Effects of Shifts of Aggregate Demand
Upon Income Distribution

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Tight full employment was said to exist when more jobs than unemployed workers were available for a broad spectrum of skills and locations.
I. Introduction

When poverty exists in the midst of affluence, it represents the result of the distribution of income. This is what makes poverty different in the United States than in poorer countries, where it is the result of a deficiency in the capacity to produce.

In the United States a large portion of those living in poverty and an even larger portion of those living close to poverty do so because of the income they receive from work. The questions that need answering if some day a serious war on poverty is to be mounted relate to the distribution of income and the policy tools that are available which can affect the distribution of income in the relatively short run. The emphasis upon the short run makes programs based upon investment in human capital irrelevant.

Policy. It also means that the impact of economic growth upon the extent of poverty [Anderson 1] is not germane. The problem is to affect emphasis will be upon the determinants of the distribution of income, within a given capacity to produce and labor force attributes.

My interest in income distribution is one of a general economist whose area of special competence, if any, is in aggregate economics.

Early in the preparations for a possible War on Poverty, I was drawn into discussions dealing with the prospective campaign. My view was summarized in the subtitle of a talk at the Berkeley Conference: [Minsky's] a subtitle that was too flip for the editor of the published version. The subtitle was "Is This Trip Necessary".
In this paper I consciously ignored the poverty of those not expected to be in the labor force, which can be handled only by a sufficiently generous scheme of transfer payments. The argument of the paper, and of some subsequent writings, was that the achievement and sustaining of a truly adequate aggregate demand, which would lead to continuing tight full employment, could do almost all of the job of eliminating poverty.

My thesis was that tight full employment would help eliminate poverty in two ways: one way was by employing the unemployed and moving part-time workers into the fully employed class. The second way was by fostering labor market conditions so that low wages will increase at a faster rate than high wages.

Tight full employment as I defined it was neither achieved nor sustained during the 1960's. As an interim measure of tight full employment I suggested a measured unemployment rate of 3.0%, considerably below the best we have achieved since 1953 but well above measured rates in Europe. In spite of a war added onto an investment boom the lowest monthly unemployment rate achieved during the current expansion was 3.5%, and for a sustained period we never got low below 3.7%.

The events of the expansion have indicated that if we take the elimination of poverty seriously, we cannot rely upon "undirected" aggregate demand increases to do the job. This is because of two facets of what happened:

1. The crunch of August-September 1966 shows that a sustained expansion such as took place between early 1953 and the fall of 1966 and even sustained growth breeds "stresses and strains" within the economy which make the continuation of the expansion unlikely. Thus achievement of tight full employment may require more than just a... expansionary monetary and fiscal policy.
2. The distribution of relative wages did not appreciably improve during the expansion of the 1960's. To explain the wage structure, labor markets represent the result of an increasing population. However, the tightening in the wage structure that was observed during the war and the postwar period does not appear to be lasting, as labor markets are still undergoing profound changes on an administrative basis. It may be that conscious policy with regard to the structure of aggregate demand is necessary if the desired change in the wage structure is to be achieved. The question is whether "directed" demand can achieve the goal, or whether a system of direct controls is needed with or without directed demand.

II. Income Distribution as a Policy Goal

After the summer of 1967, the "question" of the distribution of income, in all its dimensions and not only as measured income, should be the leading issue. One way of stating the problem is to recognize that there is some maximum inequality of a generalized income that is compatible with social stability. It seems clear that a good wording of the leading social imperative "is to secure domestic peace and tranquility".

The maximum inequality consistent with any set of social goals is not invariant. It is useful to conjecture, following Saitovsky (Saitovsky, 19), that in a technically sophisticated, highly urbanized
society inequality of measured income more truly reflects inequality of real or "subjective" income than in a less sophisticated, rural environment. In the dimensions not measured by the earning and spending of private income, life may be easier and the contributions of public and free goods more evenly distributed in a rural and small town setting than in our modern cities. Whereas the "inequality" in the distribution of private income may be partially offset by the distribution of free and public goods in a small town or rural setting, in our modern urban ghettos the coverage of free goods has decreased and public goods typically are distributed so as to aggravate the measured inequality in measured income. In addition there are problems of perception and tradition: rural poverty may be associated with a belief in the inevitability of status differences whereas urban societies are associated with social and economic mobility.

Another facet of the necessity for a consensus that equity exists in the distribution of income is that, in a modern urban society, for a broad set of occupations public benefits exceed private benefits. The dependence of any household or business upon output upon the smooth working of other units is so obvious that observed difference in income received must correspond to some notion of "fairness". It is no accident that existing relative incomes are not accepted as being fair by school teachers, policemen, other "blue collar civil servants" as well as by many industrial and service workers.

The question of the equity of the income distribution and what policy can do to affect income distribution is much broader than the war on poverty.
Once the achievement of greater equality of disposable income as a policy goal, the policy instruments by which this goal be achieved need to be determined. Roughly speaking there are two classes of policy instruments by which this can be achieved. One by affecting factor payments from production, the other by a system of transfer payments.

There has been much discussion of broadening the tax system to provide transfer payments by right, the so-called negative income tax (Greens). Objections to the negative income tax are possible on two planes. One is the technical one that if the income guarantee is "adequate" a sizable disincentive effect may exist, therefore decreasing attainable real gross national product. The second set of objections are political and social; the creation of a large class of social residues men and women is not conducive to either social cohesion or domestic tranquility.

The virtues of the negative income tax are that it eliminates the stigma and costs of case load welfare and in principal it could provide adequate income for the economically inactive portion of the population. More base adequate welfare and pension schemes and, in addition, some way of guaranteeing such income protection as a right are necessary. But it is an admission of failure to make the economy return to social goals, seek to resort to taxation, transfers as a substitute for income from factor payments.

On the other hand, the position hypothesized to Henry Simons [13, 15] is that an enterprise economy tends to generate a distribution of income and wealth that is inconsistent
with the continuation of political democracy seems particularly relevant today. The solution to this dilemma proposed by Simons, an effective system of progressive income taxation and transfers, is as relevant for our time as it was for his. 

The distribution of income from factor payments can be treated in two stages: the first being the distribution of income between wages and profits, the second being the range or distribution of wage income. For problems of poverty it is the distribution of wage income that is most relevant, for problems of "equity" the classical problem of the distribution of income between wages and profits is relevant.

III. The "Crunch" and the Limitation to Aggregate Demand

The 1960's witness the apparent victory of Keynesian policy prescriptions. However an economy that has the attributes that we normally associate as follows the successful application of Keynesian policy may be inherently unstable. The instability of such an economy is not the result of a tendency to stagnate or enter into a deep depression state; rather it is due to a tendency to explode.

Between the end of World War II and the crunch of 1966 the American Economy operated within an optimistic expectation climate in which decision makers were increasingly expecting reasonably full employment to be maintained and to an increasing extent both households and businesses were expecting next year to be better than
this year. This trend in the expectational climate resulted in an explosively increasing demand for private investment in the mid 1950's. Prior to the mid 1950's, the financial system had enough slack and a sufficient volume of liquidity generating financial innovations to enable investment plans to be financed. This meant that ex-post-savings had to adjust to ex-ante investment. Not rising investment generates savings. During the 1950's when a nascent investment boom took place, the savings took place as a result of changes in the Federal government's budgetary position. This was due to the application of conventional fiscal programs in designing tax and spending policies, which not only increased expected future profitability but also that the savings necessary to offset rising private investment took place in the government sector. During the investment boom of the 1960's, this "modern" fiscal policy ideas replacing traditional quantities and "an accidental way" government expenditures and tax revenues did not "explode". Thus the savings to offset the explosion of private investment had to come from the private sector.

The "Kaldorian" (Kaldor) relation, in which the propensity to save out of profits is greater than the propensity to save out of household disposable income, combined with cyclical income fluctuations toward profits whereas savings must be generated in the private sector, This shift in savings...
The "Kaldorian" relation in which the propensity to save out of profits is greater than the propensity to save out of household disposable income means that income distribution shifts towards profits whereas savings must be generated in the private sector. One way in which this change in the distribution of income can take place is through inflation. A rise in...
Inflation increases so rapidly that insolvency of suppliers, capital and consumer goods becomes relevant, then prices rise. The rise in prices in excess of the rise in money wages lowers real wages. This classical inflation pattern in which savings are forced by rising pricesBowling is such was an element in the development of 1966 and is evident during an element in the continuing price pressure of 1967. Thus the "classical" (wage-arbitrage) but the determination distribution of income deteriorates during an investment boom. It is associated with a politically unstable inflation, inconsistent with problems of "equity". It is not easily contained in the empowerment distribution of income, which poverty, as a recent example of the "great recession". However, more important to our purposes, which, besides being characters of full employment, was the acceleration of inflation pressure by a large extent, the distribution of income. As the rate that a mini-financial crisis took place, with measured unemployment rates just below the 4\% mark. The transformation between the Bolles and policy account of Santos-aldrich's 4\% unemployment rate from an "inflation" target to a measure of full employment, when measured in aggregate demand yields such wage pressures that only rising prices result.

The apparent boom at the cost of the accelerated rise in prices during 1966 and 1967. However, the evidence is that wage increases were modest throughout most of 1966, the wage price guidelines broke more on the price than the wage 13. The prophecy of rising prices was fulfilled, but the mechanism was not that calculated by the Phillips curve. [Phillips 8]

The contrast between the characteristics of the wage explosion in 1962 and 1963 is the lag of private investment in the first three years and the explosive growth in private investment in the last three years. The
Private investment lagged in the first three years of the current expansion and virtually exploded in the second three years. This investment explosion put serious pressure upon financial markets even in the absence of Federal Reserve action. When the Federal Reserve system applied some constraint, a "mini-panic" occurred.
The "mini-panic" of 1966 can be interpreted as evidence that sustained full employment may result in such an explosive increase in investment demand that it becomes impossible to achieve the needed sustained growth in demand necessary for full employment. This is so because the investment boom is due to an "euphoric" expectations climate, and to break the investment boom it is necessary to change the expectations climate. Once the expectations climate is changed, all of the private sectors become sluggish. Only by accident would public demand increase sufficiently quickly so that a relatively deep recession would not follow such a change in expectations. Of course the deep depression ratifies the changed expectations and thus it will take time to rebuild confidence.
The destabilizing investment boom of the 1960s took place before unemployment rates were lowered to the levels characteristic of tight full employment. If such explosive investment booms are a characteristic of American Capitalism, then in order to achieve and sustain tight full employment, it is necessary to contain the potential investment boom. One possible way is to go direct demand that it does not generate a loose money inducement to invest. Another possibility is to directly control investment, either by licensing investment or by licensing access to financial markets.
IV. Impact of the Great Expansion Upon Income Distribution

An important characteristic of the present day American economy is the widespread belief, which has been validated by the overall performance of the economy since World War II, that next year will be better than this year. One way in which this "betterness" appears is in higher money incomes. Thus the union contract which specifies annual 'improvement' factors and the parallel wage increases for other workers. As long as the pattern of annual wage increases exists, changes in income distribution among wage earners will be due to the pattern of wage increases.

The evidence presented by Ulman ([Ulman 14]), mainly for post World War II years prior to the recent expansion, shows that a significant positive correlation exists between the original level of gross hourly earnings and the percentage change in gross hourly earnings. This contrasts with the findings for the depression and war years. [Ross and Goldner 38].

The evidence for the expansion of 1960-66 is mixed. By some measures it appears as if there has been no appreciable change, by others it appears there has been a slight decrease in the dispersion of relative earnings as if the dispersion of relative wages had decreased slightly.

The pattern of equal arithmetic increases in wages that occurred during World War II translates into geometric increases that are inversely related to the original wage level. Thus the range of wages, in geometric terms, decreased. During the early post-war period the range changed but little. Between 1953 and 1960, the years of increasing overall slack in labor markets, the range widened. Between 1960 and 1966 the range of weekly hourly wages has shown no real change. The dispersion as measured by the coefficient of variation has shown some narrowing over this period.
Our analysis of relative weekly wages taken in 1948, as its initial observation, is too close to the end of World War II, with its elaborate wage and price controls, to serve as a "model" for relative wages. However, 1948 was the terminal year for a protracted period of tight full employment. Between 1948 and 1961 the trend was toward higher unemployment rates. The expansion of 1961-66 saw aggregate unemployment rates fall from 6.7% to 3.8%. The question is whether the "slack" affects relative earnings, and whether the tightening over a six-year period also affects relative earnings. Does chronic labor market slack widen the range of weekly earnings among industries whereas a period of labor market tightening or tightness narrows the spread?

Relative earnings in the 21 two-digit manufacturing industries plus mining, contract construction, wholesale trade and retail trade were examined. For each year the average weekly wage in each of the 25 sectors was divided by average earnings in all manufacturing to get relative wages.

In 1948, weekly earnings in 4 industries (See Table 1) were in excess of 120% of the average earnings, and 3 industries exhibited earnings that were less than 80% of the base. In sharp contrast, in 1966 weekly earnings in 6 industries were in excess of 120% of all the manufacturing earnings and earnings in 6 industries were below 80% of the base. In other words, in 1948 of the 25 industries 13 were in the range weekly earnings in all manufacturing ± 20%, in 1966 only 13 were in this range. (using ± 10% of all the manufacturing earnings as the central group, in 1948 12 of the 25 industries were in the range whereas in 1966 only 9 were.)

Not only has there been a market thinning out of the middle of the range of weekly earnings by industry, but the minimum average weekly income as a ratio to the average has decreased. In 1948 only weekly earnings in
<table>
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</tbody>
</table>

Table 1

Weekly Factory Barterage at a Rate to Average

Source: Manpower Report of the President

Table 2

Weekly Factory Barterage at a Rate to Average
Tobacco Manufactures were below 70% of the average. In 1966 three industries exhibited weekly earnings lower than 70% of all manufacturing: these were Leather and Leather Goods, Apparel and Related Manufacturing, and Retail Trade.

Of the 10 industries with the highest weekly earnings in 1948, by 1966 seven increased their relative earnings, one exhibited no serious change and two (Mining and Printing and Publishing) had substantial relative declines. In spite of their decline relative to all manufacturing during this period, earnings in both Mining and Printing and Publishing were at 116% and 109% of the average for all manufacturing in 1966.

Of the 8 industries with the lowest relative wages in 1948, seven experienced a substantial decline in their relative wages by 1966. The exception Tobacco had the lowest average weekly earnings in 1948 (69% of the all manufacturing average earnings). By 1966 this ratio for Tobacco was 76%, and Tobacco manufactures were fifth from the bottom in weekly earnings.

Some of the declines in relative weekly earnings were really substantial. Earnings in Apparel fell from 82% to 61% of the average of all manufacturing. Furniture from 92% to 81%, Leather from 79% to 67%, Textiles from 82% to 73% and Lumber from 90% to 83%. In addition Retail trade fell from 78% to 61% and Miscellaneous Manufactures from 90% to 79%.

The 7 industries that ranked from 11th (Paper and Allied Products, relative earnings 103%) to 17th (Food, relative earnings 92%) in 1948 tended to show but slight changes in their relative earnings in the period to 1966. The relative earnings of Electrical Equipment dropped 6%, all the others remained approximately unchanged in relative earnings, that is the
year
terminal relative earning was ± 0.03% of the initial relative earnings.

Thus over the period 1948–66 for the industries examined the rich
tended to get richer, the poor poorer and those in the middle tended to
hold their own.

If we break the period 1948–66 into subperiods 1948–53, 1953–60
and 1960–66 we see that the spreading of relative weekly earnings and the
thinning out of the middle range occurred during each period, although at
an accelerated rate since 1953. Whereas in 1948 weekly earnings in
18 industries were in the range 80% to 119% of the average in all manu-
facturing, in 1953 17 industries, in 1960 15 industries and in 1966 13
industries were in the middle range. (Table 2)

The increase in the spread of relative earnings in the United States
since 1948 seems to be mainly due to the relative retardation in the
increase in earnings in what were already low wage industries. The relative
retardation of what were two high earning industries in 1948, Mining and
Printing and Publishing, may be perhaps mainly due to technological changes,
although the relative retardation of earnings in mining is a part of
today's rural poverty scene.

Many of the industries in which relative wages declined between 1948
and 1966 were "sick" for part or all of this period. In the case of the
Textile, Apparel, Leather and Furniture industries one response to the industri
difficulties was a rather large scale migration from major metropolitan
centers and their historical areas toward small towns and the South.

A theorem seems to fall out of the experience of the postwar period.
Marked declines in relative earnings in an industry will be accompanied
by changes in the location of the plants in the industry.
Table 2
Average Weekly Earnings
21 Manufacturing Industries, Mining, Construction and Trade
Distribution of Relative Wages (All Manufacturing = 100)
1948, 1953, 1960, 1966

Number of Industries

<table>
<thead>
<tr>
<th>Weekly Wage as a % of All Manufacturing</th>
<th>1948</th>
<th>1953</th>
<th>1960</th>
<th>1966</th>
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</thead>
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<td>+ 120%</td>
<td>4</td>
<td>3</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>1.100 - 1.199</td>
<td>3</td>
<td>5</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>1.000 - 1.099</td>
<td>8</td>
<td>6</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td>.900 - .999</td>
<td>4</td>
<td>3</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>.800 - .899</td>
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<td>.700 - .799</td>
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<td>3</td>
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<td>&lt; .699</td>
<td>1</td>
<td>2</td>
<td>3</td>
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Source: Table 1
The maintenance, or even a continuation of the thinning out trend, during the expansion of 1961-66 is evidence that the supply curves of labor to the industries with low relative wages remained highly elastic as the overall unemployment rate decreased. This may reflect their locational advantages: with the continuing migration from rural areas, the advantageously located low wage industries may in fact be operating with a huge reservoir of labor, responsive to job opportunities at unchanging mark-ups over rural incomes.

As measured by the coefficient of variation, the spread of hourly earnings decreased slightly between 1960 and 1966, after increasing between 1948-53 and 1953-60. In spite of this, the coefficient of variation for weekly earnings increased. Thus hours worked were positively correlated with earnings so that the distribution of weekly earnings had a wider range than the distribution of hourly earnings. Inasmuch as it is earnings over a period, not the hourly rate, that is important in determining "poverty status," the minor drawing together of hourly rates that occurred during the expansion was offset by the change in relative hours worked.

An additional point worth noting. The 1960-66 period was the era of wage-price guidelines which stated "acceptable" wage increases as a percentage change: this type of wage increases would tend to stabilize the relative earnings patterns. In spite of the guidelines the evidence is that the dispersion increased.

To summarize: it appears as if the range of relative weekly earnings increased over the postwar period. This increase may have been a response to the rising relative slack in the labor market that dominated the scene through 1960. The modest tightening of the labor market since that date has not reversed the widening of the range of relative earnings. Thus if the concern about poverty is translated into a concern about relative
earnings, it may be necessary to supplement aggregative economic policies with programs designed to narrow the range of earnings from jobs.
V. Leading Sectors in Generating Aggregate Demand and Income Distribution

Aggregate demand has a structure, and this structure in turn generates the particular (including regional) demands for products and factors. The government impact upon aggregate demand also has a structure. As long as income distribution is a 'minor' or better an 'unmentionable' policy goal, then the impact upon income distribution of the particular structure of government programs cannot be ignored. Once the achievement of some maximum inequality of income becomes a social imperative, then the way in which government affects income distribution becomes a factor in determining what government does.

A number of factors have combined to create the "shortages in the midst of surpluses" labor markets of the past 10 to 15 years, and the resultant spreading of relative incomes. One has been the peculiar pattern of government demand. It is only necessary to note the way in which government spending on research and development has grown and to combine this with the growth of spending on education to recognize that leading sectors, in terms of the growth of aggregate demand, have generated initial demand for highly skilled professional and technical labor. Although the extent of government is large, the movement of Negroes from the rural South has generated a large "nay infinitely elastic" supply of unskilled and semi-skilled workers in the cities. The disturbing results reported by Batchelder [Batchelder 2], that Negro male incomes deteriorated relative to white male incomes between 1950 and 1960 within the relevant cells indicates that the average wages...
by industry as used in the previous section, may be increasing spreads of incomes within each industry.

A third factor tending to spread relative earnings has been the stop-go nature of many facets of the economy since World War II. Over this period, on the whole, the American economy has done well. There have been no deep and long depressions and to date inflation has been episodic rather than chronic. However this overall 'smoothness' was the result of a series of stop-go developments in various sectors. Not only has the country engaged in two 'minor' wars, but the leading sectors have shifted from general defense, to missiles, to space, to private investment with great rapidity. Each time a new government program, be it highways or aid to education or moon shots gets under way, local excess demand for labor is generated.

The impact of new leading sectors upon wages is different from a rise in employment that takes the form of rehiring previously employed workers or from the expansion of conventional industries. Rehiring plus expansion within a set of stable industries and occupations is in sharp contrast to the volatile and shifting patterns of the post-war period. Whereas railroad investment may have been a leading sector for the better part of a century, leading sectors of the post World War II period have often been short-lived.

We can assume a mechanism such that if local demand for labor exceeds supply, wages rise [Lipsey 5], [Schultz 10]. In addition, wage increases in a sector will generate wage increases in other sectors, even in the face of labor market slack. This is so because productivity of labor is a function of 'morale', and a decline in relative wages adversely affects morale. However in the presence of slack percentage increases will be lower than in the absence of
If a series of stop-go shocks occur and if these shocks all have their major initial labor market impact upon a restricted set of labor markets, then the income in this restricted set of labor markets will rise relative to others. If these repeated impacts occur upon what are already high wage industries and occupations then the distribution of income will be adversely affected.

I have not been able to test whether the pattern of aggregate demand creation has affected the distribution of income by such continuing impacts upon the demand for particular classes of workers. It would be necessary to have detailed occupational income data and a way of transforming each period's leading sector into rapidly rising demand for labor in particular categories to check this hypothesis.

From the way in which increases in aggregate demand have been generated, including the tax cut of 1964, we not only have been following a trickle down policy, but the trickling down has been upon a rapidly growing sector of the population: the urban unskilled worker.
VI. Policy Suggestions

From the above I extract two propositions which are relevant to policy formation:

1) That the American economy as presently organized is not capable of achieving and sustaining tight full employment.

2) Within the employment limitations of the economy, there is no significant tendency toward a narrowing of the spread of relative income from labor.

I add to the above that a narrowing of the spread of income from labor is necessary.

If the post World War II pattern of leading sectors determining aggregate demand leads to a perverse change in the distribution of income, then we ought to consider changing the pattern of leading sectors. A suggestion of real merit is that the government become an employer of last resort.

One attribute of such a top employer is that when the terms upon which it will employ are set, the minimum wage for all is determined. There is no longer any question about the 'coverage' of minimum wage legislation. In addition the minimum wage set in this manner does not have an adverse effect upon employment, as true for the present minimum wage legislation. The relative size of the wage set by the employer of last resort determines the division of the labor force between the private and the public sectors.

In a world where the expectation is that nominal wages will increase each year, it will be necessary to have some improvement factor in the terms upon which the employer of last resort hires. If the improvement factor for the employer of last resort rises at a faster rate than average and above average wages, the range of relative wages decreases. In time by such differential rates of change a target ratio between the minimum and average can be achieved.
To the extent that the high wage workers nominal income rises at some 'productivity rate', the low wage workers nominal income will need to rise at some faster rate: there may be an inflationary bias in an income policy that takes as one of its imperatives the achievement of greater equality. In addition it will be necessary to restrain profits and investment, in particularly the highly destabilizing tendency for investment demand to explode will have to be brought under control.
Much experimentation with tap employment policies — with its equivalent, the creation of programs which will have their major initial impact upon present surplus labor will be needed. However the objective is clear; it is to take the labor force as it is and make sure that fitting jobs are available. Instead of the demand for the low wage worker trickling down from the demand for the high wage worker, the policy objective should be to have increments of demand for present high wage workers "bubble up" from the demand for low wage workers. Government demand-generating programs, whether they be tax or spending, need to be evaluated in terms of their impact upon income distribution. A new set of results to benefit cost analyses of project result once the objective function is broadened to include the hard but basic task of achieving an income distribution compatible with domestic peace and tranquility.
Although we currently view the crisis in income distribution as centering around the urban slums, much of poverty is rural. An employer of last resort, willing and able to hire all who offer to work, will have a large impact on the poorer rural areas. One effect of such a employment policy will be to slow down the pace of migration to the urban complexes. It is possible that many of the urban problems are related to the rapid rate of migration, such a retaining effect following from an employer of last resort will be an added virtue.
Bibliography


