Chapter 9

Money

A woman stands before a bank teller as she prepares to make a deposit in 1929. During the Depression, 40 percent of the nation’s commercial banks failed, and depositors lost more than $140 billion (in 1999 dollars). Courtesy of Corbis/Bettmann-UPI.
The real earnings of American workers improved steadily during the first three quarters of the century, but economists disagree about what happened during the last quarter.

The hourly earnings of manufacturing workers, measured in 1999 dollars, quadrupled from early in the century through the mid-1970s. As the upper chart indicates, the wages for these workers, who were somewhat better paid than hourly workers in general, rose from $3.80 per hour in 1909 to $15.38 in 1973. In the last quarter of the century, however, earnings declined by about 10 percent, to $13.90 in 1999. The chart is based on data for manufacturing “production workers” because this is the only wage series that extends back to the early years of the century.

The steady improvement of wages from the early part of the century until the mid-1970s is undisputed, but economists disagree about the trend after that time. In The Illustrated Guide to the American Economy, Herbert Stein and Murray Foss present a chart similar to this one, showing a decline in real earnings from 1978 to 1998, and four additional charts using alternate measures that show increases in real earnings during that period. Other economists claim to see a steep decline in those decades.

There are two aspects to this puzzle: a shift from wages to other forms of compensation and significant flaws in the way the Consumer Price Index attempts to capture “real” wages. Wages may not have increased much after the mid-1970s, but the total compensation package received by employees improved significantly, as shown in the lower chart. The difference is made up by a growing array of fringe benefits that became increasingly valuable. Benefits such as employer-provided health insurance, bonuses, stock options, child care, tuition assistance, and vision and dental benefits expanded dramatically.

To complicate matters further, experts are divided about whether the Consumer Price Index measures inflation accurately (see page 176 for a discussion of how the CPI is constructed). If the CPI significantly overstates inflation, then real earnings may actually have increased somewhat since the mid-1970s.
Although the equalization of women’s and men’s earnings proceeded slowly, the process accelerated after 1980. The gap between the average earnings of white male workers and black male workers also narrowed.

The ratio of female to male earnings moved upward during most of the century, except for a moderate downturn from 1955 to 1980, when women were entering the labor force in large numbers. After 1980, however, the equalization of women’s and men’s earnings accelerated. Legislation mandating equal employment criteria and promotion opportunities, equal pay for equal work, and equal access to occupational training, especially in privileged occupations, was instrumental in this change.

In 1997, the earnings of women working full-time year-round were equal to only 74 percent of the earnings of male full-time, year-round workers. This comparison, however, ignored large differences between the average qualifications of men and women in the labor force. When women were compared with men of equivalent education and work experience, much of this difference in earnings disappeared. Among Americans aged twenty-seven to thirty-three, for example, women who never had a child earned an average of 98 percent of men’s earnings.

Data on earnings by race for the early years of the century are not available, but anecdotal evidence suggests that by 1940 the earnings gap between black and white males had narrowed considerably. From 1940 to 1980, the ratio of black male earnings to white male earnings increased substantially. There was a brief decline around 1990, but by 1997, the earnings of black men working full-time, year-round had climbed to 76 percent of the earnings of their white counterparts.

Some of the difference between the earnings of black and white males can be traced to their levels of education. Although the difference in educational achievement between black and white males was much smaller at the end of the century than at midcentury, the education gap remained substantial. In 1998, 27 percent of white males, but only 14 percent of black males, had completed at least four years of college.
Women’s Earnings as Percentage of Men’s Earnings
Year-round, full-time employment

Black Earnings as Percentage of White Earnings
Year-round, full-time employment of men
The real incomes of middle-income families at the end of the century were five times greater than those of middle-income families in 1900.

Middle-income families—those in the middle fifth of the aggregate income distribution—saw their average annual incomes, measured in constant dollars, increase from more than $15,000 in 1929 to more than $47,000 in 1998. National data on family or household income were not available before 1929. Fairly reliable estimates of per capita Gross National Product, however, show a rise of about 65 percent from 1900 to 1929, indicating that the mean income of middle-income families had registered significant improvement even before 1929.

The only major dip in this upward trend occurred during the Depression of the 1930s, but income levels recovered by the end of that decade. Wartime shortages and price controls kept the trend relatively flat during the 1940s. In the almost unbroken prosperity of the 1950s and 1960s, the real incomes of middle-income families nearly doubled. After 1972, they continued to rise, but at a slower rate.

These calculations do not take into account a variety of factors that affect real income, such as taxes, social services, fringe benefits attached to employment, and the costs of working. If each of these could be accurately calculated, the trend in real income would shift in one direction or another. On the one hand, the tax burdens of middle-income households were distinctly heavier at the end of the century than in earlier years, and the costs of working were much greater for the dual-earner families of the 1990s than for the sole breadwinners of the 1950s. On the other hand, most middle-income families at the close of the century benefited not only from government subsidies (guaranteed mortgages, Social Security payments, Medicare, student loans) that were not available earlier in the century, but also from the fringe benefits attached to full-time jobs, which were far more extensive and valuable than they had been in the past.

Nor is the quality of available goods factored into calculations of real income. Many of the goods and services that middle-income families purchased at the end of the century, such as cameras or heart surgery, were incomparably superior to those available at the beginning or middle of the century. Others, such as cellular telephones and in vitro fertilization, did not exist until the last decade of the century. When all these criteria are assessed, the vast improvement in the material circumstances of middle-income families during the century is unmistakable.
As real incomes increased during the century, Americans spent smaller shares of their incomes on food and clothing, but larger shares on medical care and transportation.

Engel's Law, proposed in 1857 by German economist Ernst Engel after he studied the budgets of Belgian families, states that the lower a family’s income, the higher the proportion spent on food, and vice versa.

As the charts show, Engel's Law remains valid. The families surveyed in 1901 spent nearly half of their incomes on food. As family income grew, that proportion declined steadily until 1997, when food accounted for only a sixth of personal consumption expenditures. The share of income spent on clothing also declined regularly. The share devoted to transportation increased sixfold from 1901 to 1950 and remained at that level through the end of the century.

The share of expenses dedicated to having and maintaining a home remained remarkably constant over the century, while the average residential space per person soared upward (see page 94). Household operations include light, heat, gas, electricity, and telephone bills, together with furniture, appliances, and cleaning materials.

Medical care costs were so small in 1901 that they were included in the “sundries” category in questionnaires. The share of personal consumption expenditures devoted to health care doubled from 1929 to 1970 and then doubled again from 1970 to 1997. The residual category is of particular interest. It includes a wide variety of elective expenditures, from life insurance premiums to football tickets, church collections, and foreign travel. These discretionary expenditures probably have a greater effect on satisfaction with one’s economic situation than the absolute level of income.
Personal Consumption Expenditures
Percentage spent on each category

Food
43% 27% 30% 24% 18% 15%

Clothing
13% 15% 12% 9% 7% 6%

Housing and Household Operation
25% 29% 26% 26% 27% 26%

Medical Care
N/A 4% 5% 9% 16% 17%

Transportation
2% 10% 13% 13% 12% 12%

Residual
17% 15% 13% 18% 21% 23%

Money 167
The enormous expansion of government funding for education, health, research, welfare, and the arts did not dampen private funding.

A surprising trend in private philanthropy, shown in the chart at left, is the predominance of gifts by living donors, which greatly exceeded the combined total of charitable bequests, corporate gifts, and foundation grants. The major increase in private fortunes after 1980 made it possible for individuals to make gifts of unprecedented scale. In the capital campaigns that were conducted almost continuously by major universities, a contribution of $1 million was not unusual.

Corporate philanthropy was almost unknown before 1950. Indeed, it was often considered an illegitimate misuse of money belonging to stockholders. But during the second half of the century it became almost obligatory for large business enterprises to display a list of good works that were not necessarily restricted to their own employees or the local community.

In 1950, the combined worth of all U.S. foundations was less than $3 billion; only four had more than $100 million in assets. In 1995, their combined worth totaled $227 billion, and about 300 foundations had assets of more than $100 million each.

The principal beneficiaries of private donors were churches and other religious organizations. The largest share of corporate gifts and foundation grants went to educational institutions, followed by human service agencies, hospitals and health research, art and culture. Although the bulk of philanthropic contributions in every category went to well-established organizations, some new activities were funded as well.
Money 169
The ratio of personal debt to personal income reached a peak in the 1990s. The bankruptcy rate climbed slowly after World War II and more rapidly during the last two decades of the century.

The ratio of the aggregate debt owed by individuals to the aggregate income received by individuals was relatively low in the early part of the century. It rose to a then-unprecedented level of .52 at the depth of the Depression in 1933, and then declined until 1945. By 1960, the ratio exceeded that of 1933, and in the last two decades of the century, it rose to record levels.

The 1998 ratio of 0.9 signifies that the total debts owed by individuals were close to their total annual incomes. At more than $7 trillion, personal debt exceeded the federal debt by a considerable margin.

Approximately three-quarters of this personal debt represented residential mortgages, most of them long-term and borrowed at moderate interest rates. The effective interest rate was even lower because mortgage interest is deductible from taxable income.

The remainder of the debt burden was composed of short-term consumer credit and home equity loans. Earlier in the century, retail merchants and service suppliers carried consumer credit accounts and installment purchase loans at nominal or no interest. In the last two decades of the century, most credit of this type was offered through credit card companies. Home equity loans, an innovation of the 1980s, represented a small but growing fraction of consumer debt, at rates substantially lower than those charged by credit card companies.

The lower chart shows all bankruptcies—municipal, corporate, farm, nonprofit, and individual—but most bankruptcies were individual. The quadrupling of bankruptcies in the last two decades of the century is partly attributable to the liberalization of the law under the Bankruptcy Reform Act of 1978 on the one hand, and to credit card debt, medical costs for catastrophic conditions, and legalized gambling on the other. Beginning in the 1980s, credit card lenders abandoned traditional measures of creditworthiness in exchange for high interest rates on revolving card balances. During the same period, legalized gambling became available throughout the United States. Both of these developments encouraged some consumers to accumulate debts they could not repay, and bankruptcy offered them a fresh start. At the same time, a booming economy led to more business startups, some of which failed and went to bankruptcy court (see page 246).
Ratio of Personal Debt to Personal Income

Bankruptcy Rate

Bankruptcies per thousand population per year

Money 171
Income inequality decreased throughout much of the century, increased from 1980 to 1995, and then leveled off.

The upper chart compares the mean income, in 1999 dollars, of families in the upper 5 percent of the national income distribution with the mean income of families in the lower 40 percent of the distribution. Both groups experienced substantial increases in their incomes after 1929, and both suffered a slight loss of income during the 1970s and into the recession of 1982. But after 1982, the two groups diverged markedly.

The average income of families in the lower 40 percent of the national income distribution increased 12 percent between 1982 and 1998, from $19,243 to $21,520. The picture is quite different for families in the upper 5 percent of the national distribution, however. Between 1982 and 1998, the average income of these affluent families rose 77 percent, from $143,052 to $252,582.

The lower chart tells this story in a different way. It compares the share of the total income of all American families that went to the affluent families in the upper 5 percent of the income distribution with the share that went to the nonaffluent families in the lower 40 percent of the distribution. In 1929, the aggregate income of the affluent 5 percent was more than twice the aggregate income of the nonaffluent 40 percent. This difference declined and then disappeared until 1985, when the affluent share began to rise again. But in the 1990s, the affluent share stabilized at 21 percent and the nonaffluent share leveled off at 14 percent.

This development can be plausibly attributed to several factors, including changing family structure, tax policy, global trade, technology, immigration, and the decline of labor unions, but it is exceedingly difficult to determine the relative weights of each factor. Neither chart takes account of noncash income such as health benefits.
Average Incomes of Affluent and Nonaffluent Families

Average income of each group in 1999 dollars, logarithmic scale

Income Shares of Affluent and Nonaffluent Families
Percentage of total national income going to each group
Poverty decreased significantly from 1959, when official measurements began, until 1973, when it increased moderately and remained at a slightly elevated level during the subsequent two decades. Between 1993 and 1999, however, the incidence of poverty declined by more than a fifth.

The federal government’s poverty threshold is determined by calculating the annual cost of a basic list of groceries for a reference family of four (two adults and two children) and then multiplying that number by three. Families whose annual incomes are less than this amount are considered “below the poverty line.” The amount of income is adjusted for the number and ages of the people living in the household, along with other factors. The chart shows the proportion of the population living in households that were below the poverty line.

In the United States, the incidence of poverty was related to race and ethnicity, location, family composition, age, and education. The incidence of poverty was more than twice as high among blacks and Hispanics than among whites. The central districts of metropolitan cities had the most poverty. The suburbs of the same cities had the least, while small towns and rural areas had poverty rates that fell between those of the inner cities and their suburbs. Far fewer married than unmarried people were poor. People living alone were more likely to be poor than people in families, and women were more likely to be poor than men. Children and young adults aged eighteen to twenty-four were more likely to be poor than any other age group. People who did not complete high school were more likely to be poor than those who attended college. These effects were cumulative so that, for example, a black unmarried mother under age twenty-four was likely to be poor, while a married white college graduate between the ages of forty-five and fifty-four was almost certain not to be.

In 1999, the incidence of poverty fell to its lowest level in two decades. It declined among every racial and ethnic group, falling to a record low among blacks and matching historic lows among Hispanics. The poverty rate was the lowest since 1979 among children, and the lowest on record for Americans aged sixty-five and older. The incidence of poverty fell to record lows for married-couple families as well as families headed by women with no husband present. Much of this significant decline in poverty occurred among residents of central cities.

Poverty, as defined by the government’s monthly income threshold, was a permanent or semi-permanent condition for some Americans, but a transient experience for many others. During 1993 and 1994, the latest years for which these data are available, 30 percent of the population was poor for at least two consecutive months. However, only 5 percent of the population was poor for the entire twenty-four months.

The government’s measure of poverty is simple but rather crude. Its most basic flaw is the measure of income, rather than expenditure or standard of living. Households “below the poverty line” actually spend considerably more money than they take in: they draw down assets, borrow money, and avail themselves of nonincome benefits such as food stamps and Medicaid.
Inflation alternated with deflation and periods of price stability from 1900 to 1955. Every year thereafter witnessed some inflation, although at substantially reduced levels toward the end of the century.

The century’s most extreme increases in consumer prices were registered before, during, and immediately after American participation in World War I. Serious deflation was associated with the Panic of 1907, the recession of 1921–22, and the first part of the Depression of the 1930s. After 1955, consumer prices rose every year, but the amount of the increase varied from a minimum of eight tenths of 1 percent in 1959 to a maximum of 13.5 percent in 1980. The amplitude of these variations subsided in the 1980s and 1990s.

The chart shows the year-to-year change in the Consumer Price Index, commonly known as the inflation rate. The CPI is constructed by combining the price indices of eight classes of goods and services that are components of the budget of nearly all consumer units: food and beverages; housing; clothing; transportation; medical care; recreation; education and communication; and “other goods and services.” The latter category is composed primarily of personal expenses. The eight broad categories are broken down into smaller categories. Every month, prices for approximately 71,000 goods and services are collected from 22,000 outlets in 44 geographic areas to construct the price index.

The eight categories that are combined in the CPI do not necessarily move in tandem. Between 1980 and 1998, for example, the CPI rose by 98 percent, while the price of medical care rose by 223 percent and the price of clothing increased by 46 percent. Nor do the prices of individual items within each category move in tandem. Between 1980 and 1998, the price of tomatoes increased 192 percent, while the price of eggs went up 53 percent.

The prices of rare objects of all kinds, from baseball cards to Old Master paintings, frequently exhibited inflation rates much higher than those of the CPI, in some cases hundreds of times higher. Similarly, the prices of rare services, from the stud fees of winning racehorses to the hourly rates of corporate lawyers, often exceeded the prices of ordinary commodities by wide margins.
Inflation Rate
Annual percent change in Consumer Price Index

Price stability

1999 = 2.2%