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Chapter Author: Edward D. Hollander

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Introduction

EDWARD D. HOLLANDER
Bureau of Labor Statistics

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The papers in this volume are focused on problems of analysis, of the interpretation of bodies of data. Explanatory, experimental, they are not parts of a coordinated and unified analysis but explorations of new data or byproducts of other analyses. The feature they have in common is that they extend our empirical knowledge of the income distribution, especially in relation to demand, consumption, and saving.

During the last twenty years economists have manifested increasing interest in studying functional relationships among aggregate economic magnitudes. In the field of income and consumption this emphasis on aggregate relations may, to some degree, be held responsible for the failure to gain a clear understanding of the behavior of these aggregates. Interwoven into the social-economic pattern are a multitude of independent units determined and motivated independently, each reacting in its own way. The study of functional distributions among aggregates is beginning to reflect the growing awareness of the importance of the behavior of the components, a shift of emphasis to distributional characteristics among demographic, income, occupational, and other population groups.

If the characteristics of income distributions, of economic aggregates, and of social-economic cultures are interrelated in a measurable way, there is a basis not only for objective discussion of optimum income distribution and intelligent criticism of social-economic institutions but also for economic prognosis. The type of welfare analysis such an approach permits is a great advance over older approaches which examined merely the social and political implications of the unequal distribution of a fixed aggregate income.

The functional approach to the analysis of income distribution was clearly in the minds of those who designed the Allerton Park Conference. As George Garvy points out, the "global distribution" tells us little, and admits of rather formalistic and, on the whole, not very productive analysis. The papers in this volume, and others recently published,[1] show the trend toward functional analysis in empirical work, away from the old welfare norm. They inquire into relations between income and other significant variables in society – family size, occupation, community size, region, age – and into the two primarily related forms of economic behavior – consumption and savings.

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We are still seeking to understand the response of consumption and saving behavior to various stimuli. We know, of course, that they are particularly sensitive to income: this, in fact, has been the reason for our interest in income and income size distribution for many years. But we are only on the verge of discoveries concerning the influences of other factors in the income-consumption-saving relation. The influence of demographic factors – age, sex, family size; the influence of cultural factors – occupation, climate, tastes, and the forms of political and social organization; even the influence of income, does not express itself in any linear or invariate way, but acts differently at different stages of the business cycle or under different expectations of income size and stability.

Consequently, the very economic stability we seek to achieve has in itself a profound effect on the way incomes are spent and saved. Dorothy Brady has pointed out, for example, that when wage earners had little expectation of stability or security of income, they treated all high income as windfalls; hence their consumption and saving patterns at such times were more like those of farmers or businessmen than like those of the higher paid, stable salary classes. Since incomes have been high for almost a decade and a greater degree of security (partly the result of the social insurances) can be counted on, we can expect, and do find, evidence that

[1] J. L. Nicholson, 'Variations in Working Class Family Expenditure', *Journal of the Royal Statistical Society*. CXII, Part IV, 1949; James Tobin, 'A Statistical Demand Function for Food in the U.S.A.', *ibid.*, CXIII, Part II, 1950.

wage earners' consumption behavior resembles more nearly that of salaried workers.

We are learning about differential rates of expenditure and saving at different income levels not only in the aggregate but for different kinds of goods and services; and we are learning to penetrate the irregularities of the expenditure cycle and identify some of the more stable characteristics of consumption.

The authors of the papers presented at the Allerton Park Conference seemed preoccupied with the effects of some of these variables on income size distribution. I hope this preoccupation reflects our growing awareness of the significance of stratifying the effects of income level, distribution, and stability to get at the underlying influences on the consumption and saving patterns of various groups in society, and is not an attempt to iron out the last wrinkles in the measurement of over-all size distributions or even the differential distributions for various classes in society.

We are near a much clearer understanding of saving and its relation to both consumption and investment. Much of the discussion at the Conference centered on these complex relationships – particularly in the light of cultural, social, and demographic characteristics which condition or even determine the parameters of the saving function: community income, the place of families in the income distribution, the age distribution, the urban-rural distribution of population and income, and accumulations of social and economic pressures that led Simon Kuznets to speculate on the probability of 'compulsive' as well as 'permissive' consumption.

Having liberated the concept of saving from the strictures of morality, we must now liberate it from the conventions of accounting. We need to look at it in terms of its motivation, forms, and effects rather than in terms of double entry bookkeeping. We need to distinguish between saving – that is, *abstention* from consumption – and the many ways in which consumption is *accelerated, deferred, or financed.* The payments on a house or a life insurance policy may be reckoned as saving in the accounting sense, but to the individual consumer they seem more like expenditures to meet the most inflexible and inescapable of his consumption commitments. It is, therefore, entirely unreasonable to expect expenditures of this kind to behave like saving – properly understood to be the residual income after the commitments of consumption (past and future as well as present) have been met. The usual aim of such saving is investment in income-producing property. Surely, we shall learn to understand saving better when we consider it in this context of motivation. Only then will we be able to understand its extremely high income elasticity – the elasticity of a demand for money beyond the demand for the things money will buy.

The same kind of transaction may of course be a form of expenditure for one family and a form of saving for investment for another: the purchase of a house, for example. Moreover, for the time being we are not always able to measure these separately since the transaction is the basic unit of measurement and the transaction as evidence may be ambiguous. Nevertheless, this should not obscure the phenomena of saving and investment, especially in their relations to income. Many people have property and liquid assets representing deferred expenditure (if only until their burials); comparatively few have investments, in the functional sense.

Only if we understand this kind of distinction can we possibly account, for example, for the enormous volume of savings bonds that have been bought and are being bought and held today, when their future purchasing power is so uncertain. As investments they are doubtful; as savings they provide ready means for some future purchase.

When we look at saving and investment in relation to income, and particularly in relation to the income size distribution, we can appreciate what diverse influences are at work determining the amounts to be saved and the amounts to be invested by individuals. The motivations of 'saving up' for deferred consumption are still those of the ant – prudent, provident, and conservative. To the extent that individuals accumulate assets for future security (to which in most cases these assets prove unequal), the various methods of socializing the risks of the future – old age, unemployment, perhaps sickness – will lessen the necessity. To the extent that the accumulation is for some purchase, it becomes difficult to distinguish it from installment financing: neither in economics nor in personal management is there a great difference between 'saving up' for a purchase before it is made and paying for it afterward. To this extent we might regard installment credit as merely the obverse of this kind of 'saving up'. In the discussion at the Conference both Clark Warburton and Raymond Goldsmith emphasized the need for modifying our approach to the analysis of saving. A more rational system of social accounting, as suggested by Goldsmith, and analysis of patterns of use of incomes instead of the consumption-saving dichotomy, as suggested by Warburton, are promising avenues.

Investment – that is, the purchase of income-producing property with funds withheld from consumption – is differently motivated, differently timed, and differently related to income level and income distribution. For families occupying positions over most of the income range, any investment is unwitting or even involuntary. If the bank, the insurance company, or the government that is the custodian of their savings invests these funds, it is certainly not a positive investment on the part of the individual. Kuznets' works have shown the concentration and relative stability of saving for such purposes among the highest income classes. We cannot, therefore, ignore the effects of our progressive taxes, for example, or of the inflation-deflation cycles on the motivation and the means for investment among the individuals at this end of the income distribution.

These are matters of much more than theoretical interest – for example, the management of governmental surpluses and deficits and of the national debt raises questions of the means of dampening the inflationary and deflationary effects. How are we to encourage saving when it is necessary as a counter-inflationary influence? Or encourage consumption and dissaving when these are necessary as counter-deflationary forces? What kind of income distribution, with what kind of consumption pattern, is compatible with what kind of level and rate of saving? For answers to such questions we must look to the behavior of saving and consumption at different points on the income size distribution scale at different phases of the business cycle.

We are accustomed to analysis in terms of the income elasticity of various kinds of consumption, and we have customarily imputed to time-to-time and place-to-place differences in income the kinds of elasticity that characterized the differences between income groups at a point in time and place. This may serve usefully as a first approximation, but as we learn more about the effects of income on consumption we can expect closer approximations. We need, as James Duesenberry pointed out, to distinguish between the short- and the long-run effects. The family that receives more than its customary real income does not necessarily consume in the same way as families accustomed to the higher income. The $4,000 family which rises to the $6,000 income level (leaving aside changes in price) does not necessarily spend like the families accustomed to $6,000. This is often observed in the expenditures that follow in the wake of windfall income, such as the payment of soldiers' bonuses or terminal leave. In fact, one might say that under such conditions families spend as though they did not expect to have so much money again, in contrast to the families who spend as though they expect to have it every year.

In some occupations continuous employment at stable incomes can be expected; in others year-to-year variations in income are usual. A wave of prosperity that sweeps over a large group of the population, raising and buoying incomes, will have an effect on consumption patterns quite different from the equivalent aggregate income differently distributed and differently sustained. The prosperity American wage earners, farmers, and independent business and professional people have enjoyed during the last decade has led them to reassess their economic status and perhaps to assume new attitudes toward the stability of their new-found prosperity.

Will their consumption behavior respond accordingly? This is really a more specific analytical statement of the classic expenditure lag: it attempts to explain why and how expenditures lag when real income increases. Should we not be interested also in the reverse process? Should we not be trying to analyze past behavior in order to surmise what we can expect in the way of lags and changes in consumption patterns if we are again confronted with drastically shrinking incomes?

In stressing consumption as a form of cultural behavior, we must relate it to other aspects of culture. We have perhaps paid too little attention to the difference between the level and standard of living, between the mean and range of what society can provide its members, and what it aspires to, expressed in terms of acceptable but unattained values. It is not merely a case of the rich man's necessities being the poor man's luxuries. Each stratum in a society has its own standards of living. It does not merely imitate other strata. This is particularly relevant to the questions of income elasticity of demand and of the behavior of transitory demand arising from transitory income. For example, expenditures for medical care tend to behave like luxuries, despite the admonitions of doctors and life insurance companies.

We must constantly consult the income-consumption curves for evidence of the social value placed upon various forms of consumption. This is the key not only to patterns of production and resources but also to problems of budget making and the measurement of material well-being. Can we assume that expenditures that behave similarly in the income-consumption curve fulfill a similar function in our social-cultural scale of values? If so, this might provide a link that has been missing in our chain of comparisons of levels of living between times, between places, and between populations characterized by different expenditure patterns. This was the crucial question raised in the opening session of the Conference. Friedman's paper deals with a method that breaks clearly with the normative approach and looks for a solution in behavioristic or functional analysis, even though this might open the results to criticism on subjective grounds.

We are interested in the consumption function not only – as economists have always been – for its own sake, but because we are coming to recognize its crucial importance in the growth and equilibrium of the economy. Our interest in consumption no longer focuses only on notions of adequacy; though many groups in many countries are not far removed from subsistence margins, we cannot speak of necessities in an absolute or biological sense only. Adequacy, therefore, invariably carries the connotation of social, cultural, or economic – not physical – adequacy. Necessities we have learned to define as expenditures for goods people will not do without. We have learned further to classify goods according to the intercepts and slopes of the income-consumption curves.

We have accumulated over decades an enormous body of data on income and consumption. To some of us it seems that our concern from now on should be with the analytical exploitation of these data, without having, as Duesenberry said, "to take the data down into the cellar to torture them". To identify the underlying relationships of the variables in consumption and expenditure, we need to understand not only what the motivations are but how the various functions for various groups in the population will behave in different circumstances.

This is not too much to hope for. In the papers presented at the Conference, and in others, there is mounting evidence of the merits and of the possibilities of such an approach. Janet A. Fisher's paper on the economics of an aging population, though urging caution, suggests some tentative conclusions on the patterns of expenditure of different age groups. Variations in income-expenditure patterns among groups of farm families and between farm and nonfarm have been studied and discussed by Margaret G. Reid. In an earlier study Mrs. Brady also pointed out some relationships between saving and occupation and class of worker.

Once we have segregated these variables and charted their behavior under various circumstances, we should be able to reconstruct for various past or future economic syndromes the charts of relevant causes and effects. It is as though – to use an analogy from demography – we had learned to measure gross births and deaths and were in the process of being able to convert these to rates. We would then be ready to take the next step: to convert them to age-sex-specific rates in order that we might infer the changes for any population if we knew its demographic composition. In the same sense we can hope that we are approaching a stage in our research when we may be able to infer or forecast for certain economic models the behavior of the consumption and savings functions once we know the composition of the income aggregate – its size, its distribution – among various classes of the population, and its place in a time series of such distributions. We can hope that our research will reveal the relationships between consumption and saving, on the one hand, and income and various demographic, geographic, and cultural characteristics, on the other, and that we shall find relationships that are stable or change in some systematic manner from one situation to another – from time to time or from place to place or from one society to another. I think this is not to be dismissed merely as wishful thinking. Consumption and saving, as we have repeatedly observed, are forms of behavior manifested in a framework of social demographic, geographic, and cultural characteristics that are relatively stable. We have reason to believe that our difficulties in identifying and measuring these functions and relationships arise from their complexity, not from their instability. We can console ourselves that it took many generations to discover great constants of the physical sciences too.