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Chapter Title: The Distribution of Income among the Individuals and Households

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THE DISTRIBUTION OF INCOME AMONG THE INDIVIDUALS AND HOUSEHOLDS that go to make up the nation is one of our important statistics. Unless economic activity is looked upon as a pastime or a vocation whose pursuit is its own reward, compensation for personal participation or for the use of property is in a sense its *ultima ratio.* Income tends to be a criterion of an economy's performance and influences an individual's pattern of consumption and savings, and to an important degree his efficiency as a producer. The distribution of income by size is one of the points at which we can observe the flow of the product of the economy to consumers and producers, and at which we can, therefore, discern a key link in the economic mechanism, helpful in understanding some of its workings and in appraising some of its advantages and disadvantages.

The importance of a size distribution of income is matched by the difficulty of getting reliable and continuous measures, especially in a society that traditionally has tended to minimize state interference. Its members are the sole adequate source of information about the income receipts of individuals and households; and in an individualistic free society they are neither eager nor always able to tell all about their income, in strict accordance with the economist's concept. Indeed, most of our accurate economic information comes not from individuals but from enterprises, which keep accounts because they are essential to survival and growth as well as to daily living. And enterprises being, in a sense, creatures of society and of its sovereign organs, can be easily called to account. They cannot provide us, however, with a distribution of income among individuals and households, which may receive income from various sources, or with data on the social characteristics of recipients whose home life is their own.[1]

[1] A free economic society in which individuals have a fair amount of liberty as consumers and producers and in which it is, therefore, indispensable to analyze the distribution of income by size as a basis for ascertaining the patterns of consumer and producer behavior is exactly the type of society in which getting such information is difficult because of the natural resistance of its members. In an authoritarian society individuals as consumers and producers have much less freedom and it may be less important to analyze the size distribution of income as a system of production incentives or as a basis for relating consumption and investment patterns, but it is easier to get the data. This paradox may have some intriguing aspects in that the existence of free agents in a society may enhance both the value of studying their behavior and the difficulty of getting the data; and the subjection of free agents to authoritarian control acts both to facilitate the supply of data and to reduce the need for them.

All this is by way of explaining why the investigation whose results are summarized below[2] is confined largely to the upper income groups. For them alone do we have, in this country, continuous information on their number and income for a fairly long period. With this information, derived from federal income tax returns by individuals, we can estimate their shares in total income on a basis that, despite several qualifications inherent in the data, is fairly comparable from year to year. Information on the large proportion of the income population below the top has become available for only a few recent years, and even for these it is too scanty for detailed analysis.

The percentage shares of upper income groups in total income can be estimated annually for 1919-47; and, in less detail, back to 1913. Subject to some limitations, they can be estimated also in the countrywide aggregates of employee compensation, entrepreneurial income, dividends, interest, and rent. We can, therefore, observe the average structure of the size distribution, as revealed by shares of upper income groups, in total income and in various types. The average level and structure of the shares of the upper and lower groups is the first topic discussed in Part A, and the two major findings may be put briefly:

1) The average income shares (income ex capital gains and before taxes) of upper income groups between the two world wars were: the top 1 percent of the population, 15 percent of income, top 5 percent, 30 percent of income.

2) The shares of upper income groups were largest in the countrywide aggregate of dividends: the top 1 percent of the population received on the average 65 percent of total dividends paid to individuals, the top 5 percent, 77 percent. Their shares were lowest in the countrywide total of employee compensation, averaging about 6½ percent for the top 1 percent and 17 percent for the top 5 percent group.

These findings can be interpreted properly if it is recognized that in distinguishing the top 1 and 5 percent groups, we reach well down the income scale. As shown in Appendix Table 1, the *lowest* units in the top 1 percent group received incomes which, on a *per capita* basis, ranged (for 1919-38) from somewhat over $2,000

[2] A two volume report under the same title is now being prepared for publication at the National Bureau of Economic Research.

to somewhat over $4,000, i.e., from over $8,000 to over $16,000 for a family of four. For the lowest units in the top 5 percent group, per capita incomes ranged from about $1,250 to about $2,000, i.e., from $5,000 to $8,000 for a family of four. Furthermore, the percentage shares of the top 1 and 5 percent groups cited above are averages for 1919-38: as indicated below, the shares declined markedly during World War II and postwar years.

The size of income shares and even of their changes in any distribution depend upon the recipient unit used (the individual, family, consuming unit, etc.); the scope of income (including or excluding income in kind, capital gains, other transfer items, etc.); the extent to which several types of income from various sources combine to swell the total income of a given recipient unit; and the period over which income is cumulated (a year, two years, etc.). In addition to such statistical characteristics of the size distribution, we consider others that reveal the demographic and social composition of income classes—sex, age, education, size of family, location (rural, urban, cities of different size), occupation, industrial attachment, and the like. The effects of the statistical characteristics of the distribution on the shares of upper income groups and of their social characteristics must both be taken into account in interpreting income inequality—all of which form the second group of topics discussed in Part A. The conclusions do not lend themselves to a brief summary. But in general they show the large degree to which income inequality, as measured here, is due to our use of income for a single year and the composition of upper income groups: more persons at productive ages, with higher formal education and experience, and consuming units whose place of residence entails high costs of living.

In Part B we deal with changes in the shares of upper income groups, in both total income and countrywide aggregates of various types of income. While the period covered is at most some three decades, the diversity of the patterns of change and of the income types gives a rather complex picture—treated here only in broad outline and suggesting two major findings:

3) The shares of upper income groups declined substantially from 1939 to 1944 or 1945, and by 1948 had recovered little. From 1939 to 1945 the share of the top 1 percent group dropped from over 13 to 9.5 percent and the share of the top 5 percent group,

from over 28 to 19.5 percent. If capital gains and taxes are allowed for, the decline was even sharper—from over 12 to over 7 percent for the top 1 and from over 27 to about 17 percent for the top 5 percent group.

4) During business cycles in the interwar period income shares of upper income groups changed, on the whole, little. That of the top 1 percent group was irregularly related to business cycles; shares of the upper income groups below the top 1 percent tended to move counter to business cycles, as did that of the top 5 percent group as a whole.

To know how the country's income is distributed among individuals and families and how its distribution changes is useful only if we can better explain the behavior of income recipients as producers and as consumers. Of the possible implications of our findings concerning income shares of upper income groups, we have explored only one, that for the level and short term movements of individuals' savings. This necessarily entailed scrutinizing data on the patterns of individuals' savings—with special attention to savings of upper income groups as contrasted with savings of all groups. The bearing of these data, and of the level and movements of shares of upper income groups, on the role of their savings during business cycles, is set forth in Part C, with the following tentative conclusions:

5) During business cycles the savings-income ratios for the upper income groups fluctuated much less relatively than those for the lower income groups. This, together with the stability of the income shares of upper income groups, suggests that their savings constituted a fairly stable proportion of the total income of individuals. Consequently, the extreme variability during business cycles of the savings-income ratio for the total population must have been due largely to violent changes in the savings-inome ratios for lower income groups.

6) In view of the distinct probability that savings of upper and of lower income groups seek different investment channels, the changing distribution during business cycles of total individual savings between savings by upper and lower income groups should be recognized as affecting the savings-investment flow.

In Part D the major avenues of further work in the field, whether along the lines pursued here or along others, are briefly discussed. While Part D may seem out of place in a summary, we venture to include it for two reasons: it qualifies our results and, in revealing the ignorance that appears to prevail in so vital a field of economic intelligence, may serve to stimulate more work.

A Average Income Shares of Upper Income Groups

1 *Average Levels*

The averages are for the two interwar decades, 1919-38. We exclude information for years before 1919 and since 1938 in order to eliminate the marked effect of the wars on the distribution of income by size.

Shares of upper income groups are based upon comparisons between federal tax data and countrywide aggregates of income receipts by individuals. The definition of individuals' incomes corresponds to that of national income: receipts for the participation of individuals or of their property in the productive process. This means, unless otherwise noted, including employee compensation, entrepreneurial income, dividends, interest, and rent; excluding capital gains and other transfers, and not allowing any deductions except of business expenses.

Tax data are available for return units, classified by net income, as defined for tax purposes. We reduce classes of returns to classes of persons represented on the returns (income recipients and dependents); record the total income (as defined above) for each class; calculate per capita income for each class; array the classes downward by size of per capita income, then interpolate for the top 1, 3, 5, etc. percent of the total population. At each partition line we estimate the total income reported above that line; the proportion this income constitutes of the countrywide aggregate is the share of the income group above the partition line. This procedure yields the shares we call the 'basic' variant because it is the variant for which we can exploit most fully the detailed data in the annual tabulations of federal income tax returns (Table 1, col. 1, lines 1-5).

During 1919-38 these tax returns covered almost exclusively nonfarm residents, and countrywide aggregates of individuals' income receipts for the nonfarm population are available. Therefore, we can compare the income and population represented on federal tax returns not only with total income and population but also with