



# Summary

Fall 2000

Volume 9, Number 4

## CONTENTS

### INSTITUTE RESEARCH

#### Program: Distribution of Income and Wealth

- 4 Conference: Saving, Intergenerational Transfers, and the Distribution of Wealth
- 10 Workshop on Earnings Inequality
- 12 Lisa A. Keister, Family Structure, Race, and Wealth Ownership: A Longitudinal Exploration of Wealth Accumulation Processes
- 13 Axel Börsch-Supan, Anette Reil-Held, Ralf Rodepeter, Reinhold Schnabel and Joachim Winter, Household Savings in Germany
- 13 Arthur B. Kennickell, An Examination of Changes in the Distribution of Wealth from 1989 to 1998: Evidence from the Survey of Consumer Finances
- 14 Leonard Broom and William Shay, Discontinuities in the Distribution of Great Wealth: Sectoral Forces Old and New
- 15 William J. Collins and Robert A. Margo, Race and the Value of Owner-Occupied Housing, 1940–1990

#### Program: Financial Markets and Monetary Policy

- 15 Jan A. Kregel, Can European Banks Survive a Unified Currency in a Nationally Segmented Capital Market?
- 16 L. Randall Wray, Why Does the Fed Want Slower Growth?

#### Program: Federal Budget Policy

- 17 Wynne Godley, Drowning in Debt

#### Special Studies

# Summary

Fall 2000

Volume 9, Number 4

## SCHOLARS

WYNNE GODLEY *Distinguished Scholar*  
PHILIP ARESTIS *Visiting Senior Scholar*  
WALTER M. CADETTE *Senior Scholar*  
STEVEN M. FAZZARI *Senior Scholar*  
JAMES K. GALBRAITH *Senior Scholar*  
JAN A. KREGEL *Visiting Senior Scholar*  
DAVID A. LEVY *Vice Chairman and Director of Forecasting*  
S JAY LEVY *Chairman*  
ROBERT A. MARGO *Senior Scholar*  
DIMITRI B. PAPADIMITRIOU *President*  
JOEL PERLMANN *Senior Scholar*  
JAMES B. REBITZER *Senior Scholar*  
MALCOLM SAWYER *Visiting Senior Scholar*  
EDWARD N. WOLFF *Senior Scholar*  
L. RANDALL WRAY *Visiting Senior Scholar*  
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GEORGE SHERER *Resident Scholar*  
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AJIT ZACHARIAS *Resident Research Associate*

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WILLIAM H. LAZONICK  
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BARBARA WOLFE

The Jerome Levy Economics Institute of Bard College, founded in 1986, is a nonprofit, nonpartisan, independently funded research organization devoted to public service. Through scholarship and economic forecasting it generates viable, effective public policy responses to important economic problems that profoundly affect the quality of life in the United States and abroad.

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What's Behind the Recent Rise in Profitability?

Edward N. Wolff

No. 297, March 2000

Krugman on the Liquidity Trap: Why Inflation Won't

Bring Recovery in Japan

Jan A. Kregel

No. 298, March 2000

The Public Commodities Problem

Karl Widerquist

No. 299, March 2000

Recent Trends in Wealth Ownership, 1983–1998

Edward N. Wolff

No. 300, May 2000

Trends in Direct Measures of Job Skill Requirements

Michael J. Handel

No. 301, May 2000

Kaleckian Models of Growth in a Stock-Flow Monetary Framework:

A Neo-Kaldorian Model

Marc Lavoie and Wynne Godley

No. 302, June 2000

"It" Happened, But Not Again: A Minskian Analysis of Japan's Lost Decade

Marc-André Pigeon

No. 303, June 2000

Family Structure, Race, and Wealth Ownership:

A Longitudinal Exploration of Wealth Accumulation Processes

Lisa A. Keister

No. 304, July 2000

Can European Banks Survive a Unified Currency in a

Nationally Segmented Capital Market?

Jan A. Kregel

No. 305, July 2000

Household Savings in Germany

Axel Börsch-Supan, Anette Reil-Held, Ralf Rodepeter,

Reinhold Schnabel, and Joachim Winter

No. 306, July 2000

An Examination of Changes in the Distribution of Wealth

from 1989 to 1998: Evidence from the Survey of Consumer Finances

Arthur B. Kennickell

No. 307, July 2000

Discontinuities in the Distribution of Great Wealth: Sectoral Forces

Old and New

Edward N. Wolff and William Shiller

## POLICY NOTES

Social Security Privatization: A Bad Idea

Walter M. Cadette

1999/10

Explaining the U.S. Trade Deficit

Anwar M. Shaikh

2000/1

Is the New Economy Rewriting the Rules?

James K. Galbraith

2000/2

Welfare College Students: Measuring the Impact of Welfare Reform

Thomas Karier

2000/3

Health Care Finance in Need of Rethinking

Walter M. Cadette

2000/4

Can the Expansion Be Sustained? A Minskian View

L. Randall Wray

2000/5

Drowning In Debt

Wynne Godley

2000/6

Why Does the Fed Want Slower Growth?

L. Randall Wray

2000/7

## PUBLIC POLICY BRIEFS

**Do Institutions Affect the Wage Structure?:**

Right-to-Work Laws, Unionization, and the Minimum Wage

Oren M. Levin-Waldman

No. 57, 1999 (Highlights, No. 57A)

**A New Approach to Tax-Exempt Bonds:**

Infrastructure Financing with the AGIS Bond

Edward V. Regan

No. 58, 1999 (Highlights, No. 58A)

**Financing Long-Term Care:**

Replacing a Welfare Model with an Insurance Model

Walter M. Cadette

No. 59, 2000 (Highlights, No. 59A)

**A Dual Mandate for the Federal Reserve:**

The Pursuit of Price Stability and Full Employment

EDWARD N. WOLFF Senior Scholar

**Publications:** “International Comparisons of Wealth Inequality,” in Frank Ackerman, Neva R. Goodwin, Laurie Dougherty, and Kevin Gallagher, eds., *The Political Economy of Inequality* (Island Press, 2000); “Who Are the Rich? A Demographic Profile of High-Income and High-Wealth Americans,” in Joel Slemrod, ed., *Does Atlas Shrug? The Economic Consequences of Taxing the Rich* (Harvard University Press, 2000); “Recent Trends in the Distribution of Household Wealth,” in Ray Marshall, ed., *Back to Shared Prosperity?* (M.E. Sharpe, 2000).  
**Presentations:** “How Stagnant Are Services?” International Conference on the Economics and Socio-Economics of Services, Lille, France, June 22–23; “Outsourcing of Services and the Productivity Recovery in U.S. Manufacturing in the 1980s and 1990s,” NBER Productivity Summer Institute, Cambridge, July 29–August 1; “Skills and Changing Comparative Advantage,” Thirteenth International Conference on Input-Output Techniques, Macerata, Italy, August 20–25; “The Stagnating Fortunes of the Middle Class,” Conference: Should Differences in Income and Wealth Matter? Palo Alto, September 21–24.

L. RANDALL WRAY Visiting Senior Scholar

**Publications:** Review of *Money and the Public Interest* by Perry Mehrling, *Eastern Economic Journal*, Winter 2000; “Modern Money” in *What is Money?* edited by John Smithin (Routledge, 2000); “Penal Keynesianism at the Turn of the Millennium,” *Challenge*, September/October 2000.  
**Presentations:** “Why Does the Fed Want Slower Growth?” Federal Reserve Leadership Education Program, Maritime Institute of Technology Training and Conference Center, Baltimore, June 15–16; “Demand Constraints and the New Economy,” JPKE–University of Tennessee Summer Workshop, June.  
**Media:** Interview, Kansas City radio station KKFI, June; panel discussion on *Kansas City This Week*, program on KMBC (NBC affiliate), May 21; interview for “Morality and Money” series on eastern Tennessee NPR affiliate WETS, July 21.

MARC-ANDRÉ PIGEON Research Assistant

**Presentations:** “Japan’s Story: A Mixed Minskian Analysis,” Eastern Economic Association, Crystal City, Virginia March 26; “It Happened, But Not Again: A Minskian Analysis of Japan’s Lost Decade and Some Thoughts on the Parallels with Recent Events in the U.S. and Canada,” Canadian Economics Association Meeting, Vancouver, June 3.

## RECENT INSTITUTE PUBLICATIONS

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### WORKING PAPERS

*The Distribution of Wages: A Non-parametric Decomposition*

Conchita D’Ambrosio

No. 284, October 1999

*Computers and the Wage Structure*

Michael J. Handel

No. 285, October 1999

*The History of Wage Inequality in America, 1820 to 1970*

Robert A. Margo

No. 286, November 1999

*Functional Finance: What, Why, and How?*

Stephanie Bell

No. 287, November 1999

*The Social Wage, Welfare Policy, and the Phases of Capital Accumulation*

Jamee K. Moudud and Ajit Zacharias

No. 291, December 1999

*Why Do Political Action Committees Give Money to Candidates?*

*Campaign Contributions, Policy Choices, and Election Outcomes*

Christopher Magee

No. 292, December 1999

*Employment Inequalities*

Andrew Glyn and Wiemer Salverda

No. 293, December 1999

*The Brazilian Crisis: From Inertial Inflation to Fiscal Fragility*

## LETTER FROM THE PRESIDENT

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To our readers:

The program on the distribution of income and wealth begins with summaries of sessions held at the conference Saving, Intergenerational Transfers, and the Distribution of Wealth, organized by Senior Scholar Edward N. Wolff. Summaries are also provided of the sessions held at the Workshop on Earnings Inequality organized by Resident Scholar Michael J. Handel. There were five working papers in the program. Lisa A. Keister, of The Ohio State University, examines the impact of family structure on the racial disparities in wealth accumulation. Axel Börsch-Supan, Anette Reil-Held, Ralf Rodepeter, Reinhold Schnabel and Joachim Winter, all of Mannheim University, discuss measurement and policy problems surrounding household saving behavior in Germany. The issues involved in using the data from the Survey of Consumer Finances to estimate the distribution of household wealth in the United States are analyzed by Arthur B. Kennickell of the Board of Governors of the Federal Reserve System. Leonard Broom, of Australian National University, and William Shay, of Harvard University, examine the importance of sectoral factors in the wealth accumulation patterns of the very wealthy. The final working paper summarized is by William J. Collins, of Vanderbilt University, and Senior Scholar Robert A. Margo; the authors discuss the trends in the gap between value of black-owned and white-owned homes.

A working paper and a policy note are summarized in the program on financial markets and monetary policy. Visiting Senior Scholar Jan A. Kregel discusses the factors impeding the development of a unified capital market in the European Economic and Monetary Union and their implications for the international competitiveness of European banks, and the role of the euro in the global capital markets. The policy note by Visiting Senior Scholar L. Randall Wray argues that the interest policy pursued by the Federal Reserve is theoretically and empirically unjustifiable.

In the program on federal budget policy, Distinguished Scholar Wynne Godley argues in a policy note that the current expansion in the United States is in serious danger without appropriate changes in fiscal and exchange rate policies.

Two working papers are summarized under special studies: Marc Lavoie, of the University of Ottawa, and Distinguished Scholar Wynne Godley propose a new model of economic growth, while Chairman S Jay Levy compares the views of Jerome

## Program: Distribution of Income and Wealth

### Conference: Saving, Intergenerational Transfers, and the Distribution of Wealth

*The conference, held June 7–9 at Blithewood, was coordinated by Edward N. Wolff of the Levy Institute and New York University. Brief summaries of the sessions are given below. Detailed summaries will be published separately in the proceedings of the conference.*

#### Speaker: James K. Galbraith

In his talk, “Inequalities of Pay, Income, and Wealth: What Are The Connections?,” Galbraith compared inequality, income, and pay in the U.S. to that of European countries to try to reconcile noted differences between them. He asserted that the mainstream view (that a tradeoff exists between efficiency and equity) is at odds with the empirical evidence because, accordingly, the United States and Europe should be going through antithetic experiences when, in fact, their experiences are similar. That is, the United States, having taken the inequality and efficiency path, should be experiencing increasing pay inequalities with its falling unemployment, and Europe, having taken the equity and unemployment road, should be experiencing falling inequality with its rising unemployment; this has not been the case. In fact, wage dispersions in the United States have been declining over the past five years, and these dispersions have been consistently negatively correlated with the unemployment rate on a month-to-month and year-to-year basis since 1920. Similarly, European countries with higher internal inequality generally had higher unemployment for every year measured (1970 through 1992).

Galbraith noted that since the mid to late 1970s, European countries with lower per capita GDP have also had higher unemployment rates. Therefore, if economic barriers between European countries have indeed been removed, the appropri-

respondence between equality and employment. The difference is that because the United States is doing relatively better (in terms of per capita GDP), unemployment and inequality are falling, while in most European countries they are not.

Galbraith said that a more interesting question is how the United States achieved its present prosperity, especially in terms of wealth accumulation, absent cuts in wages (removing wage flexibility as an answer) and an expansive federal budget deficit. His answer: The structure of the economy has changed to allow the burden of running deficits to be shifted from the public to the private sector, with the public sector providing the infrastructure necessary to make possible household debt accumulation. That infrastructure consists of higher education (which screens for suitability to join the financially sophisticated middle class), Social Security and Medicare, and direct support for access to credit (in the form of guarantee and subsidy programs for first-time home buyers, the creation of the savings and loan network, and the Community Reinvestment Act, to name a few). The percentage of college graduates in the U.S. adult population is about twice that of the European countries. The U.S. share of health care spending in GDP is about twice that of Europe as a whole, and the credit networks present in the former are substantially less available in the latter. Added to these conditions has been an institutional factor: a statutorily created Federal Reserve with a mandate of full employment, balanced growth, and reasonable price stability, as compared to the constitutionally independent European central bank with the sole objective of price stability.

Europe’s problem, then, is reducing unemployment (a promise made to most of the electorate by center-left governments) in a constructed economic environment that requires, for example, budget deficits no larger than 3 percent of GDP, and a central bank focused solely on stabilizing prices. In

- Card, D., and A. Krueger. 1992. "Does School Quality Matter?: Returns to Education and the Characteristics of Public Schools in the United States." *Journal of Political Economy* 100: 1–40.
- Coleman, J., E. Campbell, C. Hobson, J. McPartland, A. Mood, F. D. Weinfeld, and R. York. 1966. *Equality of Educational Opportunity*. Washington D.C.: Department of Health, Education, and Welfare.
- Finn, J., and C. Achilles. 1990. "Answers and Questions about Class Size: A Statewide Experiment." *American Education Research Journal* 27: 557–577.
- Hanushek, E. 1997. "Are Resources Important? (Testimony of Eric Alan Hanushek, March 11, 1996)." *Journal of Negro Education* 66: 289–303.
- Hedges, L., R. Laine, and R. Greenwald. 1994. "Does Money Matter?: A Meta-Analysis of Studies of the Effects of Differential School Inputs on School Outcomes." *Education Researcher* 22: 5–14.
- Jencks, C. S., S. Bartlett, M. Corcoran, J. Crouse, D. Eaglesfield, G. Jackson, K. McClelland, P. Mueser, M. Olneck, J. Schwartz, S. Ward, and J. Williams. 1979. *Who Gets Ahead?: The Determinants of Economic Success in America*. New York: Basic Books.
- Jencks, C. S., M. Smith, H. Acland, M. J. Bane, D. Cohen, H. Gintis, B. Heyns, and S. Michelson. 1972. *Inequality: A Reassessment of the Effect of Family and Schooling in America*. New York: Basic Books.

#### NEW SCHOLAR

**Jörg Bibow** has joined the Institute as a Visiting Scholar. Bibow is working in the area of central banking and financial systems. His research focuses on the effects of monetary policy on economic performance, especially the monetary policies conducted by the Deutsche Bundesbank and the European Central Bank. The background to this work is his earlier research on John Maynard Keynes's monetary thought. Bibow received a B.Com. Honours in economics from the University of the Witwatersrand, Johannesburg, a Diplom-Volkswirt from the University of Hamburg, and an M.Phil. and Ph.D. in economics from University of Cambridge, UK. He is on leave from the University of Hamburg, where he lectures on central banking and European integration.

## PUBLICATIONS AND PRESENTATIONS

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### PUBLICATIONS AND PRESENTATIONS BY LEVY INSTITUTE SCHOLARS

PHILIP ARESTIS Visiting Senior Scholar

**Publications:** "Benchmarking' Economics" (with J. Beath), *Royal Economic Society Newsletter*, July 2000.

**Presentations:** "Financial Policies and the Average Productivity of Capital: Evidence from Developed and Developing Economies" (with Panicos Demetriades and Bassam Fattouh), Annual Conference of the Royal Economic Society, St. Andrews University, July 10–13; "Economic Growth: New Evidence" (with Panicos Demetriades and Bassam Fattouh), Annual Conference of the Money, Macro and Finance Research Group, South Bank University, September 6–8; "The Causes of Euro Instability" (with I Riefano-Frisancho Mariscal A Brown and

*American Historical Review*, February 2000; Review of *The New Dollars and Dreams* by Frank Levy, *Journal of Economic Literature*, March 2000; "Regional Wage Gaps and the Settlement of the Midwest," *Explorations in Economic History*, April 2000; Review of *Essays on the Great Depression* by Ben S. Bernanke, EH.Net, H-Net Reviews, July 2000. URL: <http://www.h-net.msu.edu/reviews/showrev.cgi?path=222963252660>.

**Presentations:** "Rising Wage Dispersion in American Manufacturing in the 19th Century," Economic History Workshop, Harvard University, March; at the Economics Workshop, University of Texas at Austin, March; at the Fourth World Congress of Cliometrics Montreal July and at the

Session 5. *Racial Projections: How to Do Them, Whether to Do Them*  
**Barry Edmonston** and **Sharon M. Lee**, Portland State University: “Recent Trends in Intermarriage and Immigration and Their Effects on the Future Racial Composition of the U.S. Population” (co-authored by **Jeffrey S. Passel**, Urban Institute)

**C. Matthew Snipp**, Stanford University: “Clues to the Future of Other Racial Groups from the American Indian Experience”

**Joel Perlmann**, Levy Institute: “Counts for Social Psychologists or Genealogists? Some Examples and Implications”

#### Featured Speakers

**Susan Schechter**, Office of Management and Budget: “The Process at OMB, and the Guidelines to Date”

**Nathan Glazer**, Harvard University: “The Race Data We Need”

**Kenneth Prewitt**, U.S. Census Bureau: “The 2000 Census: A Turning Point”

*The winter issue of the Summary will contain synopses of these speeches and papers (including discussants’ comments). The entire conference is also available from the audio webcast archives on our website ([www.levy.org/webcast](http://www.levy.org/webcast)).*

## UPCOMING CONFERENCE

### After the Bell: Education Solutions outside the School

June 4–5, 2001

As a part of its continuing engagement with pressing public policy issues, the Levy Institute is co-sponsoring a conference with the Center for Advanced Social Science Research, New York University, on educational policy and the determinants of educational achievement. The conference is being organized by Dalton Conley, the Center’s director and associate professor of sociology at New York University. A brief account of the background of the conference and themes to be addressed are given below. More information will be posted on the Levy Institute website as it becomes available.

Almost 37 years ago, James Coleman and his co-authors

students, these were largely school composition effects: only for Southern blacks did expenditures seem to matter. The most shocking and important finding was that the indicators that are usually the focus of educational policy debate—per-pupil expenditures and student-to-teacher ratios—did not appear to matter much.

Since the Coleman Report’s publication, many researchers have examined the methodology and reanalyzed the original data, which comprised information on more than 600,000 students in 4,000 schools, and have found that the overall pattern of findings held steady (see, e.g., Jencks et al. 1972, 1979). Perhaps the strongest and most controversial claim by those commenting about school-level characteristics, most notably funding, has been made by economist Erik Hanushek, who said that such factors make little difference in school outcomes. In 1996, he testified as an expert witness “in favor of ending court ordered remediation” of public school segregation in St. Louis, Missouri. He insisted that the differences between a 40:1 student-teacher ratio and one of 15:1 were inconsequential and not related to school performance (Hanushek 1997 in Arum 2000). However, more recent research has shown that school effects might be stronger than Hanushek and others argue (see, e.g., Arum 1998; Card and Krueger 1992; Finn and Achilles 1990; Hedges, Laine, and Greenwald 1994).

The ground over which researchers are battling in trying to estimate the net effects of schools on educational achievement is not vast. Though scholars may not agree on the extent of school effects, there is, across the ideological spectrum, a tacit consensus that the effects of other background characteristics—community, family, genetics—are stronger. Yet why, after 35 years of evidence that schools are marginal to academic achievement, have educational politics and policy continued to focus almost exclusively on schools? What would an education policy look like if it did not mention the word “school”? Can government address achievement differences that are rooted in the home? What are the political implications? These are some of the questions that motivate this conference of scholars and policymakers, which marks the 35th anniversary of the issuance of the Coleman Report.



incomes and labor force participation; investments in hospitals and medical and research centers in low-income regions; investments in independent, open, European (rather than national) research universities; and mechanisms to expand credit opportunities.

### **Session 1. Wealth Trends in the United States in the 1990s**

**Arthur B. Kennickell**, of the Board of Governors of the Federal Reserve System, reported on his study of the distribution of wealth from 1989 to 1998. He took data for the very wealthy from the *Forbes* 400—the magazine’s survey of the 400 wealthiest people in the United States—for the years 1989–1999. Data for the remaining income distribution were taken for the years 1989, 1992, 1995, and 1998 from the Survey of Consumer Finances (SCF). The data suggest that since 1995, the level of wealth has jumped notably among the wealthiest families. The total amount of net worth accounted for by the *Forbes* 400 rose in real terms from about \$379 billion to about \$740 billion (a 95 percent increase); the number of billionaires rose from 97 to 191 (a 97 percent increase). SCF data for the rest of the distribution were less conclusive. The proportion of families with a net worth of \$500,000 in 1998 did not change significantly from 1989. Point estimates of the Gini coefficient fell from 1989 to 1992, and then rose to a point above the 1989 level by 1998, but none of these changes are statistically significant. In the absence of particularly strong information to use in choosing between possible adjustments, Kennickell advised a strong note of caution before making conclusions about changes in the distribution of wealth.

**Barry Johnson**, of the Statistics of Income (SOI) Division of the Internal Revenue Service, U.S. Department of the Treasury, discussed his use of SOI data to study the wealthiest group of individuals in the United States over the period 1986 to 1995, and presented preliminary estimates for 1998. The SOI data come from federal estate tax returns (Form 706), which include a complete accounting of all of a decedent’s assets and debts and a demographic profile. Johnson produced estimates of the wealth of the living population from estate tax data by assuming that those who die in a given year are a sample of the living population, given the mortality rate. He estimated that there

about 22 percent of total U.S. personal wealth, nearly the same as in 1995. The share held by the top 0.5 percent of the population also held steady at 17 percent. In fact, these figures seem to have been fairly steady since 1985.

Discussant **John C. Weicher**, of the Hudson Institute, compared the view of the top 1 percent of wealth holders in the two studies’ data sources, asserting that they differ by \$2 to \$3 trillion in regard to the concentration of wealth. He took this to imply that a large amount of wealth is managing to avoid the estate tax. The pattern of changes in the concentration of wealth in both studies appears strongly cyclical: there is an increase in wealth concentration during an expansion and a decrease during a contraction. According to Weicher, two significant problems exist in studying the distribution of wealth: there is not enough theoretical basis for it and data are scarce. He believes that work in this area needs to be conducted on a consistent basis going back as far as possible. Especially needed are data going back at least as far as 1983 to shed light on the controversial changes in distributions of income and wealth in the 1980s. Kennickell stated that, given the available data, it is very difficult to make comparisons between the early 1980s and later surveys; Johnson did not even discuss the wealth distribution in 1983. Weicher admitted that there are many great difficulties in making the earlier data consistent with the later data, but he believes that these two scholars are particularly well qualified to make the attempt.

### **Session 2. Wealth Extremes in the United States**

**William Shay**, of the Center for Basic Research in the Social Sciences, presented work coauthored with Leonard Broom on the characteristics of the very wealthy, using data from the *Forbes* survey of the 400 wealthiest Americans (individuals or families). According to these scholars, broad surveys of the distribution of income, such as the Panel Study of Income Dynamics and the Survey of Consumer Finances, suffer from measurement problems at the apex of the distribution. Using the *Forbes* 400 enables focusing on the extreme of wealth distribution during a period of dramatic changes in the composition and concentration of wealth. The authors found that the maximum wealth of the richest individual rose from \$3.4 billion in

polarization of wealth between demographic groups in the United States from 1983 to 1998. Their main finding was that changes in household characteristics did not have a large influence on the evolution of the U.S. distribution of wealth in the period under examination. Instead, most of the observed variation can be attributed to the within-group wealth distribution, which underwent a dramatic change. For example, polarization between homeowners and renters and between different educational groups continuously decreased from 1983 to 1998. In contrast, polarization by racial group, family type, and income class first increased from 1983 to 1989 and then declined from 1989 to 1998.

Discussant **Michael J. Handel**, of the Levy Institute, criticized Shay for being unclear about the underlying theory of his analysis. Handel believes that important factors in the accumulation of great wealth are monopoly profits, quasi-rents extracted by initial entrants in fast-growing product markets, and windfalls from speculative booms in asset markets. Shay differentiated between abstract and real property, but Handel wondered how this distinction could be maintained when those creating great fortunes through productive activity usually hold their wealth in equity. Commenting on D'Ambrosio's presentation, Handel noted that the focus was mainly descriptive and he would have liked to see more analysis. In addition, he wondered about the finding that the distribution of wealth had become as unequal within low wealth groups (nonhomeowners, nonwhites) as within higher-wealth groups. It seems unlikely that the upper tail of either group increased, because nonhomeowners are not likely to become a great deal wealthier without leaving the renter category, and because other research does not suggest much growth in nonwhite wealth. Likewise, it would be unexpected to find that the lower tail of these groups had lost much wealth, since the two periods covered by this paper were both periods of growth.

### **Session 3. Intergenerational Transfers in the United States**

**Frank Stafford** of the University of Michigan and **Ngina Chiteji** of Skidmore College and the Center for Poverty, Risk, and Mental Health, University of Michigan discussed the role of intergenerational transmission of information regarding assets

statistically significant impact, even after controlling for a variety of factors that included bequests, parental affluence, and parental education levels.

According to **Paul G. Schervish**, of Boston College, the notion that lower-income groups contribute a greater percentage of income to charity than do high-income groups is not supported by the empirical analysis he conducted along with John J. Havens. In 1995, the richest 5 percent of all households contributed 50 percent of all charitable dollars. There is also a direct correlation—both cross-sectionally and over time—between the level of wealth and the amount of charitable giving. Schervish and Havens have developed a wealth transfer microsimulation model to generate estimates of the amount of wealth transfer over the first half of this century. In contrast to the \$10 trillion estimated by previous research, they find that the amount ranged from \$41 trillion to \$136 trillion, depending on the assumptions made regarding saving rates, rates of wealth accumulation, growth rates of national income, and a few other pertinent variables. However, Schervish pointed out, there are a number of unresolved issues regarding the procedures used in the microsimulation model; the sensitivity of the present findings to their resolution should be a future area of research.

Discussant **André Masson** of DELTA-CNRS expressed skepticism regarding the idea underpinning the Stafford-Chiteji model that intergenerational transmission of asset ownership can be treated as similar to the transmission of biological or psychological traits. He also speculated that the positive correlation that they found between parents' and children's asset ownership rates may reflect transmission of preferences rather than information, as was argued by the authors. Masson stated that the main lesson he learned from Schervish's presentation is that charity is a luxury good for the very rich. He also criticized the estimates for not taking into account the trends in the concentration of wealth.

### **Session 4. Trends in Home Ownership**

**Dalton Conley**, of New York University, investigated the relationship between home ownership, on the one hand, and

Levy and Kalecki had points of difference in their views on profits and capitalism. Kalecki was a Pole who lived in a society characterized by rigid stratification along class and political lines. He believed that capitalism was fundamentally unable to overcome problems of poverty and unemployment and therefore saw socialism as the only alternative. By contrast, the America in which Levy lived was a more fluid society, which extolled and rewarded innovators. He saw capitalism as offering a superior environment for freedom, arguing that under socialism, one's only choice was a government job, whereas under cap-

italism, one could work for a private employer, the government, or oneself. Under proper management, Levy believed, a capitalist economy can achieve full employment and steady growth.

The high rate of unemployment in most of Europe today confirms Kalecki's view that such a situation is endemic to capitalism. Levy would have argued that this is the result of policy failures and "wasted" profits (those secured by businesses that assume no productive risks). Irrespective of which is right, both men would have agreed that understanding the movements of profits is the key to understanding macroeconomic phenomena.

## INSTITUTE NEWS

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### RECENT EVENTS

#### Conference

##### **Multiraciality: How Will the New Census Data Be Used?**

September 22–23, 2000

Researchers gathered at Blithewood to present and discuss their recent work on issues related to the changes introduced in Census 2000 regarding the way information about race is collected. The conference was organized by Senior Scholar Joel Perlmann and Mary Waters of Harvard University. Papers presented at the conference and the speakers featured are listed below.

#### *Session 1. Empirical Analyses of Data on Multiraciality*

**Reynolds Farley**, University of Michigan, and **Jorge del Pinal**, U.S. Census Bureau: "New Race Collection Procedures in the 1999 American Community Survey"

**David Harris**, University of Michigan: "Does it Matter How We Measure?: Implications of Definitions of Race on the Characteristics of Mixed-Race Youth"

**Hans Johnson** and **Sonya Tafoya**, Public Policy Institute of California: "The Multi-Racial Population in California"

**Josh Goldstein** and **Ann Morning**, Princeton University: "Counting Up the Minority Population: Using the OMB-DOJ Guidelines"

Studies: "Inadequacies of Multiple Response Race Data in the Federal Statistical System"

#### *Session 3. Panel Discussion: From Enumeration to Law*

**Joel Perlmann**, Levy Institute, and **Mary Waters**, Harvard University: "Preliminary Comments to Open a Discussion on the Implications of Multiracial Counts for Racial and Ethnic Preference Data"

**Anita S. Hodgkiss**, The Advancement Project: "The View from the DOJ"

**David McMillen**, U.S. House of Representatives: "The View from the Hill"

**Hugh Davis Graham**, Vanderbilt University: "This Step in the Perspective of the History of Civil Rights"

**Jennifer L. Hochschild**, Princeton University: "This Step in the Perspective of Public Policy Development"

#### *Session 4. Historical and Comparative Experience with Evolving Race Data*

**Margo J. Anderson**, University of Wisconsin at Milwaukee: "Where Did Race, Class, and Gender Come From? Historical Roots of Federal Statistical Classifications"

**Naomi Mezey**, Georgetown University Law Center: "The Census as National Imagination: The Chinese Category in

loans, issue of new equity, and retained earnings. It is assumed that banks do not make any profits and that bank deposits are the only form of money (since there is no government sector). The change in money supply is therefore equal to the new loans advanced.

Behavioral relationships in the model are derived from different strands of Post Keynesian economics. Firms, or rather, the aggregated non-bank business sector, make decisions regarding pricing, output level, investment, and financing of investment. With regard to the first two decisions, standard assumptions are made: markup pricing and instantaneous quantity adjustment by firms to demand. Investment is assumed to respond positively to “animal spirits,” the capacity utilization rate, the ratio of retained earnings to capital stock, and the valuation ratio (Tobin’s  $q$ ), and negatively to interest charges. Financing decisions are made in such a way that bank borrowing becomes the residual variable that closes the gap between other sources of investment funds and planned investment. Households make decisions regarding their consumption on the basis of expected income and capital gains; their portfolio decisions are governed by the relative rates of return on bank deposits and equities. Banks supply an amount of credit that is demanded by its credit-worthy customers.

The lags introduced in the postulated set of behavioral and accounting relations yield a dynamical system. Simulations were used to study its behavior in response to changes in parameters. Lavoie and Godley found that the model has two regimes, depending on whether the sensitivity of investment to the valuation ratio was lower or higher than the sensitivity of investment to the capacity utilization rate. Since available empirical evidence favors the first case, the authors describe this as the “normal” regime. They found, *inter alia*, that for the normal regime, a rise in the propensity to consume and a rise in the real wage both have a positive effect on long-run growth, and that a rise in the interest rate has a negative one. These results are significant, since they confirm, in a formally rigorous fashion, some of the fundamental insights of Post Keynesian economics.

Lavoie and Godley argue that their model’s underlying approach has several advantages. Built on a consistent accounting system for monetary stocks and flows, it is logically coherent. Adopting the accounting system as the basis for the model

## **Profits: The Views of Jerome Levy and Michal Kalecki**

S JAY LEVY

Working Paper No. 309, August 2000

[www.levy.org/docs/wrkpap/papers/309.html](http://www.levy.org/docs/wrkpap/papers/309.html)

Jerome Levy became seriously interested in economics and started the derivation of the profits identity in 1908. That was a recessionary year with high unemployment and the jobless had no recourse to unemployment insurance or a public safety net. Levy’s research was motivated by a desire to find means to fight the scourge of unemployment. Independently, about 30 years later, Michal Kalecki devised a nearly identical version of the profits identity. He too was disturbed by unemployment and poverty.

Chairman S Jay Levy explains that the profits identity is an accounting relationship that expresses the total profits in an economy as a sum of various types of expenditures (e.g., investment, consumption, net exports). Kalecki’s derivation of this identity was greatly facilitated by the developments in national income accounting during his time; he was content with a formulation that aggregated various kinds of expenditure into a small number of categories. Jerome Levy, by contrast, did not have the benefit of national income accounting concepts. Unlike Kalecki, he derived the profits identity by considering all types of transactions that occur in the economy as well as non-transaction accounting charges (for example, depreciation). For the purpose of the profits identity, Levy identified each transaction as either representing business receipts or business costs.

Levy and Kalecki differed on the implications that can be drawn from the profits identity. For both, elucidating the determinants of markups—that is, profits expressed as a proportion of sales—was the key question. Kalecki argued that capitalism becomes increasingly dominated by monopolies, as a result of which, markups rise and investment stagnates. Since aggregate profits depend on aggregate investment, rising markups along with stagnant profits imply that wage income will fall, both relatively and absolutely. Kalecki argued that only replacing capitalism with socialism could overcome this problem. Levy, however, was concerned with whether the problem of an indus-

alternative form of insurance when social insurance is less available. It is also possible that homeowners tend to support more conservative policies. Conley found that societies with great income inequality tend to have higher rates of home ownership, and that states that spend a higher proportion of their GDP on social insurance have lower home ownership rates. He reexamined poverty rates using a measure in which homeowners were excluded from the group considered to be below the poverty line, finding that there is substantially less international variation in poverty rates and that the relative ranks of various countries change substantially when this measure is used.

According to **Erik Hurst**, of the University of Chicago, differences in housing wealth account for a large portion of the wealth gap between black and white Americans. He presented research from a study coauthored by Kerwin Kofi Charles, of the University of Michigan, following a sample of black and white renters over time to analyze their likelihood of becoming homeowners. A substantial racial gap exists even after differences in income, wealth, and education are accounted for. Hurst and Charles found that blacks are less likely than otherwise comparable whites to become homeowners chiefly because they are less likely to apply for mortgages in the first place. They also find strong evidence that black applicants are almost twice as likely as comparable whites to be rejected for a mortgage, even when credit history proxies and measures of household wealth are included. This differential treatment, however, explains less than 3 percent of the racial difference in ownership rates. Hurst pointed to large differences, by race, in the role that families play in helping to generate mortgage down payments, and provided evidence that this might be the source of the racial difference in application rates.

According to **Annamaria Lusardi**, of the University of Chicago, discussant for the session, housing is an important issue to those concerned with the distribution of wealth because housing equity represents the most important asset in many households' portfolios. But housing is a complex issue that is hard to model. People usually assume that more home ownership is better, but this may not always be the case. Some families have too large a portion of their portfolio invested in this one asset.

She also criticized his using home ownership as a factor that automatically qualifies someone as 'nonpoor'; lifetime resources, she suggested, would be a more appropriate variable.

#### **Session 5. Wealth Inequality in Europe and Japan I**

**Mariacristina Rossi** and **Anthony Shorrocks**, of the University of Essex, discussed the problems in generating reliable data on the distribution of household wealth in the United Kingdom. A novel attempt was made to compare and reconcile the two main available micro-level sources of data: the British Household Panel Study and a dataset containing 50,000 individual estate records from the Inland Revenue, both for the year 1995. The comparison facilitated a detailed examination of the average holdings of each type of asset and debt, as well as the pattern of holdings across individuals. The reliability of the two datasets was assessed by comparing the average asset and debt values with estimates obtained from the UK Personal Sector Balance Sheet (similar to the US flow of funds data). Rossi and Shorrocks also conducted regression analysis to shed light on how the pattern of asset and debt holdings differ from one dataset to the other.

**Axel Börsch-Supan**, of the University of Mannheim, presented an analysis of the pattern of household saving in Germany based on the joint work he is doing with Anette Reil-Held, Ralf Rodepeter, Reinhold Schnabel and Joachim Winter. Different measures and concepts of saving were discussed and estimated. The central finding is a hump-shaped age-saving profile with a high overall household saving rate: saving remains positive even for the older cohorts and low-income cohorts. This poses a puzzle because Germany has one of the most generous public pension and health insurance systems in the world. Börsch-Supan argued that the gains in life-cycle income experienced by the average worker who retired in 1970 were unusually and unexpectedly large, too much to be consumed away. Further, the inability of the elderly to change their consumption habits dramatically in old age also contributed to their "excess" saving.

Discussant **James Davies** of The University of Western Ontario praised Rossi and Shorrocks for their painstaking and novel effort in creating a source of data that reconciles the disparities

### **Session 6. Wealth Inequality in Europe and Japan II**

According to **Luc Arrondel** of DELTA-CNRS, the theory of precautionary saving holds that in addition to the variables postulated by the life-cycle model—age and permanent income—uncertainty regarding future income and the degree of risk aversion play a role in saving behavior. Recent theoretical work has suggested that the precautionary motive has implications regarding portfolio choice too. Arrondel examined how far these theoretical insights are confirmed empirically by using the results from a 1997 survey of roughly 10,000 French households about their wealth and attitudes toward risk-bearing. Precautionary saving, he reported, accounted only for about 6 percent of total saving. The results regarding the effects of precautionary motive on portfolio choice were mixed. For example, Arrondel found support for the theoretical prediction that borrowing constraints induce households to be more risk-averse, but none for the prediction that households confronted with income risk will tend to be more risk-averse in their portfolio choice.

**Charles Yuji Horioka**, of Osaka University, presented the joint research he has been conducting with Takatsugu Kouno and Shiho Iwamoto on the strength, nature, and economic impact of bequest motives in Japan. The data sources used were from two surveys conducted by the Japanese Ministry of Posts and Telecommunications: the Comparative Survey of Savings in Japan and the United States (1996) and the Survey on Financial Asset Choice of Households (1996 and 1998). Bequest motive was found to be weak in both nations, but especially so in Japan. Further, in both countries, the vast majority of those making bequests fall into two categories: parents who plan to leave their children whatever saving remains (“unintended” or “accidental” bequests) and parents hoping to induce children to provide them with care in old age. Data on saving by age cohorts indicate that a substantial proportion of the elderly dissave in Japan. Results from estimating a dissaving function for the elderly indicated that intended bequests aggravate the extent of dissaving. Horioka suggested that these findings lend support to the life-cycle model of saving.

Discussant **Lars Osberg**, of Dalhousie University, commended

also critical about Horioka’s omission of people’s mixed motivations and unwillingness to consider negative visions of the future in forming their bequest decisions.

### **Session 7. Racial Divisions**

**Maury Gittleman**, of the Bureau of Labor Statistics, U.S. Department of Commerce, discussed racial disparities in wealth accumulation in the United States. His joint research with Edward N. Wolff, using data from the Panel Study on Income Dynamics, decomposes the change in average wealth over 1984 to 1994 for African-American and other households into three components: intergenerational transfers, saving, and change in asset values. The results suggest that, for African-Americans, the share of changing asset values in wealth accumulation is relatively more important, while intergenerational transfers are far less so. Counterfactual experiments with the data showed that if African-Americans were similar to others in terms of level of intergenerational transfers, level of family income, portfolio composition, and saving rates, the wealth gap between them would have narrowed. Nevertheless, according to Gittleman, the 1984 gap was so huge that even under these favorable conditions, the ratio of African-American households’ wealth to that of other households would have only increased to 0.36 at the end of 1994, as compared to the actual level of 0.28.

**Lisa Keister**, of The Ohio State University, stated that her previous research had shown that differences in portfolio behavior or in educational levels between blacks and others cannot account for the wealth disparities between the two groups in the United States. A relatively neglected factor that might contribute to racial inequalities in wealth accumulation is family structure. Keister investigated the effects of the structure of family of origin and family in adulthood using the data collected from the National Longitudinal Survey of Youth on the 1979 cohort. Her results indicate that variables characterizing the structure of the family of origin, such as the number of siblings (negative effect) and parents living together (positive effect), have pronounced effects on the net asset position and that these effects are significantly different for whites, blacks, and Hispanics.

## Program: Federal Budget Policy

### Drowning in Debt

WYNNE GODLEY

Policy Note 2000/6

[www.levy.org/docs/pn/00-6.html](http://www.levy.org/docs/pn/00-6.html)

Analysts generally agree that the current U.S. boom is bound to lose steam soon because of inflationary dangers. The debate seems to center around whether the Fed can engineer the economy to settle at a lower, albeit sustainable long-run rate of growth, the general presumption being that this can be achieved without any substantial change in the stance and structure of fiscal policy. Distinguished Scholar Wynne Godley argues that such a rosy scenario is unlikely to prevail.

Godley points out that the remarkable feature of the post-1991 expansion has not been an extraordinary rise in output growth—there have been many nine-year periods during which output growth was faster—but a growth in private expenditure (consumption plus investment) that has exceeded output growth. In an accounting sense, the faster growth in private expenditure can be attributed to the deterioration in the balance of payments, but since this and the government budget surplus represent a reduction in private disposable income, the question still remains as to how private spending was able to rise at such a rapid rate. The answer lies in the unprecedented growth of private indebtedness: household debt is now equal to personal disposable income and corporate debt is 74 percent of corporate GDP.

While the high level of debt itself poses a risk to continued growth, Godley argues that a more serious threat is the authorities' assumption that growth can continue with rising budget

surpluses. On the basis of the reasonable assumption that the balance of payments will continue to deteriorate, a rise in budget surpluses can occur only if private indebtedness continues to rise, which implies that the private net saving rate—already at negative 7 percent of disposable income—continues to become increasingly negative. If saving does not continue to fall, this must be accompanied by a deteriorating government budget and an improvement in the balance of payments, both of which could happen (given fiscal policy and trade propensities) only if demand and income were to stagnate or collapse.

Godley dismissed the argument that there is nothing to prevent private saving from falling indefinitely. The experiences of countries that underwent a similar borrowing binge suggest that such private sector deficits are followed by a period of correction, with recession and rising unemployment. The argument that the phenomenal growth in household net worth validates the current levels of debt is also fallacious since it ignores the facts that (a) the decisive constraint on borrowing will come from servicing the debt, and (b) half of the non-financial private sector debt is held by businesses. Corporate indebtedness now exceeds the levels last seen in the late 1980s, when the last credit boom unraveled.

If private net saving were to return over the next few years to the level that was normal in the United States until quite recently, there would hardly be any growth during that period. While a relaxation of fiscal policy is possible in theory, and will be necessary in practice to check the negative effects of the downturn, Godley concludes that he finds it hard to imagine how the growing external deficit could be stemmed without a substantial devaluation of the dollar.

## Special Studies

### Kaleckian Models of Growth in a Stock-Flow Monetary Framework: A Neo-Kaldorian Model

that is closely related to well-known social accounting matrices. The second is the set of ideas regarding growth, money, and

instruments. In spite of early evidence that the euro is becoming an alternative to the dollar in global capital markets, the maintenance and enhancement of its position will depend on greater capital market unification within the EMU.

The emergence of the euro as a major currency in the global capital markets has as its corollary increased competition between U.S. and European banks. However, the rate of return on equity for European banks is currently lower than for their U.S. counterparts. One of the reasons behind this is the relatively large dependence of banks on lending to businesses, which subjects a large proportion of banks' assets to full capital requirement weighting. Another reason is that Europeans have been slow to achieve cost reductions through consolidating their retail banking operations and transforming commercial banks into investment banks.

The competitiveness of European banks is also hampered by the less developed state of asset securitization. In the United States, banks have been able to reduce their required regulatory capital by removing 100 percent weighted loans from the balance sheet by selling them to capital market investors through special purpose vehicles as collateralized loan obligations. The development of such a market for the euro zone would require harmonization of financial market regulations within the EMU. Indeed, argues Kregel, if European banks cannot engage in the same financial engineering of the euro within the EMU as they can in dollar markets, the euro will never improve its position vis-à-vis the dollar as an international currency.

While several analysts have drawn parallels between the monetary unification of the United States and the path followed by the EMU, Kregel points out that there are substantial differences. First, in the United States, the control over the issue of currency is vested in the federal government; by contrast, in the EMU, this control has been handed over to a monetary authority that lacks any political legitimacy and is legally beyond political control. Second, the principle of "subsidiarity" is in stark opposition to the United States where a federal agency enforces common regulations on all interstate commercial and financial transactions. Kregel concludes that the success of the euro and the prospects of European banks in the global market will depend on the extent to which financial market conditions can be harmonized within the EMU.

theoretical model underpinning this policy postulates that, as interest rates rise, investment will fall, lowering employment and output, independent of the state of the economy. This model misrepresents the effects of rising interest rates. These immediately increase the costs of short-term financing of businesses, which, to the extent that they are able without losing market share to foreign producers, they pass on to consumers in the form of higher prices; if demand falls, they cut some kinds of spending. Rising interest rates reduce consumption spending only if debt loads are relatively high, since what matters for households is the monthly payment on their debt, not interest rates. These considerations show that there is no smooth credit demand schedule as postulated by the Fed's model and that the effects of rising interest rates are highly dependent on the state of demand and indebtedness.

The Fed's model is also empirically flawed. The rationale behind raising interest rates is that if the current growth rate of aggregate demand persists, it will tighten the labor market to a degree that workers will start demanding higher compensation; businesses will then have no choice but to raise prices, thus triggering inflation. However, since 1970 every case of rapid increase in U.S. inflation has taken place during high, not low unemployment periods; periods of low unemployment—the 1960s and the 1990s—were characterized by low inflation. Wray also argues that the Consumer Price Index is a poor indicator of demand–supply imbalances and therefore cannot be used in the formulation of anti-inflation policy, and that existing research on inflation points to the benign, or at most, neutral effect that moderate inflation has on growth.

Apart from its lack of foundation in theory and evidence, Wray argues that the Fed's objective of raising unemployment to fight inflation is bad public policy because it seeks to inflict concentrated burdens on a small section of the population to obtain benefits that are widely spread. Research has shown that joblessness disproportionately affects those at the bottom of the labor market: the low-skilled, the poorly-educated, and minorities. It would be against common sense to believe that raising the joblessness of these segments of the labor force will help overcome shortages of highly skilled and highly educated workers and thus prevent raising wages.

According to Wray, the U.S. economy will slow down



Discussant **Richard Curtin**, of the University of Michigan, characterized the work presented by Gittleman as a useful extension of existing research on racial disparities in wealth. He pointed out that the results may be sensitive to measurement problems that may affect African-American and other households by substantially different magnitudes. Curtin agreed with Keister's assessment that the attributes in the early stages of the life-cycle can have significant influence on the position that one attains in the distribution of wealth in later life. However, he pointed out that closer examination is required on the issue of how changing marital status affects upward mobility.

#### **Session 8. Wealth Taxation**

**John Laitner**, of the University of Michigan, reported his analysis of the possible long-run consequences of reduction or elimination of the federal unified gift and estate tax, focusing on its effects on national wealth accumulation and the degree of inequality in the cross-sectional distribution of household net worth. To do so, he constructed an intertemporal general equilibrium model with parameters characterizing household preferences calibrated to match survey data. Two interpretations fit the data plausibly well. Under one interpretation, all families are dynastic. If so, the fraction of each cohort receiving a bequest and the ratio of lifetime transfers to bequests seems in rough agreement with survey evidence, but the simulated degree of inequality falls far short of empirically observed levels. Under the second interpretation, between 5 and 10 percent of households are altruistic. This interpretation can match the actual distribution of wealth much more closely, and it yields the best fit with empirical evidence, but the incidence of inheritance is smaller than surveys show. If the first interpretation is correct, a change in the estate tax will have little effect on inequality. But if the second is correct, inequality will increase tremendously with the elimination of the estate tax. Laitner concludes that if the motive for reducing estate taxes is to increase national wealth accumulation, policymakers might consider other options that may achieve the objective without causing such a large increase in inequality.

**Pierre Pestieau**, of the University of Liège, gave an intuitive dis-

However, it can tax capital income through a withholding tax as an indirect way of taxing the initial endowment a person receives from inheritance, because people with larger unobservable inheritances save more than do other people and will therefore receive more capital income. However, the government also has a motivation for subsidizing capital income, because it creates wealth and so has a positive externality; this turns out to be optimal only under the extreme assumption that all bequests are fully observable and taxable. If there is a high correlation between inherited endowment and productivity, and if inheritance is unobservable, then optimal tax on capital is large and positive.

**James Poterba**, of Massachusetts Institute of Technology, discussant for the session, asserted that both of these papers are directed at very pragmatic questions about estate taxes: their insights would be invaluable to the current debates on this issue in Congress. Laitner's paper tried to quantify the tradeoff between the increase in capital stock and the increase in inequality that might follow from a reduction in the estate tax. Pestieau takes the view of a social planner trying to achieve an equal distribution of consumption and shows that if bequests are not fully observable, then the planner may use some other tax as a second-best way to obtain it, even if that tax might have other associated distortions. Poterba concluded that there is growing recognition that this area of economic theory delivers ambiguous results, not just about some of the details, but about basic issues such as why people leave transfers and how changes in estate tax laws affect inequality. But, he believes, these two papers represent a substantial advance in the economic analysis of those questions.

#### **Session 9. Sources, Inter Vivos Transfers, and Psychological Aspects of Wealth Accumulation**

**F. Thomas Juster** and **Joseph Lupton**, both of the Institute for Social Research, presented work coauthored with James P. Smith and Frank P. Stafford, both of the University of Michigan. Their work examined secular trends in household savings and wealth accumulation in the United States over the last four decades. Both the 1960s and the 1990s are characterized as decades of strong income growth and even stronger

rising education levels increased it, Juster and Lupton concluded that the puzzle of increasing household wealth in the face of historically low savings rates seems to be best solved by noting the tremendous capital gains over the past two decades. The large increases in equities as a share of household wealth imply that household wealth has become more volatile. This fact may have implications for business cycles because stock market swings in the future may have a larger impact on consumer behavior than they did in the past.

Discussant **Richard Burkhauser**, of Cornell University, praised Juster and Lupton's paper for focusing on an important policy indicator, the savings rate. The researchers attempt to explain why saving has fallen substantially since 1984, but at the same time wealth has risen. Using a fixed effects model controlling for age, marital status, net transfers, inheritance, and capital gains in both stocks and housing, and data from the Panel Study of Income Dynamics, Juster and Lupton examine whether changes in capital gains have affected active savings (their term for savings out of income other than capital gains). They find that there have been major increases in wealth minus pensions by age cohorts and a large percentage change in wealth due to passive savings (their term for capital gains), and that this has had a strong effect on active savings. In fact the effect was almost implausibly large. Burkhauser suggested that part of the explanation could be that capital gains taxes were much lower in the 1990s than they were in the 1960s, giving investors more reason to reduce their active savings when their capital gains increase.

**Stefan Hochguertel** of European University Institute and **Henry Ohlsson** of Göteborg University discussed whether inter vivos gifts tend to be equal among their recipients or compensatory. The altruistic model predicts that inter vivos gifts to a child decline as the child's financial resources rise. The egoistic model predicts that inter vivos gifts are independent of the child's financial resources; in the exchange model, the relationship between the amount of inter vivos gifts and the child's financial status is ambiguous. Using data from the Health and Retirement Study, the validity of the different models was assessed by examining whether children received more or less from their parents than did their siblings, after controlling for

wives regarding family income, wealth, and finances. It is important to understand such differences because they can shed light on marital problems, gender differences in attitudes toward risk, and biases in aggregate personal income estimates based on survey data. Empirical results based on data from the National Longitudinal Survey show that a substantial proportion of husbands and wives state significantly different values for family income and family wealth. Zagorsky argued that the reason for the discrepancies in reported income is that each spouse understated the income of the other and overstated his/her own. Discrepancies in wealth are due to husbands overstating assets and understating debts while their wives do the opposite. Factors behind such statements and their impact on actual economic behavior merit further research.

Discussant **John Schmitt** of the Economic Policy Institute suggested that Hochguertel and Ohlsson could have made further use of their unique database by examining how inter vivos gift giving differed according to family structure, race, and children's gender. He also argued that the omission of parental support for education, an important form of inter vivos gift, is a flaw. Schmitt commended Zagorsky on his novel data work and urged him to develop specific guidelines regarding adjustment of responses given by spouses to survey questions on income and wealth. He also suggested that further work be undertaken to examine whether the different values reported by husbands and wives narrow or widen over time and the effects such discrepancies have on divorce rates.

### **Workshop on Earnings Inequality**

*The Levy Institute organized a workshop on June 6 at Blithewood, for researchers to present and discuss their recent work on issues related to earnings inequality. Brief summaries of the sessions are given here.*

#### **Session 1. Mobility**

**Martina Morris**, of The Pennsylvania State University, discussed the results of work coauthored with Annette Bernhardt, Mark Handcock, and Marc Scott. There is a consensus among

### **Race and the Value of Owner-Occupied Housing, 1940–1990**

WILLIAM J. COLLINS AND ROBERT A. MARGO

Working Paper No. 310, August 2000

[www.levy.org/docs/wrkpap/papers/310.html](http://www.levy.org/docs/wrkpap/papers/310.html)

According to William J. Collins, of Vanderbilt University, and Senior Scholar Robert A. Margo, there has been no systematic study of the long-run evolution of the black-white gap in home values. The attempt to fill this vacuum in the existing literature is motivated by two main considerations. First, house and neighborhood quality are important determinants of household well-being; to the extent that home values reflect that quality, factors behind disparities in home values can shed light on disparities in household well-being. Second, disparities in home values can yield information about disparities in wealth because owner-occupied housing has historically been the single largest component of household wealth.

Collins and Margo employ for their study the micro-level sample data from the Integrated Public Use Microdata Series (IPUMS) for the years 1940, 1960, 1970, 1980 and 1990. In each year, the sample consists of black and white male household heads between 20 and 64 years of age who were not in school. Several steps were taken to ensure that samples are standardized across years to the extent possible. Calculations show that, for the entire country, the ratio of the value of black-owned homes to white-owned homes rose from 0.37 in 1940 to 0.65 in 1990. However, most of this increase took place prior to the 1970s. Collins and Margo point out that the post-1970 stagnation appears to be associated with a substantial decline in central cities, especially in the Midwest. The upward movement in the ratio prior to the 1970s was mainly driven by the marked rise in the relative value of black-owned homes in the South.

Collins and Margo use the IPUMS housing characteristics information in a decomposition analysis to study the sources of change in the racial gap in home values for the period 1960 to 1990. As noted above, most of the increase in the relative value of black-owned homes occurred prior to 1970; the decomposition analysis shows that the overwhelming proportion of the catching up that took place in the 1960s was the result of relative improvements in the physical characteristics (such as number of rooms, number of bathrooms, or age of buildings) of black-owned homes. However, during the 1970s and 1980s, the relative improvements in housing characteristics did not bring about any closing of the gap, mainly as a result of a decline in the unobserved quality of black-owned homes, e.g., neighborhood quality.

Collins and Margo examine two hypotheses that could explain the behavior of black-owned home values in the 1970s. The first, associated with William Julius Wilson, suggests that the outcome was due to the movement of middle-class blacks out of central cities and the subsequent decline in home values in the vacated areas. While an econometric test of the hypothesis lends it some support, the test also indicates that the movement out of central cities started earlier than the 1970s, which makes it difficult to accept the hypothesis as a full explanation. The second hypothesis is that riots in several cities in the late 1960s contributed to the decline in black-owned home values in the 1970s. The results from testing this hypothesis are suggestive, but Collins and Margo argue that they are not conclusive. Overall, their conclusion is that, while both hypotheses are insightful, further analysis is warranted of the persistence of disparity in black-white home values.

## **Program: Financial Markets and Monetary Policy**

### **Can European Banks Survive a Unified Currency in a Nationally Segmented Capital Market?**

JAN A. KREGEL

Working Paper No. 205, July 2000

regulations of financial institutions. This both prevents the creation of a unified capital market and places the EMU financial institutions, especially banks, at a competitive disadvantage vis-à-vis U.S. banks in global capital markets.

cent distributions of families over constant-dollar wealth categories, the means and medians of the distributions of net worth, the Gini coefficients for wealth, and the shares of total net worth held by different groups within the distribution. In interpreting the results, it is important to bear in mind that the 1989 SCF was conducted before the peak of a business cycle, while the 1992, 1995, and 1998 surveys were performed during succeeding phases of the subsequent recovery. While many of the changes in the percent distribution of families were statistically significant, they do not show that the percentage of families in lower or middle wealth groups increased. Both the median and mean wealth showed an upward trend during the period, and the acceleration was quicker during 1995–1998. Kennickell also found that the Gini coefficient, a measure of the inequality in distribution, and the shares of total net worth held by different groups within the distribution showed no statistically significant changes.

Kennickell notes that several researchers, most influentially Edward N. Wolff, have adjusted the SCF data in order to make them compatible with the estimates that emerge from the aggregate flow of funds accounts published by the Federal Reserve Board. However, such adjustments face serious technical problems. More significantly, each such adjustment implies a particular model of the behavior of survey respondents and therefore needs explicit justification on behavioral, theoretical, or empirical grounds before it can be accepted. Kennickell examined the sensitivity of the SCF estimates to a variety of such adjustments. Although some had the effect of depressing the share of the bottom 90 percent of the population in wealth (thus showing a growing concentration of wealth), an equally plausible adjustment had the opposite effect. Kennickell concludes that the SCF data show little change in the concentration of wealth below the *Forbes* 400 level.

### **Discontinuities in the Distribution of Great Wealth: Sectoral Forces Old and New**

LEONARD BROOM AND WILLIAM SHAY

Working Paper No. 308, August 2000

[www.levy.org/docs/wrkap/papers/308.html](http://www.levy.org/docs/wrkap/papers/308.html)

ment previous research by studying the changing pattern of wealth distribution among the *Forbes* 400 and its relationship to the changing fortunes of different economic sectors. Broom and Shay argue that the driving force behind the accumulation of great fortunes by individuals or families is not political influence or personal attributes, but the form of capital they own and the economic sector in which that capital is employed.

Accordingly, data were collected for the individual or family, and economic sector was adopted as the category for classification and analysis. The source used was the wealth data on the *Forbes* 400, a listing of the 400 richest individuals or families in the United States, and on those considered by the magazine as “near misses”—those whose net worth fell just below the minimum threshold for the richest 400 status. A cumulative database was constructed of such cases (individuals or families), controlling for miscounting due to changing kinship ties, for the period 1982–1999. *Forbes* profiles often identify more than one economic sector per case as contributing to net worth, but since disaggregation by sectors is unavailable, the net worth of each case is assigned to the chief sector. Sector classification is based on economic function; within each main sector, distinctions are drawn based on different attributes of capital that presumably affect economies of scale, cash flows, and profitability.

Using the database described above, Broom and Shay investigate the hypothesis that, independent of inheritance, demographic traits, or social ties, wealth will be concentrated in high cash-flow sectors, such as those based on the production or distribution of consumer nondurables, in finance and real estate, and in technology-intensive sectors. They find that for 1999, the shares of these sectors in total net worth were, respectively, 22.7, 20.3 and 19 percent. Not surprisingly, these sectors also surpassed the others in terms of mean net worth. Regression analysis confirmed the importance of sectoral origin. Additionally, it showed that social networks do matter: the coefficients on variables for kinship ties and family fortunes were positive and statistically significant.

Broom and Shay also point out that there have been substantial shifts in the concentration of wealth by sector over

each cohort for 16 years, during which they moved from ages 14–21 to 30–37. She found that there has been an increase in the *relative* return to education, but that this is better described as an increase in the penalty for low education and not as an increase in the reward for higher education. In other words, men with college degrees are not earning significantly more, but men with less education are earning significantly less. Therefore, she concluded, to explain the increase in inequality, researchers should be looking for an explanation of why the poorly-educated are doing worse, not why the better-educated are doing relatively better.

**Peter Gottschalk**, of Boston College, presented a joint work coauthored by Enrico Spolaore, discussing theoretical and empirical aspects of economic mobility. Gottschalk discussed several reasons why people tend to be concerned with mobility. First, it creates economic incentives. Second, it reduces multiperiod inequality. Third, it creates instability. Fourth, it reduces “origin dependence”; that is, the more mobile an economy is, the less it resembles a caste or old-boy system. In an empirical comparison of the United States and Germany, Gottschalk found that the question of which society is more mobile depends on how one views mobility. Germany has less mobility at the top and more at the bottom. Incomes in the United States are the less predictable of the two; a person’s current income there says less about his/her future income than it does in Germany. Therefore, Gottschalk concluded, contrary to previous literature, the United States is more mobile than Germany.

### **Session 2. Technology and Skills I**

**Kenneth Troske**, of the University of Missouri–Columbia, stated that the analysis of establishment-level data for the U.S. manufacturing sector he conducted with Timothy Dunne, Lucia Foster, and John Haltiwanger showed that the main effect of skill-biased technical change is increased wage differentials between establishments, mostly within the same industry. In turn, such intraindustrial wage differentials accounted for a growing and significant portion of the overall wage differentials during the period 1975–1992. Troske found that the wage differentials between establishments are positively corre-

lated in lower demand for less-skilled workers, thus leading to a growing wage gap between them and skilled workers. Previous empirical studies could not test the hypothesis satisfactorily because they generally relied on a poor specification of technology or skills or both. Fernandez attempted to overcome these deficiencies by means of a case study of a food processing plant that underwent retooling. He found that retooling led to greater wage inequality in the manner predicted by the hypothesis and that it was associated with growing racial wage inequality. However, organizational and human resource policies adopted by the firm (e.g., wage guarantees) tempered the growth in inequality.

### **Session 3. Technology and Skills II**

According to **Eli Berman** of Boston University, there was a sharp increase in the wage premium for college graduates during the late 1990s, after five to six years of stability. The average wage of a college graduate exceeded the average wage of a high school graduate by \$3,000 per year between 1996 and 1999. On the basis of certain assumptions regarding the average retirement age, the discount rate, and the annual hours of work, Berman estimated that if the wage inequality between the two groups of workers were to persist for the next twenty years, it would represent a \$1.7 trillion (human) capital gain for U.S. college graduates. The growth in wage inequality occurred in the late 1990s, even though the real wages of high school graduates increased, in contrast to the stagnant wages in the 1980s. A comparison between the two periods of growth in wage inequality suggests that recent increases in the wage premium for college graduates are due to skill-biased technological change and low college graduation rates, despite high enrollment rates.

Resident Scholar **Michael J. Handel** of the Levy Institute argued against the notion that the rising wage inequality reflected a rising payoff to education resulting from an imbalance between growth rates in the supply of and demand for skilled labor. While it is true that the supply of skilled labor decelerated in the 1980s, wage inequality did not grow sharply in the late 1980s and the early 1990s. Instead, it grew most quickly during the recession of the

#### **Session 4. Big Picture/Effects of 1990s Expansion**

Senior Scholar **James K. Galbraith**, of the Levy Institute and the University of Texas at Austin, discussed the preliminary results of a study that measures inequality across counties in the United States. The study finds that recent increases in income inequality are largely due to extreme increases in income in a small number of counties. This is consistent with the logic of a profits boom, where capital asset owners are geographically clustered, but not with that of “skill-biased technological change” or other theories that purport to explain rising income inequality as a labor market phenomenon. In any event, as other studies by Galbraith’s team at the University of Texas Inequality Project have shown, wage inequalities have been decreasing even though income inequalities have risen.

**John Schmitt**, of the Economic Policy Institute, discussed changes in the wage structure from 1989 to 1999 using data from the Current Population Survey. His results do not fit a consistent pattern and therefore do not fit with the skill bias demand shift hypothesis. The patterns of wages for men and women were greatly different, suggesting an institutional explanation. The experience of recent college graduates was a “bumpy ride,” repeatedly rising and falling. The real wages of men in the 50th and 10th percentiles have fallen over the last 20 years. The wages of those in the 10th percentile fell from 1979 to 1983 and then leveled out until the late 1990s, when they began to rise. The 90th percentile had an increase in real earnings from 1980 to 1987, and was then flat until the late 1990s. Wages of women in the 90th percentile rose steadily from 1973 to 1999, and movements of the 10th and 50th percentiles were unsteady. An examination of the annualized growth in real wages shows a different macroeconomic environment in the period from 1989 to 1994 than in the period from 1995 to 1999.

#### **Family Structure, Race, and Wealth Ownership:**

##### **A Longitudinal Exploration of Wealth Accumulation Processes**

LISA A. KEISTER

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[www.levy.org/docs/wrkpap/papers/304.html](http://www.levy.org/docs/wrkpap/papers/304.html)

addresses the influence of family structure on wealth accumulation. The theoretical core of her argument is that increasing family size and family disruptions dilute the material and non-material resources available to the family and thus negatively affect its potential for wealth accumulation.

In examining the effects of family structure on wealth, a distinction is made between the structure of family of origin and of family in adulthood. The number of siblings and family disruptions are used to characterize the structure of family of origin. The structure of family in adulthood is characterized by marital status, family size, fertility, and transitions to fertility and marriage. These structural characteristics are postulated to affect three aspects of an individual’s wealth: the overall level of wealth, rate of wealth accumulation, and composition of wealth.

Keister used the data on the 1979 cohort from the National Longitudinal Survey of Youth to explore these ideas empirically. She used data from 1985 through 1996, when the respondents were between the ages of 31 and 38, and also drew on the 1979 survey for information on their families of origin. Separate regressions were run by race to assess the impact of several variables characterizing family structure on the overall level of wealth, rates of wealth accumulation, and composition of wealth.

The results indicate a strong negative relationship between the number of siblings in family of origin and the net worth of family in adulthood for all races, although the coefficients differed significantly across races. The negative effect was pronounced for whites because, on the average, whites have more material resources to be diluted by a growing number of siblings. The effect of the number of siblings on upward mobility on the wealth ladder also differed across races: it was negative for whites, insignificant for blacks, and positive for Hispanics. Family disruptions during childhood were found to negatively affect wealth outcomes, although the effect is greater on upward mobility than on the level of wealth. Hispanics seem to be particularly susceptible to this effect, probably as a result of the greater role played by the large, extended families in that community.

Family structure in adulthood was also found to be strongly tied to wealth ownership, especially upward mobility.

period and had still more children. According to Keister, the overall findings suggest that efforts to reduce racial inequality in wealth ownership may be most effective if they seek to reduce the impact of deprivation early in life.

### **Household Savings in Germany**

AXEL BÖRSCH-SUPAN, ANETTE REIL-HELD, RALF RODEPETER, REINHOLD SCHNABEL AND JOACHIM WINTER

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[www.levy.org/docs/wrkpap/papers/306.html](http://www.levy.org/docs/wrkpap/papers/306.html)

In spite of the theoretical and empirical work devoted to it, household saving behavior is still one of the lesser-understood areas of economics. Advancing knowledge in this area is vital because the division of income between consumption and saving is one of the most important economic decisions and because private saving as a private insurance interacts with public insurance policies implemented by the government. Axel Börsch-Supan, of the Institute of Economics and Statistics at the University of Mannheim, and his coworkers, Anette Reil-Held, Ralf Rodepeter, Reinhold Schnabel, and Joachim Winter, contribute to this task by describing and analyzing household saving behavior in the former West Germany. The central policy issue addressed by the authors is why the German saving rate is so high, in spite of its having one of the most generous public pension and health insurance systems in the world.

The authors' description of savings behavior is based on four waves of the Income and Expenditure Survey conducted by the German census during the period 1978–1993. Households in these cross sections cannot be matched and therefore the panel constructed is a synthetic one formed by aggregating the cross-sectional data into age categories and identifying adjacent age-groups across waves. The authors estimate, by age-cohort, financial, real, and total saving; financial, real and total wealth; total gross income and total disposable income; and saving rates. The main finding is that the saving rate–age profile shows only a mild hump-shape. Saving rates are roughly 12 percent for all young and middle-aged groups until around age 45–49. They then decrease gradually and stabilize around age 65–69 at about 4 percent and remain

Second World War and up to the 1980s was so large and unprecedented that today's elderly just could not have anticipated it. Second, the elderly did not spend the savings amassed during this period because of habit persistence: they did not dramatically change their consumption norms formed fifty years ago. Furthermore, health conditions prevented their spending as much as would be needed to make their saving rates negative.

The authors argue that, due to the generous public pension system, the younger cohorts' motives for saving are precautionary: purchase of homes and consumer durables, and inter vivos transfers. However, the slowdown in economic growth since the 1980s and the deteriorating dependency ratio is likely to make the public pension system less generous in the future; this may revive the retirement motive for saving. According to the authors, it is also likely that, in the event of a transition from the current pay-as-you-go pension system to a partially funded one, the portfolio composition of household wealth may change in favor of equities.

### **An Examination of Changes in the Distribution of Wealth from 1989 to 1998: Evidence from the Survey of Consumer Finances**

ARTHUR B. KENNICKELL

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[www.levy.org/docs/wrkpap/papers/307.html](http://www.levy.org/docs/wrkpap/papers/307.html)

Distribution of income and wealth has in recent years become an important area of scholarly and public debate. Arthur B. Kennickell, of the Survey of Consumer Finances for the Board of Governors of the Federal Reserve System, discusses the issues related to the measurement of wealth distribution and the inferences that can be made from publicly available data. Here, he considers data from the *Forbes* 400 and the Survey of Consumer Finances (SCF), both over the period 1989–1998.

*Forbes* publishes annual estimates of the wealth of the 400 richest people in the United States. Their estimates indicate that, while the growth in wealth was relatively modest during 1989 to 1995, there was a sharp acceleration after that. From 1995 to 1998, in real terms, the total amount of wealth held by the *Forbes* 400 grew by 95 percent and the number of billion-