



Silent Depression: Notes

By [Dr. Mason Gaffney]

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Peterson, Chap. 1

CHAPTER 1

Peterson, Wallace C., 1994. Silent Depression. NY: W.W. Norton
Notes in outline form, for student use.

Preface

Telegraphs policy recommendations to come.

1. "Massive investment," public and private, in physical and human capital.
2. National Health Insurance.
3. "Overhaul" Federal tax system (no specifics given here).

These are Peterson's recommendations - not always the same as mine, or yours. Peterson has a point of view, which he shows openly. This does not mean he is more biased than other writers; he is just more open and honest about it. You may agree or disagree without its affecting your grade in this course. The point is to learn the factual material he presents, and understand his arguments.

Chapter 1: The Unraveling of the American Dream

Words to know. You must know not just the word as defined in Webster's, but its usage in economic discourse. "Usage" means not just technical meaning, but sometimes also the "baggage" or overtones that words carry because they are used as slogans for this or that faction.

Anachronism (e.g. Peterson's reference to Democratic control of Congress)

Stimulus

Safeguards, p.18

FDIC

Federal spending as a "floor"

(Federal securities as a stabilizer for banks)

Keynes, Keynesian, Keynesianism, p.19

"the economy" p.20 et seq
insolvency

bankruptcy p.24

P/e ratio (Price/earnings)

Rate of exchange between present and future goods

annual growth rate p.20

$$r = (F/P)^{1/n} - 1$$

doubling time, and Rule of 72

discretionary income

quarter (= 3 mos.)

OUTLINE OF CHAPTER 1 (8 points)

1. The "U.S. economy peaked," 1973.

Measure of "the economy" used here is the hourly wage rate. Later he shows us other measures.

"Peaked" means topped off. This means it's been going downhill ever since.

2. Safeguards dating from the 1930s made this depression "silent": hence the book title. Instead of a dramatic "crash," we are going down slowly. Not a heart attack, but a "cancer."

Safeguard #1: FDIC

#2: High, steady level of Federal spending. (Here, Peterson telegraphs that he is a "demand-sider.")

#3: Not mentioned, high level of Federal debt, "non-defaultable," stabilizes banks.

3. The top 20% (in income and wealth) are now in charge. Washington rhetoric and policies reflect their concerns. One of these is a high stock market. High wage rates are not a priority; rather, Washington views them with alarm.

(Ask yourself: if the stock market shut down for a year, would it make any difference to our national output?)

4. Some history

A. Major eras

1929-39, Great Depression, high unemployment

1939-45, World War II, output tripled

(Unsaid: P/e remained low, land was highly affordable to new businessmen, farmers, and homebuyers.)

1948-73, Cold War and Reconstruction of Europe helped keep us going at high level (there were also two hot wars, Korea and Viet Nam)

B. Intellectual syntax for policy: 1947-73 was the "Age of Keynes."

Average yearly growth rate was 3.7% - close to long-term prior average.

5. Elements of "The American Dream."

- a. Good jobs
- b. Home ownership
- c. New appliances, etc. (omits cars!)
- d. Fringe benefits
- e. Leisure (shorter hours, vacations, etc.)
- f. College for children
- g. Upward mobility
- h. What can you add to this list? What is your dream?

6. Problems to solve now

- a. Unemployment

Official rate is high, but real rate is higher because of undercounting. P. estimates that 10-11% is more like it, p.22.

b. Sociological problems resulting: higher divorce rate, lower marriage and birth rates, other evidences of family dissolution

- c. Loss of pension promises
- d. Unreachable health care
- e. Unreachable home ownership
- f. Unreachable higher education (fails to mention lower support for K-12 education)
- g. Fails to mention high cost of auto insurance; long commutes; etc.

7. Loss of leisure: longer hours, more family members working (but cf. p.43)

8. Problem today is more like slow cancer than a heart attack or stroke. (Slow metabolism may be a better analogy.)

END OF CHAPTER 1

Peterson, Wallace C., 1994. Silent Depression. NY: W.W. Norton

Notes in outline form, for student use.

Chap. 2: "Diagnosing the Silent Depression"

Words and phrases to know.

- Demand-side economics
- Annual rate of growth
- Oxymoron
- Final product
- Intermediate product
- Net out
- Depreciation
- Depletion
- Obsolescence
- Real income (base year for much of the data is 1989 or 1990)
- Mean vs. median
- CPI
- Uncouple
- Phillips Curve
- Trade-off
- "Dismal Science"
- Rule of 72 (concerns "doubling-time")
- "Productivity" (means AP of labor; overlooks MP of labor, and productivities of land and capital)

OUTLINE OF CHAPTER 2

1. History of waves

A. There have been 32 cycles since 1854

B. NBER defines "recession" as when "rate of growth of output" falls for 2 quarters. There have been 8 such recessions, 1945-89.

This definition strikes me as being much too sensitive to small changes in rate of growth. Rate of growth is bound to fall sometimes - it can't keep rising forever. Even a constant rate of growth is of doubtful value: who needs to have more every year, when we soon get more than we have time to savor and enjoy, or even store in the attic?

Peterson writes interchangeably of recession, slump, downturn, economic decline, and trauma. He reserves "depression" for a heavy slump - and he says we are in one today.

Never mind the little ripples. There have been nine big waves since 1798, peaking in 1798, 1819, 1836, 1857, 1873, 1893, 1929 ("The Great Depression"), 1970, and 1989. We will ignore the little ones, and focus on these big ones. Later we will take one as a case study: the one that peaked in 1836, called "The Canal Boom."

C. NBER has a "Business Cycle Dating Committee." Their job is not to go out with business cycles, but to tell us when we are in upswings and downswings. The Chair is Prof. Robert Hall of Stanford.¹ They told us we pulled out of the last downswing in March, 1991, but you could have fooled me, and a lot of people seeking work. Unemployment stayed high - they just don't give it much weight any more. They are calling our condition "jobless prosperity." Prosperity for whom? "Jobless prosperity" is one of the great oxymorons of all time, and should alert us to a serious bias in NBER. Who was it said, "Never trust anyone over thirty"?

2. Measures of economic well-being.

A. The National Income and Product Accounts (NIPA)

The Great Depression spawned our first real "national accounts." They evolved during W.W. II (1941-45), and were used to help measure and mobilize our war effort. Gross National Product (GNP) and National Income (NI) are highlights of these "National Income and Product Accounts" (NIPA). The Department of Commerce (USDC) is the agency that keeps and publishes these accounts. Peterson calls them "highly useful," but even so prefers other measures of economic well-being. He is wise, because NIPA is deeply flawed.

i. GNP measures gross final products - intermediate products are netted out. That much is good. However, GNP fails to deduct anything for depreciation and obsolescence of existing capital stock. Thus, it tends to overstate the production of the current year. (I say "tends to" because there are other factors

¹Hall is also co-author of The Flat Tax, now a hot item in Washington.

at work, and the net result depends on their relative strength. "Tends to" just says that this single factor, taken alone, pushes in the direction of overstatement.)

ii. NI is net of depreciation. In principle, NI should give us a better measure of current net output. In practice, NI badly **overstates** depreciation, thus tending to **understate** true NI. This is why GNP is still used: NI may understate true NI by as much as GNP overstates it.

[How does NI overstate depreciation? The national income accountants in USDC do not measure depreciation independently. Instead, they take data from the IRS, which gets them from tax returns. Tax filers are known to overstate depreciation by a large factor. They do this to lower their taxable income; tax lawyers have raised this to an art-form, and Washington lets them get away with it. Many durable goods are depreciated more than once over their economic lives, by each of a series of owners. Thus, in any given year, many capital goods are being depreciated that have already been depreciated once or more in the past.² USDC does not correct for this.³]

iii. Both GNP and NI are gross of depletion of natural resources. This omission makes them both tend to **overstate** this year's net contribution to economic well-being. If you got a permit to log off all the redwoods in Sequoia Nat. Park, the lumber would add to national income with no adjustment for loss of the old trees. Environmentalists and allied reformers have complained about this for two generations, and President Carter once ordered Commerce to report on how to measure depletion, and come up with a "Green National Product." President Reagan

²Owner A is allowed to tax-depreciate buildings faster than they actually lose value. "A" then sells to B, who may and does depreciate the same building all over again. The Treasury makes up for some of this loss by taxing A's gain on the sale - it is classed as a "capital gain." However, the NIPA bookkeepers do not count A's gain as part of national income: they omit **all** capital gains.

³It is tempting to blame all this on the universal scapegoat, "bureaucracy." Many bureaucrats, actually, are conscientious professionals who press for improving accuracy. They are blocked by Congress. Shall we then blame "politicians"? They are another handy scapegoat. Congress, however, is responding to pressures from private tax filers who avoid taxes in the manner described, and who seek to avoid the light.

dropped this project after 1981, however ("When you've seen one redwood tree, you've seen 'em all") and there is no sign now of any imminent change stirring in USDC.⁴

The upshot for us here: Peterson is right to prefer some other measure of national well-being.

B. The real income of individual workers. This is Peterson's preferred measure. He defines a "depression" as a fall in the mean real income of workers. This suggests Peterson is mainly concerned with the welfare of "Joe Sixpack" (although later we will spot some inconsistencies).

Understand several technical points about this measure: each word in the first sentence has a meaning.

i. It omits property income, so when property income rises while wage rates fall (as has happened since 1973) we get a "silent" or Peterson depression even while the stock market soars.

ii. It omits supervisory workers. However, it includes 80% of all workers; and all workers wages and salaries are related because people can shift from one class to another.

iii. It omits farm workers. The published data are at fault - not Peterson. Published data, in turn, neglect farm workers for "political" reasons, i.e. the pressures brought by farm employers, and the lack of voting by farm workers.

iv. It omits public employees. Their wage rates are less sensitive to cyclical ups and downs in the short run.

v. What is measured is the **mean** wage rate. Some other measures (e.g. family income) are published as the **median**. Know the difference of mean and median.

vi. The **real** wage rate means the rate is figured in constant \$. This means there is a Consumer Price Index (CPI) showing the rise of prices from some base year. To get the real

⁴A new organization in San Francisco, "Redefining Progress," is now regularly issuing a "Green GNP" that purports to adjust for depletion. They have had some success, and bear watching.

wage rate, they divide the nominal rate (in current \$) by the CPI.⁵

vii. The wage income is that of individual workers, not of families or households. Households are doing better than individuals because more women are working outside the house. This comes at a cost in neglect of children and community, and has been blamed for the rise of juvenile crime.

viii. Only the wages of those who are employed are counted. If they entered the unemployed as earning zero wages, it would bring down the mean a lot.

C. Conventional economists put more stress on other measures.

i. Output of goods and services. For some reason, it is just **changes** in output that are measured. (This suggests an overemphasis on gross growth as an end in itself. Others believe the quality of life is more important than sheer quantity; and there are limits of the earth that force us to limit quantitative growth.)

ii. Unemployment. Political concern with this as a problem has dwindled steadily since 1936, when it was #1 on everyone's mind. Now, Washington views a little unemployment as a good thing, to hold down "inflation," which has become a codeword for wage rates. The unemployed are virtually unrepresented.

3. Macroeconomics is a "new way of thinking" about economics. Everything was new once. Now, let's call it a different way of thinking. Its best-known originator was John M. Keynes, 1936. Peterson is high on Keynes.

A "new way of thinking" is sometimes called a new "paradigm." I often use the word "syntax," meaning "a connected, orderly system, with harmonious arrangement of parts or elements." (Grammar, for example, is a syntax.) The economy is

⁵There is another index called "The GNP Deflator." For simplicity here we will stick with one, the CPI.

a system. An Economic Syntax is a set of rules for how the parts of this system fit together, **and interact**.⁶

In a few words, Macro deals with relations of sequence; Micro deals with relations of co-existence. Macro deals with journeys and transitions; Micro deals with destinations and equilibria. Macro is like a cinema; Micro like a still shot. Macro deals with the whole; Micro with the parts. In several later assignments I explain in some detail how the Macro Syntax differs from the Micro. To peak ahead, see readings #II,B and C; #III,A; #IV, F; and #IV, C.

4. Jobs and output

Peterson says they rise and fall together. This is a blind spot, I believe, and inconsistent with 2,B (above). A big part of the Macro problem is that jobs and output are uncoupled: hence we can have "jobless prosperity."

5. Full employment and inflation

Peterson says they go together. This makes him a believer in "The Phillips Curve," which poses a nasty trade-off: we have to give up either price stability or full employment. (Would you rather be shot or hanged? Would you rather give up food or sex?) This is the kind of thinking that makes some people call economics "dismal." We can do better.

The Phillips Curve went out with President Jimmy Carter, but it still lives in the Federal Reserve Board which regulates our money supply.

Endorsing Phillips seems to weaken Peterson's position, but we will see where he goes with this.

6. Three sets of time-series numbers are presented.

⁶A "Cosmos" is like a syntax, but more inclusive, evolutionary, and - well - pretentious. Here we will settle for a less ambitious syntax concept: it is already complex enough to stretch our minds.

A. Real weekly earnings of individual production workers (ex public and farm workers), 1947-90. They peaked in 1973. They grew at an annual rate of 1.9% to 1973. At this annual rate, they double in 38 years ($72/1.9 = 38$). They fell at an annual rate of .9%, 1973-90, thus dropping 15.5% overall.

B. Median real family income, 1947-90. This also climbed to 1973, but then it leveled off. Why the difference from "A"?

i. Family income includes property income.

ii. More family members are now working.

C. "Productivity."

This means output per worker, aka the "average product of labor" (AP). Peterson attaches great importance to this.

As far as determining wages are concerned, he should give more importance to the "marginal product of labor," or marginal productivity (MP). When employers substitute capital for labor and downsize, they raise the AP of labor (if you ignore the unemployed), and lower the MP, at the same time. This is a bit of "Micro" that needs to be considered in Macro.

Peterson believes that productivity growth also peaked in 1973. However, if you study Figure 3, p.41, this alleged peak is hard to detect. It says to me that the MP of labor is "uncoupled" from the AP.

7. Skip pp. 42-46. Study Fig. 4, p.47. "The Silent Depression" is in Real Weekly Wages - much more than in the other measures shown.

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Chap. 3: "Shrinking of the Middle Class"

Words and phrases to know.

Panglossian
Quintal, quintile¹
Relative change
Bell curve (normal curve of frequency distribution)
Skew
Mean
Median
Data (note that it is plural; the singular is datum)

OUTLINE OF AND COMMENT ON CHAPTER 3

1. In the last several years, many people, after being "downsized," have moved to lower-paying jobs.

This confirms Pete's wisdom in choosing weekly earnings as our measure of well-being, rather than unemployment. People who survive by taking bad jobs escape unemployment, but they are worse off. They also are adding less to the national product (lower marginal productivities). A person who was supervising a tire plant, and now gets a job sweeping floors, is adding less to national output.

This lower MP is not due to their becoming less able persons, on the average. It is due to changes in the way

¹The text misspells this as "quintal" (p.54). A "quintal" is something else: it is an old Roman term meaning 100 units; today it often means 100 kilograms. Peterson obviously means "quintile." Adding to the confusion, he is using it loosely. Strictly, quintile means the value marking the boundary of each fifth. Peterson uses it to mean the fifth itself, rather than its boundary. No need for us to be picky, though: just say "20%," or "Fifth," where he writes "quintal."

Is that hard to remember? If you were dealing in expensive whiskey you'd sure remember the difference between a fifth and a quart, so just think of a gallon split into five bottles.

As long as we're being picky, a U.S. "fifth" is no longer labeled as such, but as 750 ml. This is a concession to the metric system: 750 ml is almost exactly a fifth of a gallon. I doubt if they even changed the bottle size; just the label.

employers are organizing work. Individual employers are mostly not doing this deliberately to spite labor. They are in the grip of massive social, economic, and political forces that are changing - and that we can change back. It is these massive forces we analyze in this course.

2. 1992 campaign, candidates Bush and Clinton agreed on the virtue of a "middle-class tax cut."

Contrast politics today, when many candidates endorse a "flat-tax," which is an upper class tax cut. The flat rate structure is one favor for the upper class, but the main feature of the flat tax is not found in its name: it is deceptively labeled. The main feature is to **exempt all property income** from taxation, leaving wages and salaries and entrepreneurship to bear all taxes. David Shulman accurately describes these as "taxes on upward mobility." They are also taxes on youth. The heavy political support for this "flat tax" proposal indicates to what extent politics is now dominated by property owners, and how little heed is given to workers [including professionals, entrepreneurs, and the upwardly mobile].

3. There is a fear of discussing distribution, because it might stir up "class warfare."

Actually, class warfare goes on continually. We would blind ourselves to pretend otherwise. We'd better discuss it, or we won't have a clue what's going on. In the last 20 years, property has won most of the battles, including battles of the mind, such that workers are only dimly aware of their own interests. If you don't even know you're being attacked, you're bound to lose. California's Prop. 13, 1976, was a major victory for property. Robert Kuttner² describes it as *The Revolt of the Haves* (a book title). David Shulman³ described it as "breaching the social compact." Labor is disorganized, and divided into ethnic blocs that foolishly target each other, rather than property, as "them." The so-called flat tax is another "Revolt of the Haves," but this time at the national level.

²Kuttner is a columnist for Business Week.

³Shulman is Chief Equity Strategist for Salomon Bros. in New York. He was formerly a professor here at UCR.

The "haves" are on the whole older than the "have-nots," so class war overlaps with generational war. Some ethnic groups are overrepresented among the "haves," others among the "have-nots," and people on all sides of this are easily diverted into converting class issues into ethnic ones. To an economist, this muddies the waters considerably. Realistically, though, it happens, and we must cope with it.

Also, there are two overlapping "class wars" going on at once. There is property vs. labor; and there is rich vs. poor.

4. Measures of middle class shrinkage. Pete's pp. 56-60 are hard slogging. Here is where I can help you the most: it's a lot simpler than he makes it look.

A. Classes defined by \$ brackets.

Pete defines classes by family income.⁴ He uses \$ brackets (1990 \$)

<u>Class</u>	<u>Lower Bound</u> (\$)	<u>Upper Bound</u> (\$)
"Upper"	75,000	∞
"Middle"	25,000	74,999
"Working Poor"	13,359	24,999
"Poverty"	None	13,358

Families have moved out of the middle class, so defined, 1973-90. Table 3-1, p.57, says the percentage of families in the middle-class bracket dropped by 8.7%.

⁴Of the various measures of income he might use, he chooses Adjusted Gross Income (AGI). He does so for convenience: it is taken from income tax returns. Be aware that choosing other measures of income would change the results at least a little, and perhaps a lot. However, we don't have time here to explore all the possibilities, and will accept his measure.

Question: how does he figure that 8.7%? The drop is from 59.7% to 54.5%, which looks like a change of -5.2%. Is this a typo?

Answer: Pete is relating the change of -5.2% to the original 1973 value of 59.7%. $-5.2\%/59.7\% = -8.7\%$. This is what Pete means by "relative change." He uses this expression a lot, so learn to deal with it.

The text may confuse you because Pete is using the term "%" here in two different ways. The first meaning is a share of the total; the second meaning is the change in the share, as a fraction of the base-year value. To avoid this confusion, I will refer to changes as fractions, rather than "%s. Thus, the change from 59.7% to 54.5% is a fractional change of $-.087$.⁵

Algebraically, here is what Pete is saying:

$$(54.5\% - 59.7\%)/59.7\% = -5.2\%/59.7\% = -.087^6$$

What makes these pages hard to follow is that Pete next switches to another definition of the "classes," and then switches back again. My Table 1, below, consolidates all the info he gives us on changes in the "middle class" as defined above.

⁵We run into the same problem when measuring changes of interest rates, because these are expressed as %s. Thus, a change from 5% to 6% is a change of $1/5$, which = 20%. Thus, a rise of 1% becomes a rise of 20%. Be alert to this shift of meaning.

⁶To simplify calculations, this is often rewritten as $54.5\%/59.7\% - 1 = .913 - 1 = -.087$.

Table 1: Middle Class Families as a Percentage of All Families; and Middle Class Real Incomes as a Percentage of all Real Incomes; U.S., 1973 and 1990

Year	Middle Class Families (from text, p.58)	Middle Class Incomes (from text, p.60)	% of Families / % of Income	Upper Class Incomes (from text, p.60)
(1)	(2)	(3)	(4)=(2)/(3)	(5)
1973	59.7%	57.7%	1.03	21.4%
1990	54.5%	49.7%	1.10	29.8%
Change	-5.2%	-8.0%	--	8.4%
Change ÷ 1973 Value	-.087	-.139	--	.393

Column (4) I have added myself. It shows that the middle class's share of all families fell slower than its share of all income. This indicates that other incomes rose faster than middle class incomes. It could even mean that the mean middle class income fell.

Column (5) tells where the lost share of income went. The rise of upper class's share of income (8.4%) matches closely the fall of the middle class's share (8.0%).

B. Classes defined by Fifths

On pp.58-59, Pete redefines the classes. Now he defines them by Fifths. The Upper Class is the top Fifth; the Lower Class is the bottom Fifth; the Middle Class is the middle Three Fifths. Table 2, below, consolidates the scattered data he presents.

Table 2: Distribution of Family Income by Percentages, 1973 and 1990

Class	<u>Share</u> ---	<u>of</u> <u>Income</u> ---	Rel. Change	<u>Ave.</u> ---	<u>Income</u> ---	Rel. Change
	1973	1990	1973- 90	1973	1990	1973- 90
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Top 5%	15.5	17.4	.123	n.d.	148,000 = 15y	n.d.
Top 20%	41.1	44.3	.078	7.5x	94,397= 9.6y	2.1/ 7.5 = .28
Middle 60%	53.4%	51.2%	-.041	n.d.	n.d.	n.d.
Bottom 20%	5.5%	4.5	-.18	x	9,833 ⁷ = y	n.d.

"n.d." means "no data."

In Col. (5), "x" is used because Pete does not give us the numbers, but he does tell us that the top 20% mean income is 7.5 times that of the bottom 20%.

In Col. (6), "y" is used in a manner parallel to "x," except in this case we do know the numbers. The point here is to show the ratio of the mean incomes of the top and bottom fifths, and how it rose from 7.5 to 9.6, 1973-90.

Tables 1 and 2 together summarize the data Pete relies on to show that the rich have gotten richer and the poor poorer, 1973-90. The data seem sound, and the conclusion correct. It is also consistent with the evidence of our eyes and ears. The yachts in Newport Harbor get cushier, while the number and urgency of beggars who "Will Work for Food" grow.

⁷From p.45

5. What if everyone got richer? Then there would be no problem, says P, moving hastily on. He cops out of dealing further with this question by saying that, in fact, not everyone did get richer.

However, there are at least two important senses in which it is impossible for everyone to get richer. One concerns land. The land supply is fixed, so if some get more, others must get less, there is no other way. There is no substitute for more equal distribution of land. With land it is starkly true, "The problem is not production but distribution." There is no production: only distribution.

Take the example of S. Africa today. Those Afrikaners who seized the land of black Africans within recent memory are now trying to stave off land reform by preaching that the better, "win-win" solution is to raise output, improving everyone's lot. Raising output is fine, and the "win-win" idea is fine, but they create no new land. What raising output does, rather, is to whet the competition for land, by cheapening other goods relative to land. Land is a "superior good," meaning that as incomes rise, people spend a higher fraction of their incomes on land (to rent or buy or hold). Thus, raising output sharpens the sting of unrequited land hunger.

Likewise, for us in the U.S.A., a good measure is the labor-price of a home. How many years' wages are needed to buy a home? Data are available, and will be reviewed.

A second sense in which people cannot all get richer is in terms of social status. This refers not mainly to snobbery, but to one's access to friends and associates. If your childhood friends and schoolmates all move into a gated community, or retire in Bermuda, you are left behind with strangers you may not like as much, and who may not like you, either. A cornucopia of new gadgets will not compensate.

With more equal distribution of wealth and income, those problems would be less acute.

6. Mobility

Pete cites Michigan study of class mobility of 5,000 families over 20 years.

People and families have always moved up and down among classes. The "top 20%" in 1990 are not entirely the same people as those of 1973. Up to 1980, however, **net** movement was about zero. After 1980, Michigan found a rise of downward mobility; a fall of upward mobility; and a permanent fall in the size of the middle class.

Upward mobility is least for the young, and for blacks. Downward mobility is greatest for blacks,⁸ and for families headed by a woman, and for the young (under 35).

Pete cites David Gordon re occupational mobility. There is a growing similarity between occupations of parents and children - a more rigid class structure.

⁸This allegation bears double-checking. Other evidence would suggest that the relative position of blacks has improved, 1973-90. I do not have the answer to this, but let us reserve judgment.

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Chap. 4: "The Stressed-out American Family"

Words and phrases to know.

DINK
OINK
YUPPIE
Baby boom
Cohort
Cash flow
Capital Gains
Unearned increment
Property tax
Proposition 13
Flat tax
Imputed income
MP/AP ratio

OUTLINE OF AND COMMENT ON CHAPTER 4

1. There has been a major change in families, 1947 to date: the change is towards "putting both parents to work with little overall gain in well-being."
2. Pete's Table 4-1, p.69, and 4-2, p.71, summarize findings. My Table 1, below, summarizes Pete's.

Table 1: Changes in the Structure of Am. Families, 1973 to 1990

Type of Family	Example or Nickname	Families as % of All Families	Average Incomes, ¹ Compared to Average of All Incomes
Married with Children	Al and Peggy Bundy ²	Down	Up
Unmarried with Children	You name an example	Up	Down
Single with Children	Murphy Brown ³	Way up	Down
Childless of Bearing Age ⁴	DINKS, OINKS, YUPPIES, Jeff and Marcy Darcy	Up	Way up
Old Folks at Home; Empty Nesters	Sun City, Retirement Homes, and other Geriatric Ghettos	Way up	Way, way up

Children without marriage is a growing trend; women and children are paying the price. Poverty is increasingly feminized and also "infantilized." Your grandmother said, "It's the woman who pays"; Pete points out the children pay, too.

¹Pete is careless about defining the terms in Table 4-2, p.71. You have to read the text, p.72, to find that he means "average income" here. (The word "average," standing alone, denotes "mean," rather than "median.")

²Peggy is atypical today: she is not working outside the home. Al is working on this, however.

³Murphy is atypical: she has a good income.

⁴Includes same-sex households. The variety of living arrangements is great, as on sitcom *Friends*.

3. Reasons for rise in incomes of the elderly

- A. Social Security; Medicare
- B. Pensions; life insurance; annuities. (Children of depression and war, this cohort was shocked by insecurity when young, and took special care of its old age ever since.)
- C. Property income
 - i. Cash flow
 - ii. Imputed income (from homes)
 - iii. Unearned increments (capital gains)
- D. Lower property tax rates
- E. Lower income tax rates
- F. Ethnic differences that overlap with age differences
- G. Differential birth rates by wealth and income: the poor have higher birth rates

Note how these age factors overlap with other factors like sex, race, class, religion, and education. There is no simple generation gap or war; no simple class war; no simple race war; no simple sex war; no simple war of "the élites" vs. "us." All these "wars" or frictions or adverse interests overlap and intermingle in a complex brew. Part of learning is to appreciate the complexity of these different "wars," the better to deal with them. Focusing on just one of them can make a good rallying cry to found an action organization, but frustration ultimately meets anyone who or any group that overlooks all but one kind of social division. One ethnic organization (NAACP, e.g.) spawns countervailing ethnic organizations (MALDEF, e.g.), but more than that, it spawns or inspires organizations based on non-ethnic classes like age (Gray Panthers, AARP) or sex (NOW, Men's Rights) or sexual orientation (Harvey Milk Lesbian and Gay Democratic Club, National Gay and Lesbian Task Force, e.g.); or environmentalism (Sierra Club, e.g.). Each of these groups fractionates within itself, too, based on the variety of individuals inside: e.g. CORE, SNCC, Black Panthers, Black Congressional Caucus, etc. Then along come aspiring umbrella and rainbow organizations like ACORN. The AFL-CIO is still around. Property organizations are always there, quietly in the background, and they often support "sweetheart" and decoy organizations to confuse and divide proletarians further.

4. Average family incomes of the Marrieds-with-children (The Bundy's) went up only because the women went to work. Working wives in this group rose from 18.6% to 65%, 1947-88. You have always lived with it and may not notice it, but that was a revolutionary change. Two big surprises:

A. Women's average earnings soared. They are still well below men, but their relative position has gone up. On p.86, though, we get the bad news that this is more from a fall in the men's real hourly-pay rate than from any rise in the women's.

This probably shows that better educated women moved into the work force, raising the average. In addition it shows some breaching of former gender barriers and glass ceilings. Nothing here tells us which effect is more weighty in producing the result. (I do know that my daughter the lawyer makes more than anyone else in the family, including me - but that's just one datum among millions.)

B. A higher fraction of the Bundy wives work than the no-kids wives. DINKs are less common than OINKs (One Income, No Kids). Pete concludes from this that women work more from economic necessity than from career ambition. ("I owe, I owe, so off to work I go.")⁵ He also notes (p.87) that the greatest rise in hours worked was among women in the income-groups where pay rose the least. This says the rise of working hours was driven by necessity, not higher opportunities.

Either way, children pay a price in relative neglect. Also, communities pay the price in loss of the former housewives' community involvement and leadership.

5. Another surprise is that the real value of public support for single mothers (AFDC, e.g.) fell, 1973-90. This is contrary to popular mythology circulated and even invented by cocksure talk-show hosts and columnists (like, errr, what's-his-name, and you-know-who, and likewise -- well, never mind.⁶)

Pete writes that this more than offsets the rise of their mean earnings from work.

⁵Some of you will disagree, and it certainly does not apply to all women. It is easier to take, however, when you consider that it probably applies to men, too. Quite a few wealthy heirs just drop their careers to "manage their investments" (and improve their golf).

⁶Pete also has his biases, and let us keep our minds open to the possibility he is wrong on some points. On this point, though, he seems to have the numbers.

Again, the children pay. You are some of those children. You have paid in poorer K-12 education; now you are paying in higher tuition. Tomorrow you pay in lower job opportunities.

Don't feel sorry for yourselves: it won't do any good. It may help you understand the mean spirit behind this, the better to deal with it, to realize that yours is the first cohort for a long time that did not have to fight a war. Veterans of former wars get awfully self-righteous, even if they never handled a weapon. During wars themselves, civilians at home feel guilty, and try to repay returning vets in various ways. After the fall of the Berlin Wall, persons with property felt there would be a social dividend, and they could collect it for themselves alone: now they (think they) can thrive without cannon fodder.

Wars, with all their faults, have egalitarian effects on a nation. We then know we are all in the same boat. A former President recognized this problem when he said this country now needs "the moral equivalent of war." He was quoting a great philosopher, but "practical" politicians sneered and went their way.

We will see later that "peace dividends" have led, historically, to cycles of boom and bust. Everyone will pay.

6. Age, Education, and Race

Table 4-3, p.77, Summarizes Pete's data nicely. Study it closely.

Note the unit Pete uses here: the ratio of median⁷ family income in specified categories to median family income of all families. This let's him compress a lot of information into one number.

Note the last column, headed "Percent Change," is what he has earlier called "Relative Change" (see Chap. 3).

A. Race

Black income held its own, but at a low level: 60% of the level for all families. Aside from the causes usually cited,

⁷The heading reads "Medium." This is a typo. He means "Median."

this is due to the lesser component of property income in black income; and the lower mean age of blacks.

The mean masks a growing skewness of income and class division among blacks themselves. However, owing to the low property component in blacks' incomes, their incomes are much less skewed than others' incomes. It is the property element in income that creates most of the skew.

"Hispanic" mean income fell, owing to immigration of less skilled Hispanics. "Hispanic" is not a race, but a heterogenous group based on native or ancestral language. Hispanics, so defined, are extremely diverse.⁸ Pete knows this, but the Census collects info this way, so it's what he has to work with.⁹

Pete gives us no data on Asians, Pacific Islanders, Native Americans, or other important groups. If he lived in California instead of Nebraska he might realize how important. If you are interested enough, consult the Census report he cites, by Mary P. Henson - it is in the Govt. Documents Room, 4th Floor, Rivera Library.

B. Age

Here the changes are heavy. The young are the losers. "Younger families are much more dependent on wage earnings than on property income, so they suffered particularly from the

⁸"Hispanics" range from the earliest Americans to the most recent immigrants, including every race, various religions, and dozens of different countries of origin and ancestry. Many poor Americans are Hispanic, but so are some of the richest. Inter-marriage has been extensive over many generations, so you can't go by the surname: a Martinez or Jimenez may be mostly Irish, while Martin Sheen and Jim Plunkett (Irish names) and , Linda Ronstadt (German) consider themselves Hispanic. Are Filipinos Hispanic or Asian? I have no idea how the Census handles all these questions, but the answers are bound to be mostly arbitrary.

⁹There is serious talk of eliminating Census questions on "race," owing to such definitional problems. Indeed, there is now talk in Congress of eliminating the whole Dept. of Commerce, which includes the U.S. Census Bureau. I cannot believe they would really eliminate the Census, which dates from 1789, mandated by the U.S. Constitution; but they might pare it down a lot.

decline in the real value of money wages over the 1973-90 period." Here is where "class war" and "generation war" coincide. The combination has the potential for orienting the generations along class lines, but so far there is little sign that the younger generation sees itself, or is organizing itself, this way (unless unseen on the Internet?)

A growing number of young adults work at more than one job. (Thus the traditional drive for shorter working hours is reversing itself. We might add growing commuting times and expenses to the working hours: poverty and deprivation take different forms.)

C. Education

Here, too, the changes are major. The numbers on p.77 shout at you. Education and income increasingly go together. This does not prove that the education causes the higher income, but it's a pretty good sign, because the income reported in Table 4-3 comes after the education reported there.

Manufacturing used to provide good job opportunities for people with limited education, but no longer. A lot of these people "left the work force," 1973-86 (p.82). What do they do when they "leave the work force"? Pete doesn't say, but generally they do more than sit and sulk, they go underground. Many enter the unreported gray or black market. Some steal. Some go to jail. Some beg. Some sell their bodies. Such human material composes the underworld, which increasingly envelopes us. Idle hands are not just wasted, they steal and destroy. Unemployment and low wages are bad for everyone, including employers.

7. Productivity

Productivity (the AP of labor) is way up in "goods-producing" (p.83). This puzzles Pete, because he has failed to distinguish AP from MP of labor (see notes on Chap. 2, p.7). "The link between output and good jobs" is broken (p.85). He is honest enough to see that the data do not support his premise, delivered earlier with great certitude, that productivity is the key to higher wages.

He is baffled, though: he says perhaps this situation is "unprecedented in human history." Is it? Here is what another writer said:

"The present century has been marked by a prodigious increase in wealth-producing power. ... it has ... multiplied enormously the effectiveness of labor. It was natural to expect this would improve the condition of the laborer. (but) inventions have not brought plenty to the poor. Industrial depression accompanies material progress. Just as a community advances and greater use of labor-saving machinery makes possible economies in production, so does poverty take on a darker aspect. Some find it hard to get a living at all. Upon lighted streets patrolled by uniformed policemen, beggars wait for the passer-by, and in the shadow of college, and library, and museum, are gathering the fiercer Huns and more hideous Vandals of whom Macaulay prophesied.

The enormous increase in productive power which has marked the present century has no tendency to extirpate poverty. It is as though an immense wedge were being forced, not underneath society, but through society. Those who are below are crushed down."

That was published in San Francisco, in **1879** - 117 years ago! The writer was Henry George; the book, *Progress and Poverty*. As the title suggests, it was about this same dilemma that Pete calls "unprecedented in human history." George's main point was that the MP of labor was not keeping up with the AP: the MP/AP ratio was falling. This same problem is upon us again today. "The more things change, the more they remain the same."

8. Intergenerational decline

"YUPPIES" get more press than their numbers warrant. Most baby-boom kids (born 1944-64) are moving downwards from their fathers' incomes (p.91).

9. Summary: slower economic growth, coupled with rising inequality in distribution.

Peterson, Wallace C., 1994. Silent Depression. NY: W.W. Norton

Notes in outline form, for student use.

Chap. 5: "The Rich Get Richer"

Words and phrases to know.

- Rentier
- Euthanasia (think Dr. Kevorkian)
- Fund vs. flow
- Unearned increment
- Capital gains
- Phantom income
- Debt vs. deficit
- Gini coefficient
- Diminishing marginal utility
- Interpersonal comparisons
- Equity (as net worth)
- Equity (as fairness)
- Composition of wealth
- Discretionary income and wealth
- Libertarian; anarchist

OUTLINE OF AND COMMENT ON CHAPTER 5

Outline of major headings:

- A. Income vs. Wealth
- B. Income Concentration, Taxing, and Federal Spending
- C. Wealth Concentration
- D. Composition of Wealth
- E. Why is Wealth Distributed so Unequally?
- F. Why did Income Concentration Grow after 1970?
- G. Why did Wealth Concentration Grow after 1970?
- H. Where are we heading?

A. Income vs. Wealth

1. Income is a flow or stream - a quantity per period of time. Wealth is a fund, like water in a lake or reservoir - a fixed amount at a point in time.¹ Income and other flows are

¹Wealth also includes the value of land, which is not a fund: it is not built up by storage, nor can society consume it to meet emergencies.

what you enter on an Income Statement; Wealth is what goes on a Balance Sheet.

2. Wealth is much more concentrated than income. For example, the top 1/5 have 44% of the income, but 70% of the wealth.

3. How measure concentration? Here we will use a simple measure: the fraction of income received, or wealth owned, by the top 1/5.

A more complete and balanced measure is the Gini Coefficient (GC). Pete cites it now and then, but doesn't explain it. All you need to know now is that it ranges from 0 (complete equality) to 1.00 (complete inequality), so higher GC means greater inequality.

Beware of doctored figures. The U.S. Census omits capital gains, thus understating concentration of income. So do the NIPA accounts. The Census also omits all incomes of \$300,000 and up - a small omission of people, but a huge omission in terms of total income. Pete prefers *The Green Book*, issued by the U.S. House of Reps. Committee on Ways and Means, 1991.² *The Green Book* gets share of top 1/5 up to 49% of income.

4. How is wealth acquired? Pete mentions inheritance and capital gains. He paints in broad and sketchy strokes. Socially and historically, there are four ways:

- a. Appropriation (seizure, sometimes linked with discovery)
- b. Appreciation (rise in value after seizure)
- c. Saving
 - i. From labor income
 - ii. From property income (plowback, retained earnings)

Once wealth is acquired or created by one of the basic methods, individuals acquire some from others by inheritance or purchase, but those merely transfer wealth, they do not create it.

²There is a lot of politics here. The Green Book figures are supplied by the Congressional Budget Office (CBO), controlled by Congress. The Census is controlled by the Administration.

(a) and (b) create no wealth. (c,i) is the smallest source of wealth. Thus, original appropriation followed by inheritance accounts for a good deal of the present distribution of wealth. There is no mystery about how wealth gets to be so concentrated. Once you get a head start, you create additional capital from the savings and capital gains yielded by the original property.

P's example of "capital gains" is a small new business, built-up by hard work and then sold for a gain. This is a form of saving from labor income (entrepreneurial labor in this case). However, the things Pete omits -- appreciation of land and stock prices -- are bigger.

B. Income Concentration, Taxing, and Federal Spending

1. Leveling effect of federal-level taxes was small.

Also, system grew less progressive. Corpn inc. tax fell; Soc. Sec. Tax rose; consumer taxes rose.

2. Leveling effect of federal spending was larger. New Deal (FDR, 1930s) and Great Society War on Poverty (LBJ, 1960s) programs: social security, welfare, unemployment compensation, Medicare (non-cash), Medicaid. Pete should include vets benefits and schooling. Table 5-5, p.108, sums up the findings.

"Market Inc" = Inc. before taxes and before xfrs.

After-tax Inc = Mkt inc less taxes

"Net Inc" = After-tax Inc plus xfrs.

"Net Change" = Net Inc. less Market Inc. (Note: it is not "relative change" - I will add that.)

Table 1: Income Distrib. by Households, Bottom 1/5 and Top 4/5, 1986, in %s

Which Group -->	Bottom 1/5	Top 4/5	Top 1/5
Kind of Income			
"Market"	1.0	99.0	52.5
"Net"	4.5	95.3	45.7
Change of Share	+3.7	-3.7	-6.8
Relative Change of Share	+370	-3.7	-13

Table 1 gives an idea how powerful is the call of Robin Hood policies. In 1986, the top 4/5 gave up 3.7% of their income share in order to raise the share of the bottom 1/5 by 370%. We also see why Pete likes the concept of "relative change": it helps make the case, which he favors, for redistributive taxing and entitlements.

They say, "There Ain't No Such Thing As A Free Lunch" (TANSTAAFL). It's a shibboleth (slogan, codeword) among libertarian (anarchist) economists. In absolute terms, that is right: the bottom 1/5 gained 3.7% of the income share, and the top 4/5 lost 3.7%. However, the **relative** change was much greater for the poor, who received, than for the others, who lost. Thus TANSTAAFL is changed to TITSATAAFL.

Table 1 shows the difference in relative changes. In class I drew on the board a long rectangle, 21 miles long. Farmer A occupies the first mile; farmer B the next 20 miles. Adding one mile to A's farm will add 100% to it, by taking only 5% from B's land.³

There is another difference, too. The second difference has to do with "diminishing marginal utility," as it is sometimes

³In this case there is also a 3rd factor to consider, distance. If each farmers' farmstead (house and barn) is centered on his land, the 1-mile strip at issue is 1 mile from A, and 10 miles from B.

called. The more you have, the less you need more.⁴ Thus, the case for Robin Hood policies will always find lots of supporters.

There is a valid argument against going overboard with Robin Hood policies. It is that we must maintain incentives to work, save, and invest productively. There is something to this; we will reopen the question later. It is possible to divide up some things equally without impairing incentives to work, save, or invest productively.

3. Pete focuses entirely on transfer payments to the poor. He is silent on federal spending programs for the rich. Federal farm price support programs are a notorious example, shoveling billions of taxpayer dollars to a few big cotton and sugar growers. If he figured these things in, his results would differ. We have no time here to attempt the corrections, but be aware that his treatment is too narrow.

C. Wealth Concentration

We have seen that wealth is more concentrated than income; and that concentration of wealth, which yields income, is a major cause of the concentration of income.

Almost everyone earns some wage or salary income. Many people, however, own no property. For example, over half of all farmland is leased, i.e. not owned by the proprietor, who is a renter. In other businesses, e.g. retailing, renting is more common than owning. Some 40% of all householders are renters. This factor alone makes wealth more concentrated than income.

Of those who do own their homes or business real estate, many have little or no equity - i.e., the bank owns the larger share. The resulting foreclosures and bankruptcies are in the paper every day.

1. Information on wealth concentration is very scarce. The rich have learned that flaunting wealth evokes anger and

⁴Followers of Pareto deny this, saying it involves making interpersonal comparisons, which they do not allow. They conclude you cannot justify taxing the rich to help the poor. They are wrong, even by their own lights: if you cannot justify changing things, neither can you justify keeping them the same. You can't justify anything, following Pareto - it leads nowhere. This is called "nihilism."

jealousy, so they sequester (hide) their wealth. They also suppress public efforts to inventory and record their wealth.

--- Example of attempted valuation of England, 1909.

--- Example of Ralph Nader's research group's effort to find "Who Owns California."

--- Double entendre of French verb, *percevoir*.

--- Diversification of portfolios of the wealthy, investing around the world and through complex, untraceable shell organizations.

Pete cites the historical reactions to The Gilded Age (1880s)⁵ (Populism and Progressivism); to the Roaring 20s (FDR and The New Deal). Will there be another reaction to "The Avaricious 80s"? - Pete implies so, but so far the reaction seems to be the opposite of what he expected, writing in early 1994.

2. Ups and downs. Concentration rises in boom times, falls in depressions and wars. Here are the shares of wealth held by the top 1%, various key years:

<u>Year</u>	<u>Wealth held by top 1%</u>	<u>Gini Coefficients</u>	
		<u>Income</u>	<u>Wealth</u>
1929	36.3%	nd	nd
1949	20.8%	nd	nd
1983	31.5%	.414	.777
1989	37.0%	.428	.793

3. Relation to stock market

Generally, a high stock market means a higher level of concentration of wealth, because the wealthy hold a large share of stocks. This fact tells us that concentration must be higher now than in 1989, because the stock market is much higher.

Notice, this does not mean the rich own more stocks now; it means that each unit is worth more. Ask yourself, how can everything be worth more in real terms, when the real value

⁵The original term, the title of a book by Mark Twain and Charles Dudley Warner, referred to 1865-73. The term was too good, however, to use only once.

of each stock is just what it will trade for? The answer is (in part), stocks are now worth more in terms of "present goods" (meaning goods currently consumable). Stocks represent mostly "future goods." A high stock market means future goods are worth more in terms of present goods. That also means that present goods are worth less in terms of future goods - but we do not measure that, we only measure the value of the stocks. This creates an illusion that higher stock values mean there is more wealth existing. Wealth really remains the same. What changes is distribution.

The wealthy hold a higher fraction of their wealth in the form of future goods, because they can afford to. The poor need to keep most of their wealth in "liquid" form (currently usable).

Another reason stocks have gone up is that the tax rate on corporate income has fallen, and people expect it to fall more, as corporate allies consolidate their power in Congress.

4. Relation to real estate market

Pete does not tell us this, but the rich also hold much of their wealth in real estate. Therefore, the share of wealth held by the top 1/5 rises when real estate rises. Normally, stocks and real estate rise and fall in sympathy, but it is not so since 1989, when real estate fell but stocks rose.⁶ The main reason, most likely, is the downtaxing of corporations: that which has occurred, and even more, that which is now expected from a pro-corporate Congress. Another reason is the fall of interest rates. Taxes and interest together make up a large share of the expenses of corporations.

5. Mobility

If you save the discretionary income yielded by initial endowments of wealth, however acquired, you get still further ahead. Thus, wealth leads to wealth over time. Wealth also marries wealth, and merges with wealth. Wealth also attracts loans. With wealth, one forms banks, which attract the deposits of millions, giving the bankers great discretion and power over the money and investments of other people.

⁶In Japan, both went down together.

Regardless, many great fortunes are dissipated. As Parkinson said, "Needs expand to meet available resources." Spendthrift heirs pop up in every family, and it only takes one to break the chain of wealth. Some spendthrifts are merely self-indulgent, like Britain's Princess Fergie. It is easy to become that way when you get used to having whatever you want, whenever you want it. Others, like Andrew Carnegie, give money to worthy causes. Many like to have buildings named for them, like the Getty and Simon and Field Museums; others prefer to fund Foundations, like Rockefeller and Lincoln. Some, like Perot and Forbes and Huffington, fancy themselves as political leaders, and throw millions into promoting themselves. There is a tendency to divide an initial fortune among large numbers of descendants and other heirs. There are also conniving henchmen, fawning courtiers, and seductive maidens ever eager to prey on the wealthy. Some of these are so successful that the fortune remains intact, but merely changes hands.⁷

Some great fortunes that have been or are being dissipated are those of Cornelius Vanderbilt; Doris Duke; Howard Hughes; and Andrew Carnegie.

Some great fortunes are lost when nations lose wars. American colonial governments confiscated vast Tory lands after the American Revolution; Confederate slaveowners lost all their slave "capital" and some of their land after the Civil War; eastern European and Cuban and Vietnamese landowners lost all during the Communist era. Even these losers are remarkably persistent, though, and this very day their heirs are reestablishing old ownerships once lost in eastern Europe. Cuban former landowners have jarred U.S. politics for years lobbying for a U.S. invasion that would restore their titles.

The more common pattern, however, is for the landowners on the losing side to come to terms with the victors, and even to help them win. They retain their holdings under the new government, as Spanish grantees in California did, first under the revolutionary Mexican government, and later under the U.S. government.

⁷Joan Irvine Smith spent years in court trying to prove that her grandfather was murdered by trustees of the Irvine Estate. Her colorful allegations may or may not be accurate, but it is a fact that the Estate passed from Irvine family control while remaining intact: it still comprises some 1/5 of Orange County.

Some family fortunes remain intact across several generations and even centuries. Some of these are the Goelets, Du Ponts, Rockefellers, Harrimans, Rothschilds, Newhalls, Chandlers, and Fords. English lordly families like the Dukes of Westminster (Grosvenors) go 'way back to 1066.

D. Composition of Wealth

"Composition" means, of what is it composed? Generally, great wealth is composed of durable things: the rich trade current goods for future goods, because they have less urgent need of current goods than do the poor. In business lingo, the poor put a premium on "liquidity"; the rich put a premium on finding stores of value that will keep without intensive supervision.

The most durable thing is land. Corporate shares are claims on an endless, generally rising cash flow, and so have economic durability. The shares are just paper, of course, but the corporate assets are durable.

Information on this subject is scarce. Pete doesn't add much: he doesn't go much beyond telling us that the rich own most corporate stocks. Pete has a blind spot, as to real estate. He says that most of what the poor do own is real estate. That gives an impression that real estate is the poor man's investment. Everyone needs a pad of some kind to live, it is true: but John du Pont's pad comes with 800 acres of prime suburban land in a posh Philadelphia suburb, Newtown Square. A shack in Parlier, Tulare County, California, may be had for under \$50,000, while Aaron Spelling's palace in Beverly Hills must have \$50,000,000 in it: 1,000 times as much. On top of that, people who can afford such palaces also buy vast lands as investments: that is how streets come to be named after Bob Hope, Frank Sinatra, et al.

If you want to pursue this further, see on Reserve, "Who Owns Southern California."

E. Why is wealth distributed so unequally?

1. It is not due to "The Bell Curve," because that is symmetrical, while the curve showing frequency distribution of wealth is anything but. Human heights, weights, and i.q.s are normally distributed. The highest i.q.s known are less than

twice the mean value - and their possessors are seldom very rich. Wealth distribution, in sharp contrast, is highly skewed, and some of the richest are not even very bright. Some even live in mental hospitals. Other factors are at work.

2. Pete says we need a theory, but then gets us off on a wrong start by saying "unfettered market forces" are the cause. That's a sort of a theory, but he hasn't thought it out. We have never had "unfettered market forces" at work. Indeed, there could hardly be markets without governments, because governments keep the peace, build the roads, and define and enforce property rights. They also originated most property rights in land, generally distributing it very unequally.

Once that is done, those with the head start, won by fair means or foul, enjoy discretionary wealth and income to buy more property, to control politicians for their own gain, to shape education and media and religion and culture to bend minds their way, and so on. Initial advantages are passed on by inheritance - of property, that is. Genes are also inherited, but intelligence tends to "regress towards the mean." Wealth, on the other hand, tends to cumulate.

Pp. 114-17 wander off into Pete's partisan politics. They are not assigned.

3. A thumbnail history of wealth concentration in the U.S. Pete paints with rough, broad strokes.

a. New England in the 17th Century was egalitarian. Pete carelessly says they practiced equal distribution of "the products of labor." That is wrong. Land was equally divided, but the Pilgrims quickly abandoned communism in the **products of labor**, because it was leading to starvation. Rather, each one planted corn "on his own particular" (in the language of the times, used in Bradford's History of Plimoth Plantation). Newcomers were given an equal share of land, but then they were on their own.

b. Pete now jumps to W.W. I, omitting most of American history, but OK, here we are. The war had equalizing effects, because the high demand for labor raised wage rates and lowered property values. The then-new income tax had equalizing effects (it was mostly on property income then, and at high rates).

Pete implies that inflation during the War had equalizing effects, but he doesn't explain why. It is because

inflation creates phantom taxable income for most forms of property, thus raising the real tax rates on property income to very high levels. Ask me or your T.A. to explain, if you don't see it (and don't be shy, it's not self-evident).

Pete attributes too much to the war, income tax, and inflation; and too little to the Granger, Populist, and Progressive Movements, 1880-1919. There was the I.C.C. in 1887; Sherman Anti-Trust Act, 1890; corporate income tax, 1909, etc. At the state and local level there was a sharp rise of taxes on property, especially as people moved to cities and needed more municipal services, including a great wave of concern for sanitation and public health.

c. Red Scare and postwar reaction, 1919-29. Progressive policies were reversed. Stocks and real estate skyrocketed. By 1929, the top 1% had 36% of all net worth.

d. Depression and W.W. II, 1930-45. Stocks and real estate prices way down. By 1949, top 1% had only 21% of net worth.

Pete says that W.W. II financing replayed the effects of W.W. I. This is wrong. During W.W. II the income tax became much less progressive. Wage withholding started, and so did loopholes for property income. Inflation and higher wage rates, however, were the same as in W.W. I.

e. 1945-70, concentration of wealth grew, even though concentration of income did not. By 1972, the top 1% were back up to having 28% of the wealth. After 1970, concentration of income grew, too.

F. Why did concentration of income grow after 1970?

1. Federal Policies

a. The Reagan revolution.

i. He got Congress to lower income tax rates and social spending. (Pete throws in a lot of asides indicating he is a partisan Democrat. It is not a bad thing for a writer to let you know where he is coming from; it warns you of possible subjectivity and bias, so you can adjust for it. The truly dangerous ideologues are the ones who claim to be totally objective and above the brawl: they seldom really are.)

ii. There was also deregulation, and some privatization.

iii. They called the Reagan package "supply side" policy. In rhetoric, this was aimed at increasing production directly, by fostering more supply, more production.⁸ The previous, Keynesian policy was to raise production and employment by raising aggregate demand - hence "demand-side economics."

iv. Spending did not fall, so the national debt took off like a startled quail. It rose from \$1 trillion in 1980 to over \$4 trillion, 1992. (Today, 1996, we are pushing \$5 trillion.) Ironically, this is more "demand-side" policy than the avowed champions of demand-side economics had ever engineered. It was done in the name of "supply-side" policy.⁹

They say that irony is lost on modern students - that subtlety is not in them. Prove they are wrong! Step one is to see how rhetoric and advocacy often differ from what actually happens, whether by accident, misunderstanding, trickery, or hypocrisy. Many people live by slogans and buzzwords, taking fine avowals at face value so long as they are phrased in the comfortable, familiar platitudes. Be yours, rather, to see through that fog to what is actually likely to happen, and what its results will be. In the wisdom of an old black spiritual, "Ev'body talk about Hebb'n ain't gwine dere."

v. Interest rates rose. This began in 1979, actually, under Carter, when he appointed Paul Volcker to head the Federal Reserve Board. This "tight money" policy had the desired effect of chilling inflation. Two of its by-products were hard on federal finances, though. It raised interest on the national debt; and it lowered federal tax revenues by ending bracket creep, and the tax yield from phantom income. (Don't expect to understand those last two now - I just include them here "for the record.")

⁸In principle, that is a good idea. In practise, it often meant simply redistributing wealth and income in favor of property, and running large deficits.

⁹When the new court economists, centered at the U. of Chicago, realized what was happening, they came up with a new rationalization for raising the national debt. They call it the "Ricardian Equivalence Theorem." Remember the name; we may get an occasion to explain it.

vi. Income was shifted to the *rentier* class. Cf. (iii), above.

vii. "Transfer payments" were shifted from the poor to the middle class. This, too, began in the 1970s. In perspective, it was a return to politics-as-usual after the extraordinarily idealistic War on Poverty episode of the doomed LBJ administration (1963-69).

viii. Tax loopholes grew wider and more brazen.

b. Fragmentation of the labor market

Differences among kinds of labor income grew wider. The class of "working poor" rose. Pete discusses four possible causes.

i. "Corporate restructuring." This means lots of "downsizing" and layoffs, especially in the middle. There is less for the peons; more for the top managers. This strikes me not as a true "cause," but a restatement of what happened. It does not explain why it happened. Such a restatement, masquerading as an explanation, is called a "tautology." It is like saying, "Jill and Jo are sisters because they have the same parents."

ii. Globalization - rise of direct competition from foreign labor, including labor hired by U.S. firms with operations abroad. Pete does not explain, however, why this is occurring now more than before.

When you can't think of one simple, dramatic reason for something, it is probably the joint result of several independent causes that come into conjunction. This, they say, is what caused the Space Challenger disaster; and the near-meltdown at 3-Mile Island; even the Pearl Harbor disaster. Most people lose patience after hearing one or two, and so the thing never seems to be explained. For those interested enough to run through a list of reasons, however, here are a few.

One reason, clearly, is that foreign nations are catching up or surpassing us in education. Another is the high costs imposed on American workers to get to work, and otherwise survive, in our scattered settlement patterns: the disintegrated fragments of what used to be real cities. Asian cities are now much more efficient than ours. Another reason is our high level of payroll taxation, imposed both on employers and employees.

Another is subsidies Washington foolishly gives to the export of U.S. capital.

We still excel, says Pete, in industries that involve manipulating information.

iii. Massive entry of women into the work force. In spite of relative gains, the wages of women average 60% of those of men.

G. Why did concentration of **wealth** rise after 1949?

Pete skips over this question. Some reasons are pretty clear, though.

1. Massive shifts in taxation off property, onto consumption and the payroll part of the income tax.
2. Massive shift away from the corporate income tax.
3. Massive rise of the social security taxes (FICA) on payrolls.
4. Permissive attitude toward tax loopholes for property income.
5. Rise of stock and land values relative to wage rates.

H. Where are we heading?

Pete does not see a "heart attack" kind of depression coming, but continued drift into a caste system, with a sluggish economy. A "culture of contentment" keeps the majority from organizing and acting to stop it. Pete would like us to be less contented with this destiny, but sounds a bit fatalistic. He is old: I doubt if your generation is fatalistic. You may not replicate the old ways that Pete's generation used to climb the walls old men build to hold you back, but you will find ways.

END OF CHAPTER 6

Peterson, Chap. 6

Peterson, Wallace C., 1994. Silent Depression. NY: W.W. Norton
Notes in outline form, for student use.

Chap. 6: "Life at the Bottom"

Words and phrases to know.

OUTLINE OF AND COMMENT ON CHAPTER 6

This chapter repeats and reinforces earlier material. These notes will hit the high spots.

1. Anti-poverty programs

A. In the 1960s, under LBJ, old anti-poverty programs were enhanced, and some new ones introduced. Enhanced were social security coverage; food stamps (also a subsidy for rich farmers); AFDC. Medicare and Medicaid were introduced.

Note lack of mention of the most important anti-poverty program of all: better jobs. Pete has a "transfer payments" mindset. Otherwise he would mention that enhanced social security coverage means more people pay the wage tax, and at higher rates - thus killing some jobs. We change the emphasis in the 2nd 5 weeks.

B. Only 1/4 of such transfer payments go to the "desperately poor." Social security support, Medicare, and unemployment compensation cover others, too.

2. Who is "poor"?

A. Orshansky's definition: poverty = an income less than 3x the cost of a minimal adequate diet (defined nutritionally). This definition is arbitrary, but it makes more sense than Pareto, who would say you can't make interpersonal comparisons, even if people are starving, thirsting, freezing, suffocating, or drowning!

The definition is outdated, however. It is based on her observation that a family of four spends 1/3 of its income on food. Today, many poor families spend over half their income on shelter alone, and a correspondingly lower share for food.

The numbers of "poor," so defined, were as ff.: 1959, 39.5 millions; 1973, 22.9 millions; 1990, 33.6 millions. However, things haven't improved from 1959-90, when you take into account the rising cost of shelter (which the official definition fails to do). This is why homelessness has risen since 1959.

B. Singles and old folks are not worse off after 1973. Poverty is higher, though, among female-headed families, blacks, and children.

3. Why the big rise in families headed by women?

Divorce rates are way up, from 1950; marriage rates are down. Why?

A. Fall in the real earnings of men.

B. Big rise in no. of women who work, esp. mothers of small children.

C. Welfare spending - but Pete doubts that this is a major factor. 1970-91, md. AFDC benefit in 1991 \$ fell 44%. Yet, in the 1980s, births to unwed mothers rose 64%!

Why, then, is there such an outcry from the media about the cause being welfare spending "out of control"? One philosopher had this to say.

"Fashions in thought distract men from their real dangers. Fashion directs the fashionable outcry of each generation against those vices of which it is least in danger, and fixes its approval on the virtue nearest to that vice which she is making endemic. The game is to have them all running about with fire extinguishers when there is a flood, and all crowding to that side of the boat that is already gunwale under." - C.S. Lewis

Pete joins most economists in pointing to an aspect of welfare more important than its amount: that is its structure, in tandem with the tax structure. Escaping from welfare means giving up payments that come tax-free in exchange for payments from work, which are taxed very high by payroll and income taxes. Putting the two together, to segue from welfare to workforce is to meet a highly punitive marginal tax structure - a higher marginal rate than is imposed on the top brackets. Add to that the costs of getting to work, dressing for work, training for

work - none of them are deductible. The disincentive effect is very strong.

Pete proposes a "negative income tax" to ease the transition to the work force.

4. Racial Aspects of Poverty

1/3 of blacks are in poverty, compared to 1/10 of others.

Marital aspect: 55% of black children under 18 lived in single-parent homes, 1990; compared with 19% of white children.

See also #5.

5. Locational Aspects of Poverty

Many blacks and Hispanics remain in the inner city, while other Americans and jobs and political power have gone suburban.

Pete may overstate the relative incidence of poverty in inner cities. There is also a lot of rural and small town poverty. Small farm towns in our hot interior valleys have lower home values than Compton, S. Central L.A., etc. Ditto for violence: rural N. Mexico has a higher incidence of violent death than most inner cities. Poverty gets around.

After 1960, many upwardly mobile blacks joined the flight to the suburbs, leaving others behind, minus the stabilizing influence of black professionals and businessmen. Jobs have left central cities, too. Urban transit systems have deteriorated, stranding those without cars.

6. Homelessness is on the rise, but is hard to count. It is exaggerated by some alarmists, and wished away by Panglossians and free-market panacea-ists like Gary Becker and Robert Rector. You just have to trust your own eyes - and what do you see?

7. Hunger is also on the rise. See the reading from the L.A. Times.

8. Peterson shies away from "group-specific" solutions to poverty. By "group-specific" he means groups based on criteria other than poverty. "The poor" as such are also a "group."

This would lead us in the direction of "a rising tide lifts all boats," but we've already been there and it hasn't. Peterson has now led us in two directions on this issue.

First, he has emphasized the inequality of distribution as a problem, and the desirability of redistribution.

Second, he has told us that "productivity" is the key to raising the demand for labor, hence wage rates and thus the welfare of the poor.

How will he resolve this apparent ambivalence? Read on!

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Notes in outline form, for student use.

Chap. 7: "Getting from There to Here"

Words and phrases to know.

Post hoc ergo propter hoc
M&A (Mergers and Acquisitions)
"Propping up the economy"
"Fiscal stimulus"

OUTLINE OF AND COMMENT ON CHAPTER 7

Intro. This chapter asks, how did we get into this fix?
Chapter 8 will ask, how do we get out of it?

The "fix" is that productivity growth slowed down after 1973, the watershed year. See data in prior chapters. Here we are just told it rose from about \$19k per worker in 1948 to about \$35k per worker, 1990. As an exercise, calculate the increase, the % increase, and the annual % rate of increase.

A. Sources of productivity and its growth

1. Quantity of capital. Later he brings in quality, and kind of capital. He never brings in youth of capital, but he should.

2. Technology - as embodied in capital, and practised by skilled workers.

3. Skill and motivation of workers.

He should have added, or even begun with, these two:

4. Land and natural resources

5. Effectiveness and motivation of management

B. Why growth of productivity has slowed down

First, he poo-poops a common idea that the U.S. rate of saving is down. On this point you may characterize Pete as a confirmed, unreconstructed Keynesian - as he keeps telling us he

is, anyway. To Keynes, the sources of investable funds are always ample; the trick is to **induce** owners to invest them to hire workers. Keynes called this "income-creating investment" (as opposed to merely transferring ownership of old assets, as in "M&A" transactions).

He omits at least three important modern points about the 1980s

-- A lot of savings went into buying government debt instead of into private income-creating, capital-creating investing. Raising public debt without creating public capital is social "dissaving."

-- "Equity withdrawal" went wild, as people borrowed on the rising values of their homes to raise their consuming;

-- The Social Security Trust Fund tipped from surplus to deficit

Pete gives three reasons why productivity growth slowed: 1, "Military Keynesianism"; 2, Infrastructure decay; 3, Dearth of productive "equipment."

1. Military Keynesianism

a. Military spending kept people at work, 1948-88. Pete implies the U.S. would otherwise have collapsed. This is "demand-side" thinking with a vengeance. Pete is a little old-fashioned on this point. That doesn't mean he is wrong: fashions change, often for insubstantial reasons. Be aware, though, that this view is no longer dominant.

Slowly, as this built up nat. debt, the debt soaked up tax revenues to pay interest. This interested absorbed what otherwise would have been "fiscal stimulus." He implies, but does not say, that paying interest creates no jobs. Worth thinking about: it says that stimulus from running deficits, however the money is spent, has a natural limit.

b. 3/4 of the goods and services the Fed gov. bought over those years were military: the "ACE complex," plus ships, ordnance, tanks, etc - conventional military hardware.

c. Military-oriented firms are very slow to reconvert to civilian production, because of their non-competitive, cost-

plus, political corporate culture. ACE and other military contracts are highly concentrated among a few big firms.

d. Military use of resources drained them from the rest of the industrial base: steel, machine tools, chemicals, cars, consumer electronics, textiles, etc. Germany and Japan, under the U.S. military umbrella, could put their capital into civilian forms.

Tech. spinoffs from military to civilian uses slowed down after a while.

2. Decaying infrastructure

a. Pete calls this here "the third deficit," along with nat. debt and foreign trade balance, but later tells us this one is 2nd in size, and first in effect on productivity.

b. Examples: Chicago's big underground flood, 1992; high congestion, everywhere.

c. i. Figures on public capital as a % of all U.S. capital, 1947-90. It peaks in 1970 at 35%, BUT: it doesn't fall much after that; and Pete doesn't tell how it is measured. Roads depreciate, but how fast?

ii. Current investing in public capital as a % of GNP: these figures seem firmer. Peaks at 3.9%, 1965-69; drops to 2.2%, 1985-89.

iii. David Aschauer blames productivity slowdown on infrastructure slowdown. Notes that Japan is higher in both kinds of growth, but Pete should warn us against fallacy of post hoc ergo propter hoc. Japan's Tanaka government notoriously led in wasting public funds on sub-economic projects, to win votes.

iv. Public capital per employed worker practically stopped growing after 1973. These figures, too, however, are poorly defined. Pete's growth rates differ slightly from the numbers he gives. At best the raw data would be fuzzy, because of definitional problems. Let's ignore this data, p.182.

v. Infrastructure raises investment opportunities for private capital: they complement each other.

This is Keynesian optimism at its rosiest. I'm all for optimism, and complementation, but Pete is skating

over 2 big problems, at least: resource constraints; and the wastes of scattered settlement. His mind is perhaps back in the "cowboy economy" of the 19th Century.

TO BE CONCLUDED

d. Some key matters omitted

i. U.S. pattern of scattered settlement inflates the cost of providing infrastructure, with no rise of productivity resulting. (Bad condition of Riverside County's roads.)

ii. Much public works spending is unproductive and wasteful. Some big problems: partial funding and stretchout of construction time; cost overruns; parasitic political add-ons (case of proposed Peripheral Canal, cost rose from \$1billion to \$5billion); gold-plating (e.g. wide streets east of Ontario runway, with curbs, gutters, sidewalks, streetlights, water, sewers, utilities - but no buildings); decentralist bias.