

“Consumption” and “Earnings”

by

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Consumption

Prepared for *The History of US Economic Policy*
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CONSUMPTION

The value of individual or household expenditures on final goods and services.

The Bureau of Labor Statistics' most recent Consumer Expenditure Survey tells us that in 2000, the average American "consuming unit," which included 2.5 persons of whom 1.4 earned some sort of income and 0.7 were children, received \$41,532 in after-tax income and consumed \$38,045 of this income. Furthermore, of this amount, \$5158 or 13.6% of this amount was spent on food, \$12,319 or 32.4% was spent on housing, and \$2,066 or 5.4% was spent on health care.

How does the level of consumption, or the pattern of expenditure shares, compare with those in the past? Drawing on Jacobs and Shipp's (1990) historical review of CES data, household expenditures at the turn of the 20th century were \$791, based on a pre-tax income of \$827. Of this amount, \$340 or 43.0% was spent on food and alcohol, \$178 or 22.5% was spent on housing, and \$21 or 2.7% was spent on health care. By mid-century, the average household consumed \$3925, of which \$1275 or 32.5% was spent on food, \$1101 or 25.8% was spent on housing, and \$200 or 5.1% was spent on health care.

This does not mean, of course, that household consumption increased fifty fold between 1901 and 2000. In real or price-adjusted terms, the actual increase for the representative household was less than five fold, but the decline in household size, from 5.3 persons in 1901 to 3.4 persons in 1950 to 2.5 persons in 2000, implies that consumption per member rose more than this. On the other hand, an increase in the

number of household members in the labor force was required to support the increase in consumption.

Reckoned in either current or constant prices, it is clear that the proportion of household expenditures devoted to food has decreased over time, to much less than half its 1901 value. The share devoted to shelter, on the other hand, has increased from about one fifth of the household budget to one third. The share devoted to health care more than doubled between 1901 and 1950 but has not increased much since then. It is important to interpret these data with care: the last of these, for example, does not mean that the share of national income spent on health care has also remained constant, but rather that much of the increase assumes the form of job-based insurance premia.

In addition to this sort of descriptive data, the Bureau of Labor Statistics and other government agencies also construct prescriptive consumption data for the purposes of economic policy. The earliest consumer expenditure surveys, for example, calculated the costs of minimum and fair standards of living for a representative “working man” and his dependents, and led to the construction of the first consumer price index or CPI. One of the most famous prescriptive measures is the Social Security Administration’s poverty line, which defines the threshold to be three times the cost of a minimum adequate diet for all the members of a household. In 2001, 13.4% of all families with children under 18 fell short of this threshold, but this number obscures some disturbing differences: for African-Americans, the proportion was 26.6%, and for those of Hispanic origin, the proportion was 23.7%.

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EARNINGS

The real or inflation-adjusted pre-tax wages, salaries and benefits that workers receive.

A complete picture of the historical evolution of earnings in the United States, and of the effects of economic policies on this evolution, must distinguish between their level, rate of change and distribution. Expressed in constant 1988 dollars, for example, the mean wage was \$12,225 in 1927 and \$31,422 in 1998, consistent with an average annual growth rate of 1.6%. However, earnings have sometimes increased much faster, and much slower, than this. Between 1950 and 1970, a period some have called the “golden age” of American capitalism, mean wages increased more than 2% per annum, a rate that, if sustained, would have allowed earnings to double from one generation to the next. Between 1970 and 1995, on the other hand, the average annual growth rate was less than 0.5%.

Conventional economic wisdom (Denison 1982) holds that much, perhaps most, of the growth in mean earnings is the result of technological change. In this context, it comes as no surprise that the period of slow earnings growth between 1970 and 1995 coincides with the productivity slowdown. Unfortunately, it is difficult to influence the rate of technological change even with targeted economic policies.

The impact of economic policies on the *distribution* of earnings is perhaps more visible, and there are three distinct historical episodes to be explained. From the Civil War to the Great Depression, the distribution tended to become more unequal, but this behavior was reversed in the subsequent Great Compression (Goldin and Margo 1992), the effects of which continued to resonate until the 1970s, after which the

distribution became more lopsided once more, a trend that has lasted to, even intensified in, the present. Those in the top decile received 30.3% of all wage income in 1932, 25.2% in 1950, 25.7% in 1970, 31.8% in 1990 and more than 35% in 2000 (Piketty and Saez 2001).

A list of the immediate institutional causes of the Great Compression would include both the National Industrial Recovery Act of 1933 and the National War Labor Board or NWLB, established in 1942 and dissolved in 1945. What is more difficult to explain is the persistence of wartime compression decades after. Some recent research suggests that a robust set of “compensation norms” emerged in the aftermath of the Great Depression and Second World War, and that these norms persisted even if their codification, in the little steel formula and other practices of the NLWB, proved to be short-lived.

Both the slowdown in the growth of earnings since the 1970s, which was mirrored in the experiences of other advanced capitalist economies, and the increasing unevenness of the earnings distribution, which was not, have also received considerable attention from social scientists. The second of these seems to contradict the Kuznets (1955) hypothesis, which claims that after some threshold level of economic development has been attained, the distribution of earnings tends to become more equal.

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