

Research Department Federal Reserve Bank of San Francisco

March 15, 1974

Income: Up or Down?

Statisticians have devised two important yardsticks of consumer purchasing power, in an attempt to provide a measure (however imperfect) of individual well-being. Those yardsticks—real disposable per capita income and real spendable weekly earnings have provided little guidance in the present critical period, however, because last year they went in opposite directions. Real disposable per capita income increased more rapidly than at any time since the tax-cut period of 1964-65, while real spendable weekly earnings posted the worst decline of the past quarter-century.

The apparent explanation for the difference is that the two yardsticks do not measure exactly the same thing. Disposable per capita income—\$4,195 in 1973—is the broader of the two measures, concerned with all forms of income received by individuals. On the other hand, the spendable earnings series—totalling \$6,580 for the 52 weeks of 1973 is restricted to certain earnings received by rank-and-file workers in the private nonfarm sector of the national economy.

It is somewhat puzzling, however, that two such broadly similar series do not move in parallel fashion. In the first half of the postwar period, they did move together; between 1947 and 1960, real disposable per capita income increased at an annual rate of 1.7 percent, while real spendable weekly earnings increased 1.6 percent annually. Thereafter they began to diverge, rising at annual

rates of 3.3 and 1.1 percent, respectively between 1960 and 1973. Indeed, in 1973, the real income measure increased 4.4 percent, in contrast to a 1.4-percent decline in the weekly earnings series. What is called for is an examination of the sources of discrepancy between the two series.

Why the series differ

Real disposable per capita income, a Commerce Department series, is based on total personal income less income taxes (Federal and state) and less social-security and other social-insurance contributions. That series is adjusted by the price deflator for personal consumption expenditures, and the result is divided by the total population. Incidentally, personal income includes not only the wages and other income earned in current production, but also transfer payments and imputed income of different types, such as the rental value of owner-occupied housing.

Real spendable weekly earnings, a Labor Department series, is derived from the average hourly earnings of all private nonfarm production (and nonsupervisory) workers listed on payrolls, multiplied by the average weekly hours of those workers. The payroll and (Federal only) income-tax liability is computed on the assumption that these earnings are realized through the year and that the worker is married, has three dependents, and has no other income. The weekly tax liability is subtracted from the weekly earn-

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ings data to obtain net weekly earnings, which are then deflated by the consumer price index to obtain real weekly net earnings.

Variations in movement of the two basic yardsticks thus can be attributed to the following factors: 1) personal income versus gross payroll (the numerator); 2) total population versus the number of production and nonsupervisory workers (the denominator); 3) tax differences, such as differences in treating overwithholding; and 4) personal-consumption price deflator versus the consumer price index. Variations in the annual percent changes of real disposable per capita income and real spendable weekly earnings reflect the net effect of differing movements registered by each of these factors.

Population vs. jobs

The Council of Economic Advisors recently calculated the relative importance of these factors, to explain the wide discrepancy that developed between the two series during the year 1973. Slightly more than half of the aggregate difference occurred because total population

grew more slowly than the number of production and nonsupervisory workers on private nonfarm payrolls: 0.7 percent for the former and 4.0 percent for the latter. In fact, this difference between the denominators of the two series helps explain most of the discrepancies arising over the past decade.

The spendable weekly earnings series tends to exhibit a downward bias in periods of strongly rising employment. (The series actually declined in five of the past eight years, while real disposable income rose significantly in every year of the period.) When economic opportunities are abundant, many married women, students and retirees enter the labor force. Compared to heads of households, these groups generally have less training, are likely to earn less than the average hourly wage, and are more likely to work less than a full workweek. For these reasons, they will tend to depress the average weekly earnings of all those employed, although each worker individually has gained in economic well-being.

Income and prices

Almost one-third of the difference between the two series last year may be explained by differential movements of after-tax income. The disposable income series rose 10.8 percent, compared to a rise of 9.2 percent in the net earnings of

all production workers. Most non-wage sources of income, which are included in the former but not in the latter series, expanded at a faster rate than wages and salaries last year. (Farm proprietor income rose about four times faster, and personal interest income also rose substantially faster.) Moreover, the income-tax overwithholding phenomenon cut into disposable income in 1972 but boosted it (through refunds) in 1973, whereas this was not a factor in the spendable-earnings series.

Finally, roughly one-fifth of the 1973 discrepancy may be explained by the different price indexes: the deflator for the disposable-income series rose 7.4 percent over the year, while the spendable earnings deflator rose 8.4 percent. The consumer price index, which is used to adjust the latter series, reflects weights as of 1960-61, while the consumption-spending deflator used for the disposable income series utilizes current expenditure weights. Food spending, whose relative importance in consumer budgets has generally decreased over time, thus has a heavier weight in the CPI than in the consumption deflator—and food prices of course soared in 1973. Moreover, mortgage interest is included in the CPI but not in the consumption deflator—and this item also rose rapidly last year.

Same signals in '74?

The differences between the two basic yardsticks should be somewhat less evident in 1974 than in 1973. The denominators of the two series should move in parallel fashion, since the increase in jobs is unlikely to outpace the population increase in this relatively stagnant period. As for the numerators, wage income may rise as rapidly as nonwage income, especially in view of the catch-up wage demands now developing in major labor negotiations, while the distortions introduced into the income series by tax overwithholding in 1972-73 will now be lacking.

The two price deflators also may move more closely together, as the differential weights in the CPI become less important. Other items (such as energy) may affect price trends just as much as food this year, while mortgage interest rates are unlikely to have the same sharp impact they exerted last year. Altogether, the two yardsticks of individual well-being may tell the same story in 1974, in contrast to the sharply divergent signals they transmitted last year.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT
 (Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 2/27/74	Change from 2/20/74	Change from year ago	
			Dollar	Percent
Loan gross adjusted and investments*	78,592	+ 192	+8,062	+ 11.43
Loans gross adjusted—	60,014	+ 108	+7,402	+ 14.07
Securities loans	1,138	- 88	- 147	- 11.44
Commercial and industrial	20,767	+ 108	+1,754	+ 9.23
Real estate	18,514	+ 5	+3,084	+ 19.99
Consumer instalment	9,167	+ 26	+1,108	+ 13.75
U.S. Treasury securities	5,892	- 54	- 449	- 7.08
Other Securities	12,686	+ 138	+1,109	+ 9.58
Deposits (less cash items)—total*	73,956	+ 247	+5,907	+ 8.68
Demand deposits adjusted	21,068	+ 199	+ 950	+ 4.72
U.S. Government deposits	631	+ 144	- 800	- 55.90
Time deposits—total*	51,110	+ 110	+6,046	+ 13.42
Savings	17,720	+ 18	- 450	- 2.48
Other time I.P.C.	23,963	+ 164	+5,891	+ 32.60
State and political subdivisions (Large negotiable CD's)	6,825 11,161	- 34 - 30	+ 398 +3,924	+ 6.19 + 54.22
Weekly Averages of Daily Figures	Week ended 2/27/74	Week ended 2/20/74	Comparable year-ago period	
Member Bank Reserve Position				
Excess Reserves	24	25		18
Borrowings	292	235		127
Net free (+) / Net borrowed (-)	- 268	- 210		-109
Federal Funds—Seven Large Banks				
Interbank Federal funds transactions				
Net purchases (+) / Net sales (-)	+1,341	+1,221		+831
Transactions: U.S. securities dealers				
Net loans (+) / Net borrowings (-)	+ 388	+ 256		+124

*Includes items not shown separately.

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