wage and price controls reduce the rate of inflation below what it otherwise would have been, and (2) did wage and price controls systematically change income distribution during the 2 ½ years the controls were in effect?

According to Rockoff (1984: 231–2), expressing the common view,

> Economists from a surprisingly wide segment of the political spectrum agree that the Vietnam [price] controls were a failure. If the impact on production and distribution were not as disastrous as some predicted, the effects on inflation also appear to have been small. A

[1] Gordon (1996) raises important doubts about this explanation.

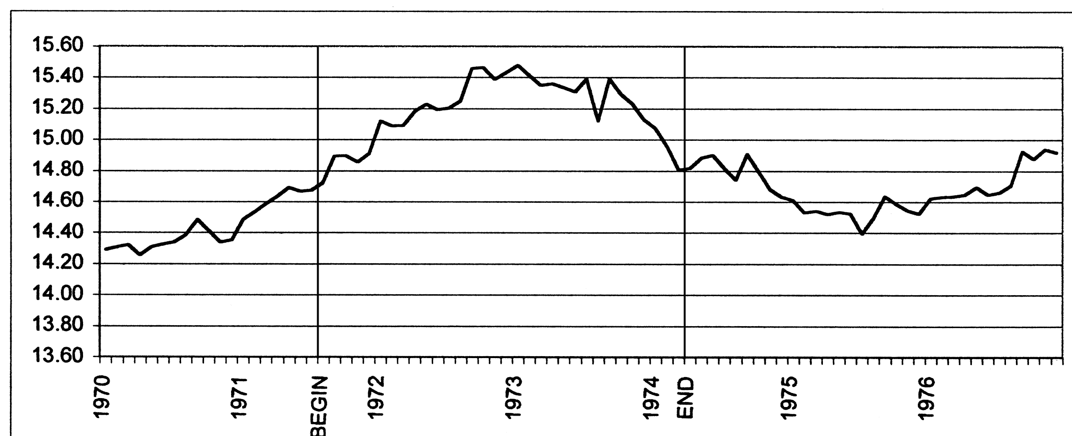

Fig. 2. Monthly real production workers' wages and the implementation of wage and price controls, 1970–1977.

> temporary reduction in inflation was traded for a higher rate of inflation as controls were removed, an even bargain at best.

In particular, Rockoff (1984), again echoing others, argued that wage and price controls were not systematically biased against workers: real wages were *higher* at the end of Nixon's wage and price controls then they were at the beginning.

3. Wage and price controls: a new hypothesis

Fig. 2 shows monthly real production worker hourly wages over the period January 1970 to December 1976. The beginning and the end of wage and price controls are indicated in the figure. Wages are measured in July 2000 dollars.

The real hourly wage in August 1971 (the beginning of controls) was $14.72. The real hourly wage in April 1974 (the end of controls) was $14.81. Real wages did rise over the complete period of the controls.

Yet the above figure clearly shows that the trajectory of wage growth changed during the era of price controls. During the first half of the wage control period, real hourly wages continued to rise along their previous growth path. After January 1973—when wage and price controls became partly "self-administered" by businesses—the trajectory of real wages changed: real wages started to decline. Importantly, the real wage decline that started after January 1973 continued *after* the end of the wage and price control program in early 1974.

Mainstream economists explained the rise in prices after January 1973 and after the end of price controls in early 1974 from a macroeconomic point-of-view, and by the invoking of vague concepts such as "catch up inflation" and a return to prices consistent with "fundamental economic variables." These two concepts, however, are really statements that mainstream economists had no explanation for why prices rose rapidly and real wages fell.

Table 1
Annualized growth rates of real hourly wages for production workers

	Mining	Construction	Durable manufacturing	Non-durable manufacturing	Transportation/ public utilities	Wholesale	Retail	FIRE	Services
5 years before	1.5%	3.3%	1.1%	1.4%	2.2%	1.5%	1.9%	1.0%	2.3%
During controls	2.3%	−0.8%	0.5%	0.3%	2.1%	−0.2%	0.0%	−1.0%	1.2%
5 years after	2.5%	−1.4%	0.9%	0.6%	0.3%	−0.1%	0.0%	−0.9%	−0.5%

Further, mainstream economists generally failed to ask why the decline in real wages during the second half of the wage control program continued on after the end of wage and price controls. Implicitly, mainstream economists assumed that the government role in wage setting during the years of controls had no lasting effect on the operation of the U.S. labor market.

As an alternative to the mainstream focus, I offer the following hypothesis: Nixon's wage and price controls set in motion the post-1973 decline in real wages of U.S. production workers. The government-imposed wage- and price-setting institutions in place from August 1971 to April 1974 shifted the balance of power between capital and labor. When these formal institutions were eliminated in April 1974, the government-caused shift in the balance of power between capital and labor was not reversed; rather, this shift in the balance of power was maintained and led to the decline in real wages that started during 1973.

4. Industry wage data

Most studies of wage and price controls have used aggregate data. In this paper, however, I use 2-digit SIC industry data. Wage-setting institutions within different industries can vary greatly, and there is no guarantee that all industries responded equally to the imposition of wage and price controls.

4.1. Industry wage changes

Table 1 shows average real hourly wages for production workers in different 2-digit SIC industries. Annualized real wage changes are presented for three periods: during the 5 years preceding the introduction of wage and price controls (August 1966 to August 1971), during the period that wage and price controls were in effect (August 1971 to April 1974), and during the 5 years following the elimination of wage and price controls (April 1974 to April 1979). These 5-year periods were selected to give an indication of the long-run growth rates of these industries before and after wage and price controls. (The same basic results are obtained when periods of different lengths are used).

Table 2
Correlations between real wage changes in different periods

Periods considered		Correlation between wage changes
5 years before controls	During controls	0.5
During controls	5 years after controls	0.7
5 years before controls	5 years after controls	−0.1

As can been seen, the aggregate wage data hides a variety of experiences within different industries. The first row of data shows that the average production worker in each industry gained significant annual increases in real wages over the 5 years preceding wage and price controls. The annualized growth rates for real wages in these years, however, differed greatly: from 1.0 percent for FIRE (Finance, Insurance, and Real Estate) to 3.3 percent for construction. Similar interindustry differences in wage growth exist for the other two periods (during controls and during the 5 years after controls).

A comparison of the first and second rows of data reveals that not all industries were equally affected by wage controls. Wage growth within the mining industry actually sped up during wage and price controls (from 1.5 percent to 2.3 percent) while wage change in construction swung sharply from rapid growth to significant decline (3.3 percent to −0.8 percent). The other industries fit between these two extremes.

Price controls played no part in the variance of industry real wage changes: the same price index—the CPI—was used to deflate nominal wages in all industries. Differences in industry wage growth during wage and price controls were due to different wage setting experiences in the different industries.

The final row of data—for the 5 years after controls—reveals that real wage growth in most industries was lower than real wage growth in the 5 years preceding wage and price controls. Clearly something had changed between these two periods. But a wide range of different industry experiences again exists during this 5-year period.

4.2. Correlations within industries

Table 2 presents correlations between industry real wage changes in different periods. The construction industry was excluded when these correlations were generated. Construction was a special case—the federal government subjected the construction industry to wage controls 6 months before the rest of the economy, and these controls were more severe than in other industries. The key findings presented above, however, would have been similar if construction industry wage changes were included.

Row 1 of Table 2 indicates the correlation between (1) industry real wage changes in the 5 years before controls were imposed (August 1967 to August 1971), and (2) industry real wage changes during the years of wage and price controls (August 1971 to April 1974). The moderate correlation of 0.5 indicates that, on average, the larger was real wage change within an industry before controls, the larger was real wage change in the same industry during the years of wage and price controls.

Row 2 indicates a higher correlation (0.7) between real wage changes during controls and real wage changes in the 5 years after controls were eliminated (April 1974 to April 1979). Production workers in industries who did well during wage and price controls were more likely to do well after wage and price controls were eliminated. Similarly, production workers in industries that did poorly during controls were more likely to do poorly after controls were eliminated.

Row 3 indicates that real wage changes before controls had little correlation with real wage changes in the years after controls. A gap of 2 ½ years, of course, exists between these two periods.

A number of economic and statistical stories can be told to explain these three correlations. I will offer, however, only the interpretation that strikes me as most plausible.

5. Interpretation

Changes in industry real wages during any period is determined, in part, by the balance of power (BoP) between capital and labor within that industry during that period of time. The BoP within an industry, in turn, is determined by a host of economic and institutional factors. The magnitude of real wage change within an industry serves as a proxy—albeit weak—of the BoP within an industry. Further, a correlation between real wage changes in different periods suggests that the BoP within an industry in one period is possibly correlated with the BoP within that same industry in the second period.

During the years of wage and price controls, the balance of power between capital and labor shifted. On the one hand, the institutions and economic conditions that determined the balance of power in the 5 years preceding controls continued to shape the balance of power between capital and labor during the years of wage and price control. But the importance of these particular institutions and economic conditions declined between the two periods.

Fig. 3 indicates this by "BoP in Before Period" continuing on to shape wage determination during wage controls. But, the magnitude of the effect is smaller in the second period.

On the other hand, new forces also kicked in to shape the balance of power between capital and labor during the years of wage and price controls. Most obviously, the new formal and informal institutions that oversaw the setting of wages over August 1971 and April 1974 had their own unique effects on the balance of power between capital and labor and, so, on wage determination. In Fig. 3, the effect of these new institutions (and in the economic environment) is represented by "BoP Change due to Wage Controls."

Real wage changes during the years of wage and price controls were, conceptually, determined by these two forces—those persisting from the past and those created anew during the era of controls.

A statistical manifestation of the effect the balance of power in the 5 years before controls had in shaping wage changes during the 2 ½ years that wage and price controls were in effect is the correlation between wage changes before controls and during controls: the 0.5 correlation discussed above. The correlation is less than one because other factors during the era of wage and price controls—in particular the institutions created to reduce wage and price growth—also shaped wage changes during this period. And, at the same time, the institu-

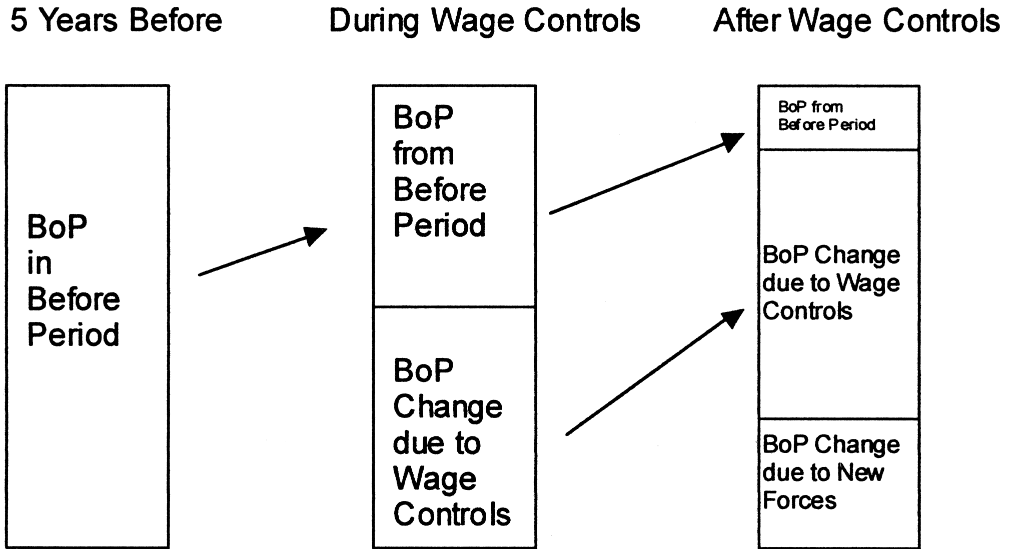

Fig. 3. Determinants of real wage controls.

tions—formal and informal—shaping the balance of power in the preceding period eroded, and their effect on current wage negotiations weakened.

Wage and price controls ended in April 1974. Real wage change during the 5 years following the end of controls was shaped by the, then, current balance of power between capital and labor. Some of the institutions and economic conditions that shaped the balance of power in the 5 years *before* controls continued to have an effect during the 5 years *after* controls were eliminated. This is indicated in Fig. 3 by the small upper box underneath After Wage Controls.

The *formal* institutions created by the Nixon administration to oversee wages and prices were phased out in April 1974. Yet, a number of *informa*l wage-setting institutions that developed because of wage controls continued on after the elimination of the formal wage- and price-setting institutions. This situation is indicated in Fig. 3 by the appearance of "BoP Change due to Wage Controls" within the After Wage Controls period.[2]

What informal wage-setting institutions developed within the formal wage- and price-setting institutions operating between August 1971 and April 1974? I would argue that Nixon's wage and price control program led to an important change in wage-setting ideology nationwide. The federal government sanctioned—and enforced—the perspective that the "national interest" required wage restraint. Wage restraint, and business attempts to slow wage growth, was now not just something that benefited the profitability of firms; it was, in the minds of some, a patriotic action. At the very least, the new focus on wage restraint across industries provided a "focal point" that permitted firms to look beyond the particular

[2] For the sake of brevity, the impact of the 1970s oil price shocks are ignored in this paper.

competitive conditions within their own industries and to aim for wage restraint within their own firms. This was a small, but important, ideological change that contributed to efforts to keep wages low.

The new informal wage-setting institutions, however, affected different industries differently. Some business leaders were better able to develop postcontrols wage collective wage restraint. Some industries were better able to look beyond their own immediate competitive conditions to focus their attention on wage restraint.

Of course, at the same time, new forces shaping wage setting also appeared in the years following the elimination of wage controls. In Fig. 3 this appears in the bottom right of the diagram. Yet these new forces, and the institutions and economic conditions from the 5 years before wage controls, had less of an impact than that provided by the informal wage setting institutions that developed during the years of wage controls.

A statistical manifestation of the above was a diversity of real wage changes in different industries after the elimination of wage controls but, at the same time, a moderately high correlation (0.7) between real wage changes within industries during the controls period and real wage changes over the 5 years after the end of controls.

The absence of a meaningful correlation between industry real wage changes in the 5 years before controls and real wage changes in the 5 years after controls indicates that the decline in real wages following controls was not merely a reaction—or correction—to "too rapid" wage growth in the years before controls were imposed.

The high correlation between real wage changes during controls and real wage changes after controls is due, then, to the fact that the BoP change that occurred when wage controls were carried over to the years after the end of controls. The mechanism for this, as claimed above, was the informal wage setting institutions created by formal wage control institutions that continued to have an effect in the postcontrol years. In short, the real wage decline seen in many industries after 1973—even after the elimination of wage and price controls—was due to changes in the balance of power between capital and labor that occurred during Nixon's wage and price control program.

6. Conclusion

Nixon's wage and price controls set in motion the post-1973 decline in real wages of U.S. production workers. The government-imposed wage- and price-setting institutions in place from August 1971 to April 1974 shifted the balance of power between capital and labor. When these formal institutions were eliminated in April 1974, the government-caused shift in the balance of power between capital and labor was not reversed. Rather, this shift in the balance of power was maintained through informal institutions, and these informal institutions set in motion the decline in real wages that started after 1973.

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