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FRBSF Weekly Letter

Slicing the Pie

Who cares about income distribution—about how the pie is sliced at mankind's crowded table? A number of people care strongly about the principle of relatively equal shares—perhaps for humanitarian reasons, or perhaps simply because of enlightened self-interest in a world where severe inequality may create social instability. Moreover, the man in the street probably would agree with these altruistic sentiments—provided of course that he continued to make a little more than his neighbor.

Despite individuals' preoccupations with where they fit in the income distribution, the economic textbooks have paid less attention to income distribution than to income growth in recent decades. David Ricardo could write in 1819 that the principal problem in political economy was to determine the laws which regulate the distribution of income, but modern American economists have paid much more attention to the laws of economic growth and inflation. The classical economists and their stepchildren, the Marxist and socialist economists, felt that the distribution of income was extremely important for the moral quality and stability of society. In contrast, mainstream economists of the past generation have often argued that distributional problems can be solved by the "trickle down" effects of the economic-growth process.

Again, many micro economists argue that the market rewards people according to their contributions to society, and that any attempt to tamper with the distribution of income ordained by the market will diminish the incentives necessary for the sustained growth of total income. The flavor of this argument can be seen in the recent debate over the so-called Laffer Curve, which suggests that the burden of taxation on Americans has created serious disincentives to work and produce. A separate argument, popularized by George Stigler, suggests that any attempt to redistribute income to the poor will generally benefit the middle class at the expense of both the rich and the poor.

Measuring differentials

Debates thus continue over the optimum distribution of income, suggesting an obvious question—how should income distribution be measured? Ideology frequently determines the categories in which economists collect their data. Classical economists focused on the rewards to the major factors of production—land, labor and capital. Marxists, in contrast, divided economic rewards into the amounts received by workers and the surpluses captured by capitalists.

In more recent times, attention has often focused on more general measures of income

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equality. One of these can be represented by a simple table which portrays the percent share of the nation's income captured by the richest 10 percent of its families, by the richest 20 percent, and so on. This sort of table can be compressed into a single number, known as a Gini coefficient, which ranges from zero to one with increasing income inequality.

Inequality over time

Over the course of American history, the general measures of income distribution have displayed two distinct phases—an early stage in which the rich got richer and the poor got relatively poorer, and a later stage in which the gap between the rich and poor gradually diminished. Nobel laureate Simon Kuznets and others have suggested that the turning point came about the time we entered the Great Depression of the 1930's. In 1929, the richest one-fifth of the American population received 15½ times as much income as the poorest one-fifth. By the outbreak of the Korean War, this gap between the richest and poorest fifths had fallen to 9 times—perhaps not enough for some egalitarians to cheer about, but still the most sustained movement toward income equality in American history.

Since the Korean War, there have been only moderate changes in the distribution of income.

While it is sometimes difficult to relate one's own situation to these relatively bloodless measures—we are unlikely to see a demonstration with raised fists and placards demanding "Lower the Gini Coefficient Now"—there are certain measures of income distribution which may be relevant to the social issues of the 1970's. Probably the two most prominent of these involve the distribution of economic rewards among the races and between the sexes.

Differences by race

Let us first consider the distribution of income by race. Nonwhite families have tended to close the income gap in the past quarter-century, at least until about 1970, but their family incomes still account for only about three-fifths of whites' incomes. The major improvement in the nonwhite/white family-income ratios occurred during the decade of the 1960's, partly because of the lengthy economic expansion of that period but also because of the consequences of the Civil Rights Act of 1964. These factors combined to produce an unprecedented rise in the ratio, from .55 in 1964 to .64 in 1970. The independent effectiveness of government anti-discrimination legislation in narrowing the racial income gap is supported by a recent study done at the National Bureau of Economic Research. In this study, Richard Freeman analyzed data from individual companies, and found that anti-discrimination policies had indeed narrowed the difference between black and white incomes.

As we moved into the more turbulent economic environment of the 1970's, the progress of the 1960's began to erode, despite continued sanctions against labor-market discrimination. By 1978, median nonwhite family income had fallen back to only 61 percent of white family income—the second lowest level in a decade. Furthermore, the normal cyclical pattern of blacks becoming worse off during recessions was stood on its head. During both recessions of the 1970's, the racial income gap narrowed, and during the subsequent business recoveries the gap widened again. One clue to this new pattern may be found in the unemployment rate. Contrary to what one might expect from the old "last-hired, first-fired" theory, the jobless rate actually rose more slowly for blacks than for whites during the recessions of the 1970's. During the recoveries, the black unemployment rate was slower to come down.

Income equality among the races probably won't be achieved in the near future, even if the gap begins to narrow again. If the pattern of progress apparent in the 1960's were to be repeated, it would still be 2013 before the average nonwhite family earned as much as the average white family. Moreover, the income gap could widen further if some recent trends continue. These include the rising proportion of nonwhite families headed by females, the declining proportion of nonwhite families with two or more income earners, and the rising proportion of white families with multiple income earners.

Differences by sex

Women workers have recently improved their position in relation to men workers, but still, the female/male earnings ratio has not improved over a longer time-span. In 1959, women earned 59 percent of what men earned, but the ratio was no higher in 1977 than in 1959. But full-time women workers fared better, receiving 67 percent as much as men workers in 1976.

Significant income differences still persist, however—and recent research suggests that the remaining gap is due less to women's failure to get equal pay for equal work than to their failure to get equal work. A study by Allan King of the University of Texas showed that of a group of men and women professionals who started their careers together, the women earned a third less than their male counterparts 14 years later, as a result of differential pay boosts in the intervening period. Since none of the women in this sample were ever married, the gradually rising income gap cannot be explained by women following their spouses from city to city or being distracted from their careers by child rearing. The more likely interpretation is that women tend to wait in the wings while men move up the organizational and bureaucratic ladders. Thus, if women want to move further toward income parity, they should concentrate their attacks on job discrimination rather than on pay discrimination in coming decades.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 10/24/79	Change from 10/17/79	Change from year ago @ Dollar	Percent
Loans (gross, adjusted) and investments*	134,446	+ 262	+ 18,400	+ 15.86
Loans (gross, adjusted) — total#	111,284	+ 307	+ 17,614	+ 18.80
Commercial and industrial	30,996	+ 295	+ 3,455	+ 12.54
Real estate	41,489	+ 218	+ 8,563	+ 26.01
Loans to individuals	23,611	+ 97	NA	NA
Securities loans	1,750	− 151	NA	NA
U.S. Treasury securities*	7,567	− 38	− 753	− 9.11
Other securities*	15,595	− 7	+ 1,544	+ 10.99
Demand deposits — total#	43,021	− 1,243	+ 1,931	+ 4.70
Demand deposits — adjusted	31,034	− 717	+ 1,348	+ 4.54
Savings deposits — total	29,837	− 265	− 745	− 2.56
Time deposits — total#	55,838	+ 314	+ 7,997	+ 16.72
Individuals, part. & corp.	47,513	+ 427	+ 8,972	+ 23.28
(Large negotiable CD's)	20,922	+ 104	+ 2,125	+ 11.30

Weekly Averages of Daily Figures	Week ended 0/24/79	Week ended 10/17/79	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves (+)/Deficiency (−)	− 2	28	54
Borrowings	179	127	36
Net free reserves (+)/Net borrowed(−)	− 181	− 99	18
Federal Funds — Seven Large Banks			
Net interbank transactions [Purchases (+)/Sales (−)]	+ 669	+ 511	+ 455
Net, U.S. Securities dealer transactions [Loans (+)/Borrowings (−)]	+ 20	+ 57	− 371

* Excludes trading account securities.
# Includes items not shown separately.
@ **Historical data are not strictly comparable due to changes in the reporting panel; however, adjustments have been applied to 1978 data to remove as much as possible the effects of the changes in coverage. In addition, for some items, historical data are not available due to definitional changes.**

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