BY OUR OWN BOOTSTRAPS

Economic Opportunity
&
the Dynamics of Income Distribution

Federal Reserve Bank of Dallas

ANNUAL REPORT

Nineteen Hundred and Ninety-Five

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A Letter from the
PRESIDENT

THAT GOOD-LOOKING FELLOW IN THE PICTURE BELOW IS ME, STANDING IN front of my family home in June 1949. My only memory of that house is returning from school one day and discovering that it was missing. I had forgotten that it was to be moved that day about a quarter-mile up the road. Once it was relocated, my dad added a couple more rooms to it. A few years later, when his income permitted, he expanded the other side of the house.

Later, we bricked it and added more rooms, plus a carport that I helped my dad build by hauling dirt to it, one wheelbarrow load at a time. It took all summer.

I think of that house and the way it grew over time as a metaphor for income growth, the topic of this year's annual report essay. My dad's was no Horatio Alger story, but his income probably rose from the lowest rung of the income distribution to the highest during his working life and then back down a notch or two. This year's essay, which looks at economic opportunity and the dynamics of income distribution, suggests that my dad's experience is more common than is generally realized. The American way is to start off at the bottom and work your way up.

Judging from the public debate, I believe many of the recent news accounts about growing income disparity are somewhat exaggerated. One fact that is missing in most of what has been written on recent income trends is that income levels are not static—there is much movement in the income classes over time. Specifically, to a much greater extent than one might expect, this year's poor may be next year's middle-income person and a high-income person the year after that. Today's poor are often tomorrow's rich. It works the other way, too, of course, as exemplified by the late-1980s joke about the easiest way to become a Texas millionaire: start out as a Texas billionaire.

While the evidence does suggest that the upper income levels have been growing relative to the lower levels, it's not that the rich are getting richer and the poor are getting poorer—both are getting richer, on average, just not at the same rate.

What's encouraging, however, is that most lower income households do rise through the income distribution, with a healthy percentage of them making it all the way to the top. That's what America is all about—the opportunity to end up ahead of where you started.

Robert D. McTeer, Jr.

ROBERT D. MCTEER, JR.
President & Chief Executive Officer

BY OUR OWN BOOTSTRAPS

Economic Opportunity & the Dynamics of Income Distribution

THE LAND OF OPPORTUNITY. ANYWHERE IN THE WORLD, THOSE WORDS bring to mind just one place—the United States of America. Opportunity defines our heritage. Waves of immigrant farmers, shopkeepers, laborers and entrepreneurs came to America for the promise of a better life. Some amassed enormous fortunes—the Rockefellers, the Carnegies, the Du Ponts, the Fords, the Vanderbilts. Many millions more, descendants of those who arrived in the New World with little more than the clothes on their backs, improved their lot in life through talent and hard work.

Opportunity permeates our folklore. There's no better example than the 120 novels Horatio Alger churned out in the years after the Civil War, all featuring ordinary boys going from rags to riches. His tales of luck and pluck so touched the national psyche that the writer's name became shorthand for achieving success.

Even today, opportunity is rarely far from our experience. Most Americans are familiar with dozens of real-life Horatio Alger stories—Sam Walton, Ross Perot, Bill Cosby, Mary Kay Ash, to

by W. Michael Cox & Richard Alm

mention just a few of the famous. They catapulted themselves from the lower or middle ranks to the top.

Although millions of people still manage to make the American Dream their reality, a dissonant chorus can be heard mourning the United States as the Land of Opportunity Lost. It's hard to ignore their litany of the crises of our times:

•The rich are getting richer, and the poor are getting poorer. Most of us are getting nowhere.

•Upward mobility is the privilege of a select few, those lucky enough to win at life's lottery.

•The middle class is vanishing.

•Today's 20-something job-seekers face meager prospects and may be the first Americans in history not to live as well as their parents.

What these skeptics typically offer up as evidence of ebbing opportunity is the distribution of income—the slicing up of the American pie. They seize on two points. First, there's a marked inequality in earnings between society's "haves" and its "have-nots." Second, and perhaps more ominous, the gap between the richest and poorest households has widened over the past two decades.

The Census Bureau provides statistical support for these claims.[1] In 1994, the latest year for which data are available, the top 20 percent—or quintile—of American households received almost half of the nation's income. Average earnings among this group were $103,253 a year. The shares of the national income going to the next three-fifths, in descending order, were 23.4 percent, with an average of $49,114; 15 percent, with an average of $31,562; and 8.9 percent, with an average of $18,735. The bottom fifth had just 3.6 percent of the economic pie, or an average of $7,565 a year. (See Exhibit 1.)

Evidence of increasing dispersion emerges from the same Census Bureau data. (See Exhibit 2.) The lowest 20 percent of income earners saw their share fall from 4.2 percent in 1975 to 3.6 percent in 1994. Over the same period, the distribution to the middle three-fifths also slipped. Only the top fifth increased

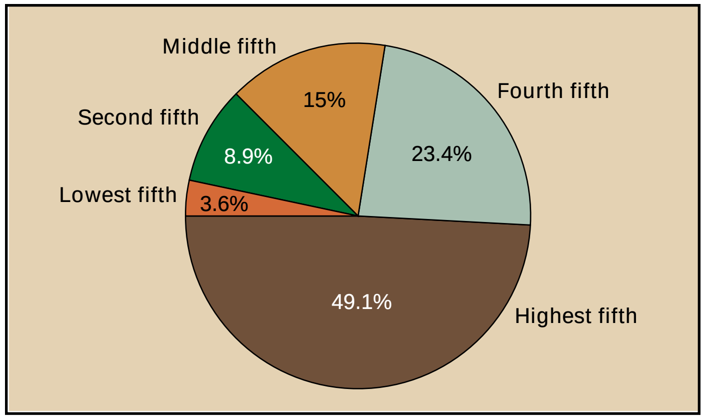


Exhibit 1
SLICING UP THE AMERICAN PIE

In 1994, the highest earning fifth of American households received 49.1 percent of the country's total income, while the bottom fifth received only 3.6 percent.

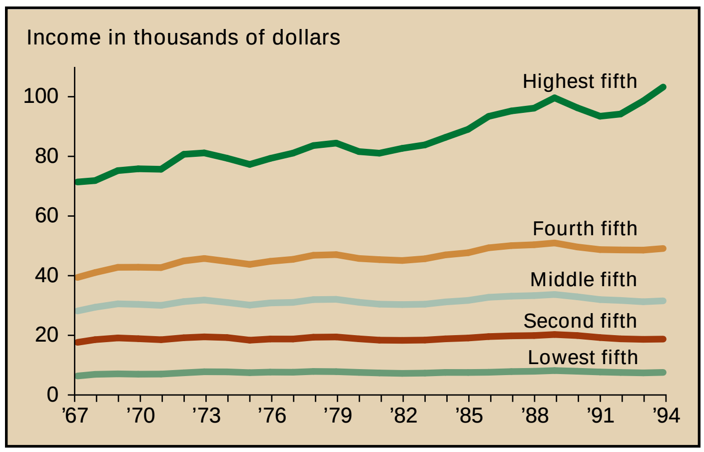


Exhibit 2
A CASTE SOCIETY?

Real mean income of households in the lowest fifth today is little higher than that of the lowest fifth 27 years ago. Today's households in the highest fifth, on the other hand, have 45 percent more income than those in the highest fifth in 1967.

[1] For consistency and to allow inflation-adjusted (real) comparisons, all money figures in this report are expressed in 1993 dollars unless otherwise noted.

their piece of the nation's income, rising from 43.7 percent in 1975 to 49.1 percent in 1994. The shift of income toward the upper end of the distribution looks even more striking when put into dollar figures. After adjusting for inflation, income of households in the lowest quintile rose only $87 from 1975 to 1994. The top tier, meanwhile, jumped $25,934.

This picture of the income distribution would be useful if America were a caste society with rigid class lines keeping those in the bottom today there tomorrow. But if ours is not a caste society, such statistics tell us virtually nothing—particularly about opportunity. By nature, opportunity is personal, an assessment of how well-off you can be tomorrow relative to today. Even the most sophisticated income distribution studies fail to tell us what we really want to know: are most Americans losing their birthright—a chance at upward mobility?

PUTTING THE HORSE BEFORE THE CART

Mobility first, then distribution

Judging from the public debate, some Americans seem to prefer a more equal distribution of income to a less equal one, perhaps on moralistic grounds, perhaps as part of an ideal of civic virtue, perhaps to avoid any overtones of class conflict.

The notion that a more equal distribution of income is a better one may appeal to philosophers or social planners, but there's no economic reason to prefer one ranking of incomes to another. In and of itself, the income distribution doesn't say much about the performance of an economy or the opportunities it offers. A widening gap isn't necessarily a sign of failure, nor is a narrowing gap a sure sign an economy is functioning well. It's a heroic leap of logic to conclude, after looking at increasing disparity between rich and poor, that Americans' opportunities aren't what they once were. Economists can point to a number of forces and trends that tilt the income distribution one way or another, many of them not bad news at all. (See Exhibit 3.)

It's quite common to find a widening of the income distribution in boom times, when almost everyone's earnings are rising rapidly. All it takes is some incomes rising more rapidly than others. On the other hand, the distribution can narrow when most income earners are experiencing hard times. In fact, compression of incomes is often what we observe in poorer countries.

Most important, a static portrait of income shares doesn't answer the question of whether low-income households are getting better or worse off over time. By definition, there will always be a bottom 20 percent, but only in a strict caste society will it contain the same individuals and families year after year. To decide that upward mobility has been lost in America, the evidence must show that the poor, for the large part, remain stuck where they are and that there's little hope of climbing up the income ladder.

In short, between opportunity and equality, it's opportunity that matters most. The prospect of upward income mobility is what individuals seek—indeed, that's what powers the whole economic system. Income's distribution comes second, both in order and importance.

To gauge opportunity in America, we need data on individuals over time. Income distribution studies aren't much help because they lump together a hodgepodge of ages, educational levels, work effort, family and marital status, gender, race and so much more. The sample never stays the same from one year to another, and researchers have no way of knowing what happened to particular members of any quintile. How many people worked their way up? How many remained at society's bottom year after year? Cross-sectional income studies can't say.

A better approach involves identifying individuals and tracking each of them year after year, capturing the ups and downs in income over a lifetime. When combined with personal data, such as age, education

Exhibit 3

Inequality Is Not Inequity

In the early 1970s, three groups of unemployed Canadians, all in their 20s, all with at least 12 years of schooling, volunteered to take up residence in a stylized economy where the only employment was making woolen belts on small hand looms. They could work as much or as little as they liked, earning $2.50 for each belt. After 98 days, the results were anything but equal: 37.2 percent of the economy's income went to the 20 percent with the highest earnings. The bottom 20 percent received only 6.6 percent.

This economic microcosm tells us one thing: even among similar people with identical work options, differences in talent, motivation and preferences will lead some workers to earn more than others. Income inequality isn't some quirk or some aberration. Quite the opposite, it's perfectly consistent with the economic laws that govern a free enterprise system.

Equality of opportunity doesn't yield equality of results. Inequality is not inequity.

In a complex modern economy, there are plenty of reasons for incomes to vary, and most of them have little to do with issues of fairness or equity. Among the most important factors are:

Education, experience. The lifetime earnings profile tracks income for various age groups. As an economy becomes more advanced, there are usually increasing rewards for education and experience, so earnings rise faster over a typical lifetime. As that happens, there's increasing diversity in income.

Two-income households. Obviously, two workers can earn more than one. The trend toward both spouses working creates some higher income households. As families choose different lifestyles, the income distribution will grow more unequal, even if individual incomes don't change at all.

Baby-boom demographics. A bulge in the population can alter a society's income distribution. When the baby boom first enters the labor force, it floods the economy with lower income workers. As the generation ages, entering peak earning years, it provides a disproportionate number of high-income households. In both cases, the distribution becomes skewed, first toward lower incomes and then toward higher incomes.

A greater "churn." A healthy economy grows by creating new, better and more affordable products. The process creates new industries and new jobs. They replace jobs in fading sectors. Economists call this the "churn." It makes society better off, and it produces big gains for entrepreneurs and higher incomes for most workers. For others, there will be spells of unemployment and downward mobility. When there are larger ups and downs in income, the distribution is likely to spread.

Longer retirements. Individuals who anticipate longer periods of retirement will, on average, accumulate more assets during their working lives and earn more interest. The income of middle-aged workers will rise relative to that of the young, once again widening the distribution.

Higher rates of return on assets. If accumulation of assets increases income disparity, higher rates of return on investment will do the same because those assets will produce more income.

A wealthier society. Once a society progresses to the point where most people can afford food, clothing, shelter and other necessities, some people choose to work harder for luxuries, while others opt to enjoy more leisure. When people make different choices about goods versus leisure, the income distribution pulls apart.

No one ought to be surprised that these are trends that have reshaped the U.S. income distribution over the past two decades. Although most of them widen the income distribution, none necessarily entails lower income households becoming worse off.

and marital status, individual earnings profiles pinpoint changes on life's journey, so researchers can see a person's income go up, down or stay the same.

INCOME MOBILITY IN AMERICA, 1975–91
Evidence from the data

In a mobile, fast-changing society, it's no easy task to collect data on individuals over a long period of time. All the statistical mills in government and private industry produce precious little information on lifetime earnings. One source of data, however, can shed some light on the patterns of income—the University of Michigan's Panel Survey on Income Dynamics, the longest tracking study ever done on Americans' earnings. Since 1968, the University of Michigan's pollsters have collected detailed information on a total of 50,915 Americans. This mass of data, carefully designed to replicate the characteristics of the population as a whole, has over the years served as the basis for hundreds of studies.

Not all the respondents in the University of Michigan survey are suitable for testing the degree of income mobility in the United States. The focus should be on those earning money or seeking to earn money—what the government calls "active" members of the labor force. That includes the employed, those laid off, the unemployed, students and retirees. Those at home maintaining a family aren't included, largely because that decision is a personal one that says little about the economy's opportunities. Also left out are children (youth under 16), prisoners, military personnel, the permanently disabled and the mentally ill. The Census Bureau uses these same exclusions for its income distribution studies.

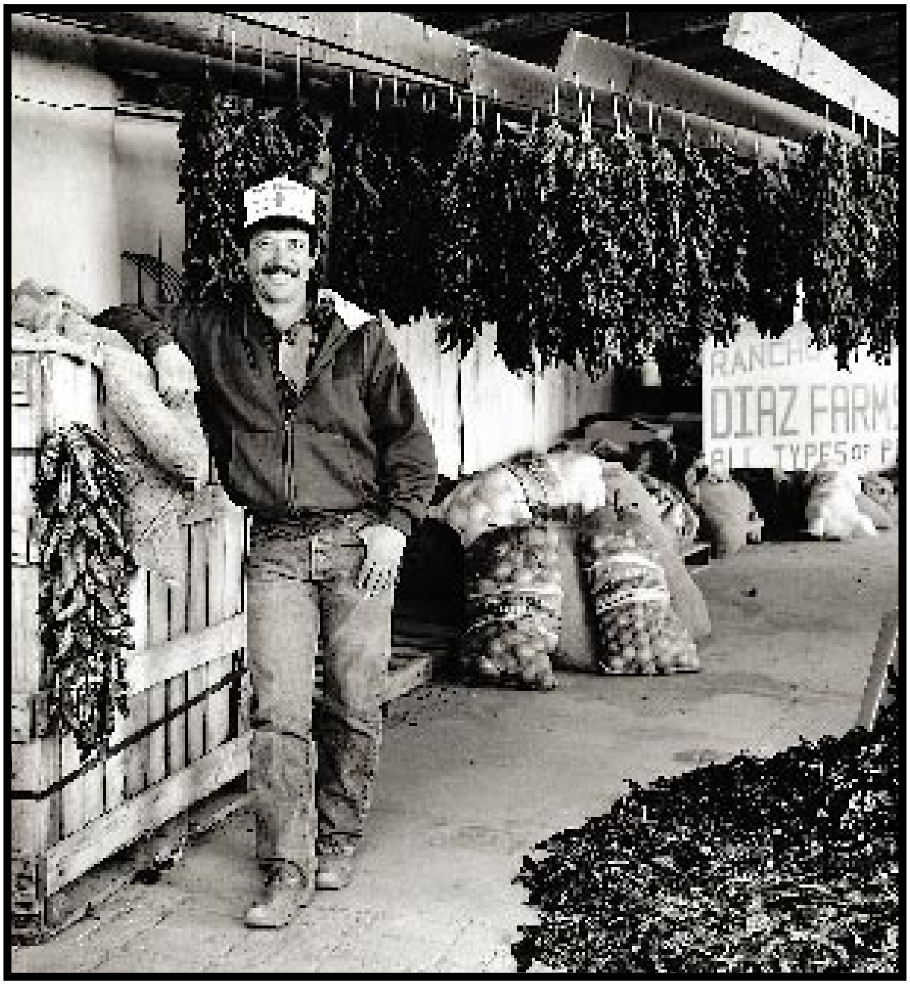
Analyzing income mobility requires one additional step—identifying those respondents who reported their income to the University of Michigan's survey over a long period of time. Many people failed to report once or more. Some dropped out and others were added. Only long strings of uninterrupted observations will show us what's really happening to incomes in America. Although respondents had to report every year, they didn't have to earn income. Using the standard government definition, income includes wages, investment earnings, pensions and government transfers such as Social Security, unemployment benefits and welfare.

The University of Michigan's income data collected before 1975 aren't compatible with later observations. Results after 1991 aren't yet in final form. The best longitudinal sample that can be put together consists of 3,725 individuals for the 17 years from 1975 to 1991. This sample may seem small, but most social science research relies on similar-sized, or even smaller, slices of the population. Even Census Bureau studies of the income distribution rely on relatively few people, rather than the entire country. What's important is that a sample offer a good proxy for the characteristics of the population as a whole—and this one does.[2]

Tracking individuals' incomes over time gives a startlingly different view of the forces shaping America's income distribution. Let's begin with the people who were in the bottom fifth of income earners in 1975. The conventional view leads us to think they were worse off in the 1990s. Nothing could be further from the truth. In the University of Michigan sample, only 5 percent of those in the bottom quintile in 1975 were still there in 1991.

Even more important, a majority of these people had made it to the top 60 percent of the income distribution—middle class or better—over that 16-year span. Almost 29 percent of them rose to the top

[2] Examination of this sample's income distribution for 1975 reveals that it approximates the distribution reported for "persons" in the Census Bureau studies.



EDDIE DIAZ

Partner, NEW MEXICO CHILI PRODUCTS, Deming, New Mexico

FOR THE DIAZ FAMILY, MONUMENTAL SUCCESS OR FAILURE ISN'T A once- or twice-in-a-lifetime experience—it's something that can happen every other growing season. "That's just an inherent part of the farming business," says Eddie Diaz, a first-generation American. "My father taught my brothers and sisters and me that to succeed in a land of opportunity, you've got to create opportunities for success where others might only see a chance to fail." In 1978, the Diaz family had to do just that, after poor market conditions forced them out of the cotton- and sorghum-growing business they had been in for more than a decade. ❡ Enter chili peppers, a crop that does extremely well in southeastern New Mexico but one the Diaz family had never grown before. Initially successful because of the increasing popularity of Mexican food, the family soon realized they were losing too much money to middlemen. That's when the family took another step that many considered too risky and launched New Mexico Chili Products, a company that processes and distributes dehydrated chilies directly to its customers. Going from processing 200,000 pounds a year when they started in 1992 to 4.5 million pounds today, the Diaz family nonetheless knows they can't rest on any laurels. "You can't dream the American Dream," says Diaz. "You've got to live it."

quintile. This is a far cry from the popular vision of a society in which the poor are getting poorer. In fact, the evidence suggests that low income is largely a transitory experience for those willing to work, a place where people may visit but rarely choose to live. (See Exhibit 4.)

There's further evidence that being in the low-income bracket isn't, for a large majority of people, permanent. Less than 0.5 percent of the sample showed up in the bottom quintile every year from 1975 to 1991.[3] Nearly a quarter of those in the bottom tier in 1975 moved up the next year and never again returned. More than three-quarters of the lowest 20 percent in 1975 made it into the top 40 percent of income earners for at least one year by 1991. In fact, the poor made the most dramatic gains in the income distribution. Those who started in the bottom quintile in 1975 had a $25,322 average gain in real income by 1991. In the top quintile, the increase was $3,974. In other words, the rich have gotten a little richer, but the poor have gotten much richer. (See Exhibit 5.)

The patterns are similar in other quintiles. Among the second poorest quintile in 1975, more than 70 percent had moved to a higher bracket by 1991—with 26 percent going all the way to the top tier. From the middle grouping, almost half of the income earners managed to make themselves better off. A third of the people in the second highest quintile made it to the highest fifth during these 17 years. All through the University of Michigan data, there's a consistent, powerful thrust toward the top of the income distribution.

Income quintile in 1975	Percent in each quintile in 1991				
	1st	2nd	3rd	4th	5th
5th (highest)	.9	2.8	10.2	23.6	62.5
4th	1.9	9.3	18.8	32.6	37.4
3rd (middle)	3.3	19.3	28.3	30.1	19.0
2nd	4.2	23.5	20.3	25.2	26.8
1st (lowest)	5.1	14.6	21.0	30.3	29.0

Exhibit 4
MOVING ON UP

Of individuals who were in the lowest income quintile in 1975, 5.1 percent were still there in 1991, 14.6 percent had moved up to the second quintile, 21 percent to the middle quintile, 30.3 percent to the fourth quintile and 29 percent to the highest quintile. Of those in the highest quintile in 1975, 62.5 percent were still there in 1991, while 0.9 percent had fallen all the way to the bottom fifth.

Income quintile in 1975	Average income in 1975	Average income in 1991	Absolute gain
5th (highest)	$45,704	$49,678	$ 3,974
4th	22,423	31,292	8,869
3rd (middle)	13,030	22,304	9,274
2nd	6,291	28,373	22,082
1st (lowest)	1,153	26,475	25,322

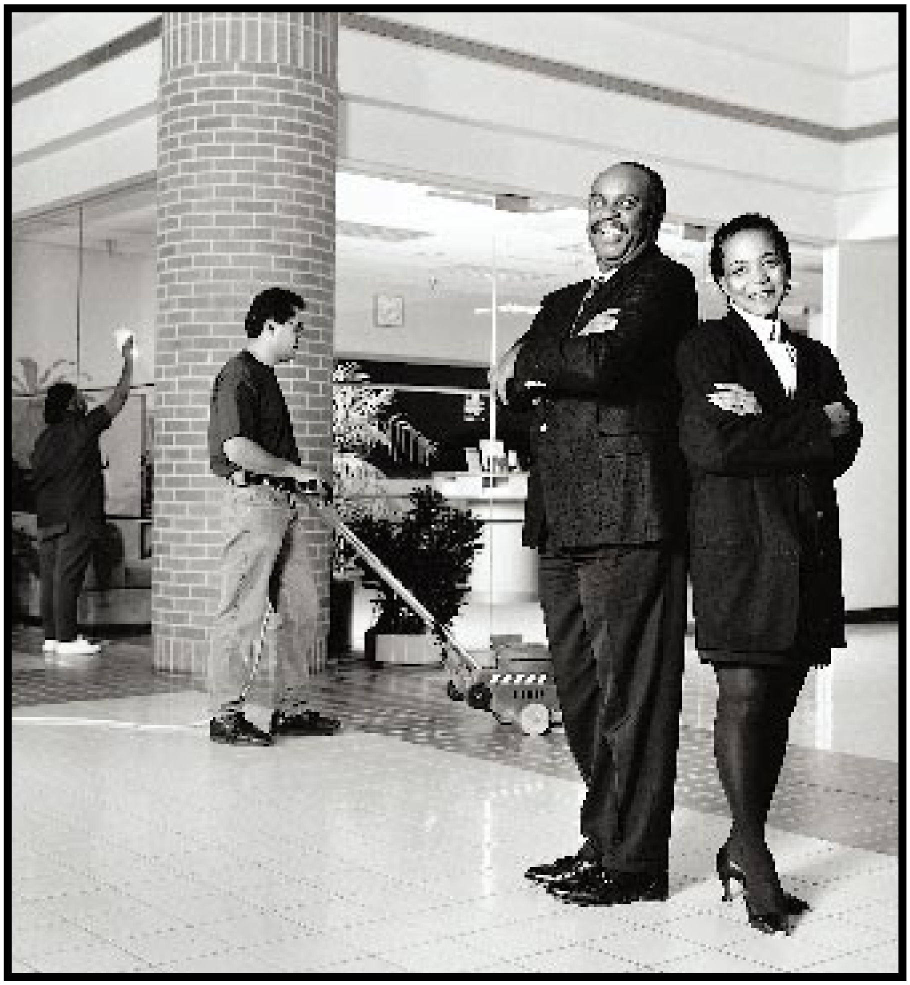
Figures are in 1993 dollars.

Exhibit 5
THE POOR ARE GETTING RICHER FASTER

Individuals in the lowest income quintile in 1975 saw, on average, a $25,322 rise in their real income over the 16 years from 1975 to 1991. Those in the highest income quintile had a $3,974 increase in real income, on average. The rich got richer, but the poor got richer faster.

The sample shows, too, that the rise in income can be swift, especially for those with education and skills. More than half of those in the lowest quintile in 1975 had reached the top three tiers within four years. Two-thirds made that leap within six years, and three-fourths did it in nine years. Not surprisingly, it's the young who move up most quickly, particularly those who get an education. Among respondents 20 to 24 years old in 1975, workers who finished college saw their real income rise fivefold, from $7,711

[3] According to Census Bureau data, the median duration of "poverty spells" is only about seven months for those with no work disability.



RON & PAM JONES

Owners, HANDY ANDY JANITORIAL, Plano, Texas

IN 1986, RON JONES FOUND HIMSELF WITHOUT A FULL-TIME JOB for the first time in his professional life, courtesy of middle-management downsizing at a major oil company. Like thousands of others across corporate America, he was left with a wealth of management experience but nothing to manage. When he was 13, Jones had started working evenings and weekends for his uncle in the commercial cleaning business, a job he kept until the oil company transferred him from Oklahoma to Massachusetts in 1983. So when "early retirement" forced him back into the job market, Jones decided to parlay the part-time work he'd done for his uncle into full-time work for himself, and he and his wife moved to Dallas to start Handy Andy Janitorial. ❡ What began as a two-person company earning $32 a month is today a 190-person company servicing 35 office buildings a week. "I grew up in a family where you worked hard," says Jones. "When my wife, Pam, and I started the company out of a spare room in our home, we used to wake up every morning around 7 o'clock to start calling on prospective clients, and we wouldn't get to sleep until after we finished cleaning buildings around 3 o'clock the next morning.…I guess it goes back to what my uncle used to tell me all the time when I was growing up: if you want your prayers answered, get off your knees and hustle."

to $40,303 in 1991. High school graduates doubled their income to $27,627. Even high school dropouts weren't completely shut off from opportunity. Their earnings rose, too, although much more slowly than those of any other group, going from $11,628 in 1975 to $19,091 in 1991. (See Exhibit 6.)

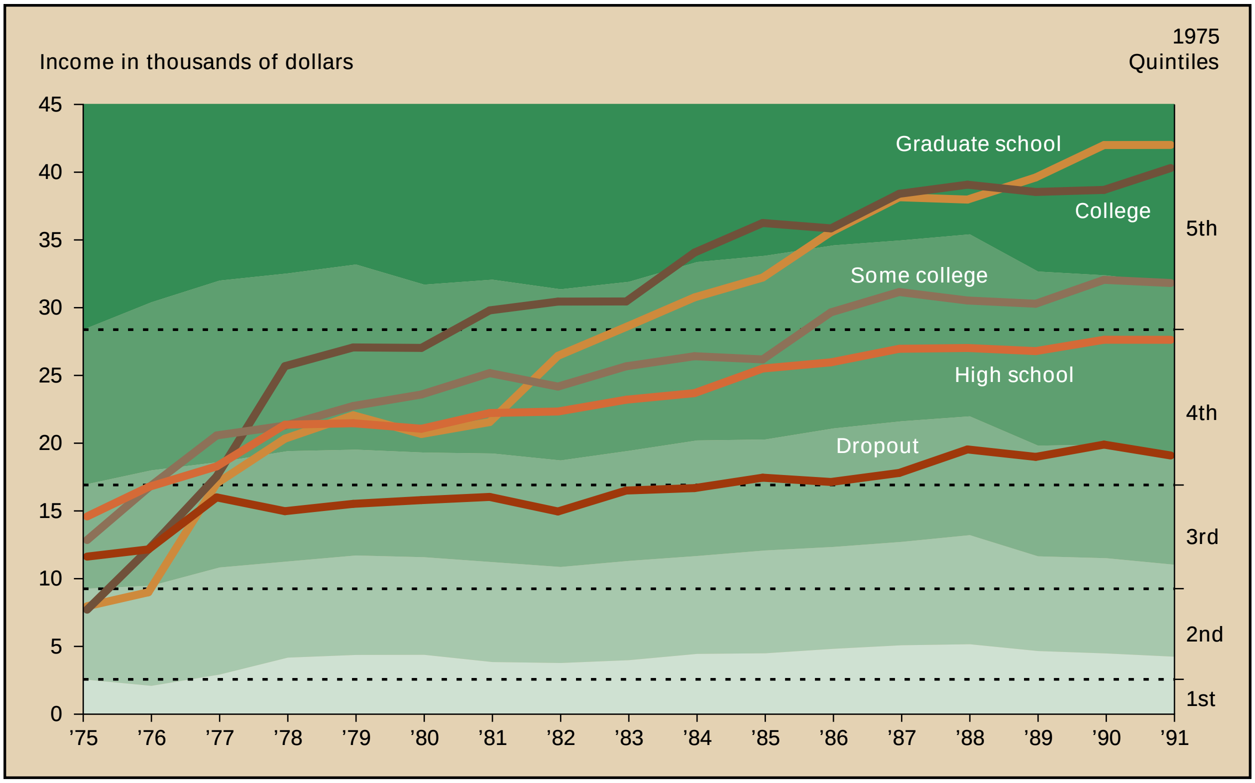


Exhibit 6

Education Pays, But Even Dropouts' Income Can Rise

Lifetime income tends to be highly related to education. Individuals aged 20 to 24 in 1975 who eventually graduated from college saw their real incomes increase $32,592, on average, over the period 1975–91, going from the next-to-the-lowest income quintile in 1975 to the top quintile in about 10 years. Those with only a high school diploma moved into the fourth income quintile after gaining a few years of work experience but tended to stay there throughout the 17-year period. By 1991, even most high school dropouts aged 20 to 24 in 1975 were able to enjoy a living standard comparable to that of the fourth income quintile in 1975, though they gained little relative to the whole population and lost ground when compared with their contemporaries who were better educated. The shaded areas show the (moving) five income quintiles over the 17-year period, while the dotted lines signify a fixed measure of living standards—the income quintiles of 1975.

The sample also tells us what happened to the "rich" of 1975. Nearly two-thirds of those in the top income quintile in 1975 could still be found in the top in 1991. Another 23 percent slipped just one bracket, leaving them in the top two-fifths of income earners. Less than 1 percent of the top fifth in 1975 plummeted all the way to the bottom of the income distribution by 1991. The trends suggest a comforting conclusion: once a household moves up the income ladder, it rarely gets pushed back down again.

What these findings reveal is that our economic system is biased toward *success*. When income mobility is examined for individuals over a long period of time, there's strong evidence to contradict notions of a society settled into stagnant income classes. No doubt, a fair amount of the upward mobility is due to young people completing their education and moving up. But you can't simultaneously count the young when compiling the numbers on poverty and omit them when figuring upward mobility. All people matter.

LIZ COKER

Chief Executive Officer, MINCO TECHNOLOGY LABS, Austin, Texas

LIZ COKER GREW UP POOR ON A LITTLE FARM IN THE FOOTHILLS of Tennessee. At 5 years old, she was milking cows and helping her father in the cotton and tobacco fields. "We were dirt poor, but then so were all of our neighbors," she recalls. "I didn't get my first store-bought dress until I was 14." By the time she was 15, Coker had quit school and gotten married. Four years later, she was a single mother working in a print shop in Dallas. She eventually landed a job at Texas Instruments, working on the production line during the day while waiting tables at night and on the weekends. In 1963, she became TI's first female engineering technician. Twelve years later, Coker left to join a start-up semiconductor company in California. Dissatisfied with how employees were being treated, she decided it was finally time to live her dream—to start her own company. After taking out a second mortgage, Coker persuaded investors to lend her $70,000 to start Minco Technology Labs, a company that processes and tests computer chips. "All the experts said the company wouldn't make it, but I didn't know any better," she says. The first full year of operation, the company did $3 million worth of business. This year, Coker expects to earn $16 million. "I never thought of failing," says Coker. "The way to make it in America is to roll up your sleeves and get to work."

TOO GOOD TO BE TRUE?
A second opinion from the Treasury

The University of Michigan data are not the only evidence that contradicts the prevailing pessimism. In 1992, the U.S. Treasury Department, using a similar income-tracking analysis, reached a similar conclusion. Significantly, the Treasury used an entirely different sample, a database of income tax returns from 14,351 households, so there's no chance this study merely offers another interpretation of the same data.

Covering the nine years from 1979 to 1988, the Treasury study found that 86 percent of those in the lowest income bracket moved to a higher grouping. Two-thirds of them reached the middle strata or above, with almost 15 percent making it all the way to the top fifth of income earners. Among people who started in other quintiles in 1979, there was similar movement up the income ladder. Nearly half of those in the middle tier, for example, rose into the top two groupings, overwhelming any downward mobility that took place. (See Exhibit 7.)

The Treasury study affirms that most Americans are still getting ahead in life. The University of Michigan data show more upward mobility, probably because they cover a period almost twice as long. Truncated at the nine-year mark, these data show just about the same upward movement as the Treasury data do, suggesting that upward mobility is a cumulative process that gathers momentum as years pass. In addition, it verifies that the quickest rise occurs among the young. The Treasury also found that wage and salary income was primarily responsible for pushing people upward in the distribution, indicating that work, not luck, is the widest path to opportunity. Ours is not a *Wheel of Fortune* economy.

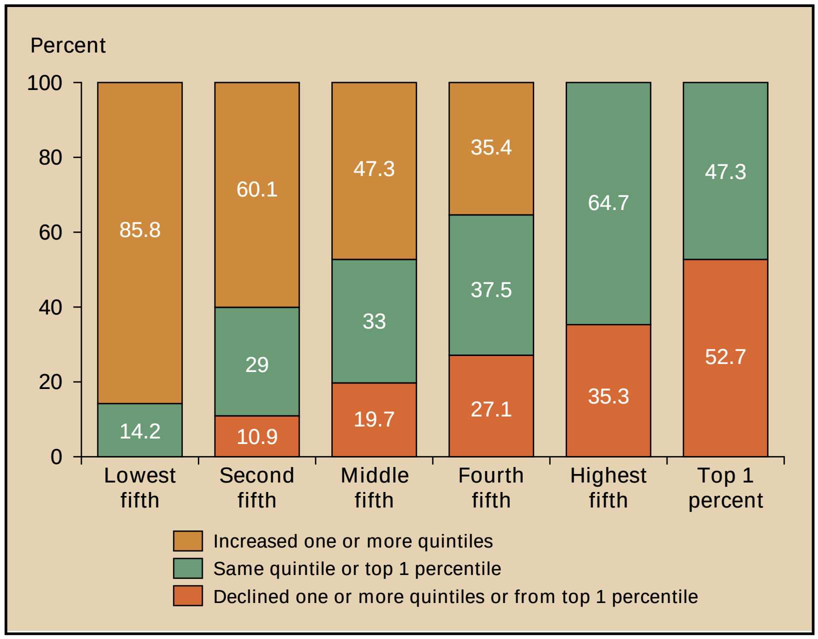


Exhibit 7
MOBILITY: A SECOND OPINION FROM THE TREASURY

According to a study completed in 1992 by the Treasury, 85.8 percent of households in the lowest income quintile in 1979 moved up one or more quintiles by 1988. Only 14.2 percent of those in the bottom in 1979 were still there nine years later. Of households in the middle fifth, 47.3 percent moved up and 19.7 percent moved down, while in the highest fifth, 35.3 percent moved down. Over half (52.7 percent) of households in the top 1 percent in 1979 had lost that status by 1988.

HOW MUCH UPWARD MOBILITY IN LIVING STANDARDS?

Although dynamic tracking studies offer a big advantage over static income distributions, they can still underestimate upward mobility in living standards. As a society gets richer, the quintile boundaries in the income distribution rise, so individuals are gaining even if they're staying put in the pecking order. A worker at the midpoint of the bottom 20 percent of income earners today, for example, lives better than someone in the same spot did two decades ago. When relative gains are mixed in with absolute, real gains, we

LE THI & HAI MINH HUYNH

Founders, FULTON SEAFOOD, Houston, Texas

WHEN HAI MINH HUYNH WAS 20, HE AND HIS FAMILY WERE IMPRISONED for eight months in Vietnam. His only crime was that he was not a communist. "Every day I would see young men, strong and healthy when they arrived, die from starvation," Huynh says. "We had to eat grass, roots, tree bark—anything that moved—to stay alive." ¶ When he was finally released, Huynh paid fishermen to help his family and him flee Vietnam. For seven months, they lived in a refugee camp until they received word that they were welcome in the United States. ¶ With the little money they had saved, Huynh and his wife opened Fulton Seafood in Houston, even though they knew nothing about the seafood business. "I bought a little dock in Louisiana and would buy from the Vietnamese fishermen there," he says, "while my wife ran the store in Houston. We had to live apart for seven years." ¶ In the beginning, things were tough—they had no customers, and Huynh's wife, who had no formal schooling and had been a street peddler since she was 13, couldn't speak English. But they believed in the American Dream—that if you work hard, you will make it. Today, Huynh's company is the largest seafood distributorship in Houston. "We love this country—it is the land of hope," Huynh says. "If you work hard in America, you will get rewarded."

Income quintile in 1975	Percent in each 1975 quintile in 1991: 1st	2nd	3rd	4th	5th	In 5th 1975 quintile sometime in 1976–91
5th (highest)	.3	2.5	7.7	20.1	69.4	98.4
4th	1.0	6.6	16.0	30.0	46.4	78.6
3rd (middle)	2.2	15.6	24.1	32.0	26.1	48.2
2nd	2.1	19.9	19.9	25.2	32.9	52.6
1st (lowest)	2.3	14.0	17.6	26.9	39.2	57.0

Exhibit 8
LIVING STANDARDS ON THE RISE

Judging by a constant measure of living standards—income quintiles of 1975—39.2 percent of those individuals in the lowest income quintile in 1975 managed, by 1991, to achieve a real income comparable to that of the highest income group in 1975. Only 2.3 percent of this group remained at a living standard equal to the lowest of 1975. Of those individuals who were at the highest living standard in 1975, 69.4 percent were able to at least maintain that standard.

can't tell how much of the rise in income is merely keeping up with the Joneses and how much of it is getting ahead of where we were.

Overall income in the United States has risen since 1975, so by 1991 the entire distribution in the University of Michigan data had moved upward. Using a constant yardstick—living standards prevailing in 1975—we can see the real gains. How many people are better off by this measure?

The absolute gains are even bigger than the relative ones. (See Exhibit 8.) Almost 98 percent of those in the bottom quintile in 1975 rose to a higher level over the next 17 years. Two-thirds of these people achieved a living standard better than what the middle fifth had in 1975. Every other income group exhibits the same strong upward push. Almost three-fifths of the people in the bottom fifth made it to the top at least one year during the period from 1976 to 1991.

By carefully tracking the path of individuals' incomes year by year, these results go a long way toward quelling fears that the United States is becoming a nation polarized between the privileged rich and permanently poor. What's particularly encouraging is the ability of those who start out in the lowest income brackets to jump into the middle and upper quintiles. There's evidence that most Americans are making their way up the income ladder through education, experience and hard work. (See Exhibit 9.)

That's what the American Dream is all about.

A COMMON THREAD

The profile of lifetime earnings

If so many Americans are rising through the income ranks, and if only a few of us stay stuck at the bottom, who makes up the lowest fifth of today's income earners? One group, of course, is the downwardly mobile, those who once earned enough to be in a higher quintile. Their descent can be voluntary, usually from retirement. Or it can be involuntary, resulting from layoffs or other hard luck. One other group is new entrants into the labor force—those adults previously outside the labor force and, predominantly, the young.[4] Most young people begin their working life as part of the bottom fifth, either as students with part-time jobs or as relatively unskilled entrants to the labor force.

Although they usually start at the bottom, the young tend to rise through the income distribution as

[4] There are four conceptually distinct groups that can enter to refill the lower and middle ranks as the sample here gains work experience and moves up. These are adults previously outside the labor force (those keeping house or in the military, for example) who enter permanently, the young who enter permanently, those who drop in and out of the labor force (but do not report their status as unemployed) and new immigrants.

Exhibit 9
Listen to Your Elders

Believe it or not, family fortune and luck aren't the way most Americans make their way toward the top. The experiences and choices of those who have prospered, as well as those who haven't, provide the basis for the following "secrets" on how to get ahead in life:

Get an education. Nearly half of those in the top 20 percent of income earners graduated from college, compared with just 4 percent of people in the bottom 20 percent. Only 2 percent of those in the highest tier dropped out of high school, but a fifth of the lowest income group failed to get a diploma. In 1993, median income of households headed by someone with a professional degree was $87,666. It drops to $51,480 for an undergraduate degree, $28,700 for a high school diploma and $16,067 for dropouts.

Get a job. Households in the top income quintile have, on average, 2.1 workers, compared with only 0.6 for the bottom fifth. Among the nonworking poor, only 13 percent say they are unable to find a job.

Work full-time, all year round. In the lowest fifth of income earners, 84 percent worked part time, worked less than half the year or did not work at all. Four-fifths of the top bracket worked 50 or more weeks of the year. Only 7 percent of part-time workers say they are looking for full-time work and unable to find it.

Save money. In the top income-earning quintile, median assets of households, excluding home equity, are $45,392. The bottom 20 percent has just $949. Not surprisingly, income from assets for the first group is 30 times what it is for the second. Savings can make a big difference, especially for retirement. For individuals 65 and older in the bottom quintile, 83 percent of income comes from Social Security and only 9 percent from savings. In the top bracket, earnings on savings account for 54 percent of income and Social Security for only 20 percent.

Form a family. Only 7 percent of the top fifth of income earners live in a "nonfamily" household. In the bottom fifth, 37 percent do. People can live more cheaply together than they can apart.

Be willing to move. The unemployment rate in McAllen, Texas, is 17.5 percent, whereas in Austin it is 3.5 percent. Wages can vary substantially, too, across regions. Geographical mobility is one way to close the income gap.

Be willing to retrain. Average hourly wages for computer programmers are $20.64, whereas for textile workers they are only $9.51. Jobs come and go as the economy evolves, often requiring that workers learn new skills to keep up with economic changes.

Get a computer. Workers who know how to operate a computer earn an average of 15 percent more than those who don't—and that's for doing the same job. The machine makes them more productive.

Stick to it. Average income tends to rise quickly in life as workers gain work experience and knowledge. Households headed by someone under age 25 average $15,197 a year in income. Average income more than doubles to $33,124 for 25- to 34-year-olds. For those 35 to 44, the figure jumps to $43,923. It takes time for learning, hard work and saving to bear fruit.

Little on this list should come as a surprise. Taken as a whole, it's what most Americans have been told since they were kids—by society, by their parents, by their teachers.

they become better educated, develop skills and gain experience. In fact, income tends to follow a pattern over a person's lifetime: it rises rapidly in the early years of working, peaks during middle age, then falls as people ease toward retirement. When the average earnings of each age group are placed side-by-side, they create a pyramidal lifetime earnings profile.

Over the past four decades, the income profile of the typical American has gotten sharply steeper. In 1951, workers reached their peak earning years at ages 35 to 44.[5] Average annual earnings for these individuals were 1.6 times the income of those in the 20 to 24 age group. By 1973, the ratio had risen to 2.3 to one. By 1993, the peak earning years moved up to ages 45 to 54, and these workers earned over three times more than 20- to 24-year-olds. (See Exhibit 10.)

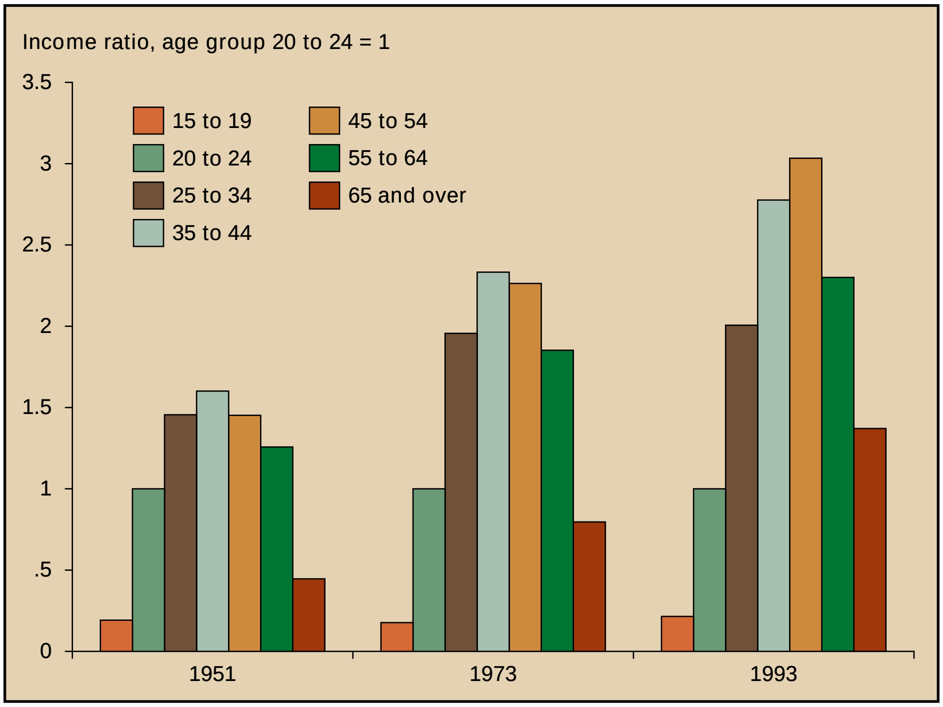


Exhibit 10
THE STEEPENING OF LIFETIME EARNINGS

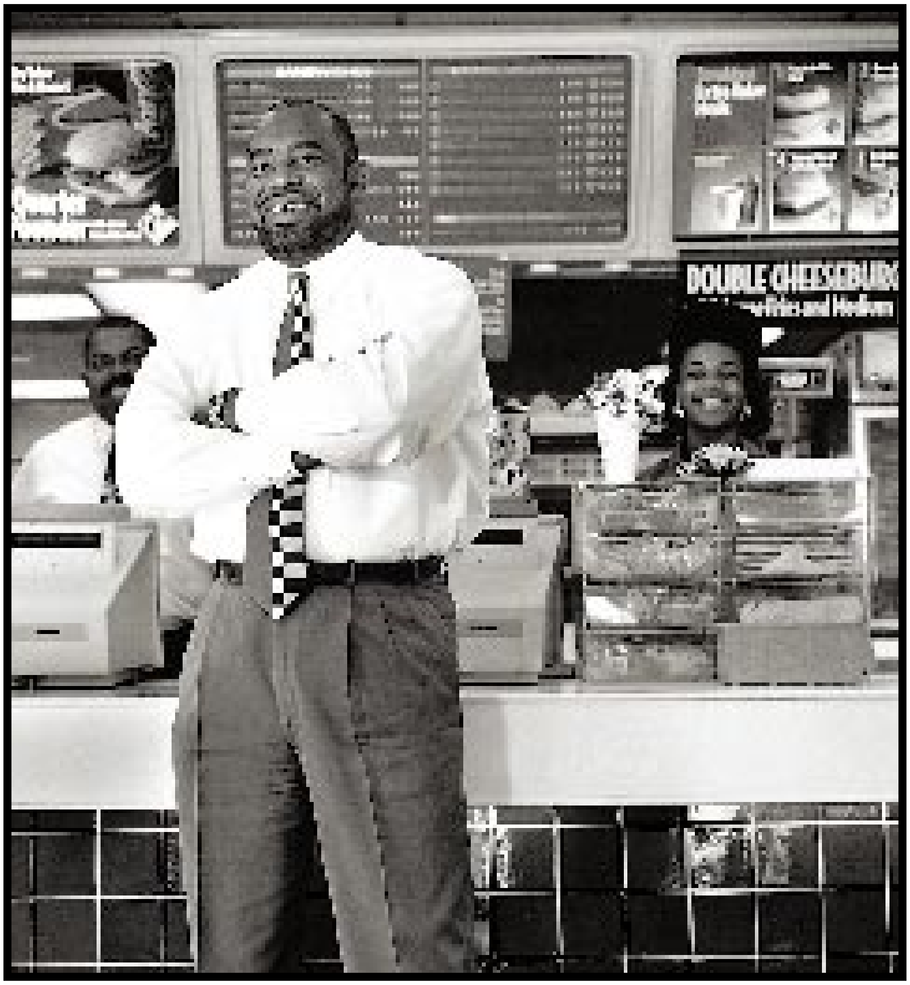
In 1951, individuals aged 35 to 44 earned 1.6 times as much as those aged 20 to 24, on average. By 1993, the highest paid age group had shifted to the 45- to 54-year-olds, who earned nearly 3.1 times as much as the 20- to 24-year-olds.

A steeper lifetime earnings profile reflects greater opportunity. One way to see this is to imagine a perfectly flat pattern of lifetime income. Workers would then earn the same income every year, with no prospect of "getting ahead" over their lifetimes. This would be a world devoid of upward mobility.

What's behind the faster rise in Americans' lifetime earnings? Most likely, it's the by-product of broad changes in the way we work. When the economy was largely industrial, most jobs employed motor skills and muscle power. People worked with their hands and their backs. Today, more Americans than ever earn their livings with "brainpower." The skills of the mind, unlike those of the body, are cumulative. Mental talents can continue to expand long after muscle and dexterity begin to falter, and that probably explains why the peak earning years have shifted to an older age group in the past two decades. As the United States retools itself for a more knowledge-intensive era, as the country moves from a blue-collar economy to a white-collar one, the income rewards to education and experience are increasing.

The lifetime earnings profile is the thread that sews together recent trends in upward mobility and income inequality. As workers are increasingly rewarded for what they've learned in the workplace, earnings become sharply higher with experience. The result is that the income gap widens between youth and middle age. It's not that the young are getting worse off; it's that older workers are doing much better.

[5] The figure is for men only. The 1951 data for women are incomplete.



PHIL HAGANS

Franchise Owner, MCDONALD'S, Houston, Texas

PHIL HAGANS WAS A "STREET-ROUGH" TEENAGER FROM ONE OF the poorest areas of Houston when he got his first job flipping burgers for minimum wage at a McDonald's restaurant. Today, Hagans is a 40-year-old entrepreneur who owns two McDonald's franchises on Houston's northeast side. He plans to open a third this year. ❡ The success he now enjoys didn't come easy for Hagans, who left his two-room Houston home at 16 because of domestic problems. A promising athlete, he attended the University of Oklahoma on a football scholarship but had to quit school after injuries ended his football career. He was just 19 when he came back home, broke and with dismal prospects of finding a job. ❡ That's when he decided to return to McDonald's, where he worked for $1.60 an hour. Six months later, Hagans was promoted to the McDonald's management training program, where he managed various restaurants around town. In 1991, Hagans bought his first franchise with $35,000 he had saved. ❡ How does Hagans account for his success? "A positive attitude is everything," he says with a broad smile. "I tell kids every day that the only difference between a stepping stone and a stumbling block is how high you lift your knees."

In the end, the steepening of lifetime earnings leads us to a somewhat surprising conclusion: upward mobility may well be an important factor in the widening of the income distribution! This is not the harsh world envisioned by those who see the rich getting richer and the poor getting poorer. In reality, both rich and poor are becoming better off. Most of us getting nowhere? To the contrary, the majority of Americans are busy climbing up the income ladder. Greater returns to education and experience can skew income toward the upper end, but we would be foolhardy to become so obsessed with the pecking order that we lose sight of what's really important. And that's opportunity.

A steeper lifetime earnings profile also puts a different slant on the notion of a vanishing middle class.[6] The center of the income distribution isn't a destination. It's just one step on the ladder of upward mobility. Forty years ago, with a flatter earnings profile, people spent most of their working lives in the middle income brackets. Today's more rapid rise in incomes means we're moving upward faster, thus spending less time in the middle.[7]

Worries about Generation X's future can be put to rest, too. Those entering the labor force in the 1990s might look at their parents' income and wonder how they will ever attain such heights. They should, however, find a steeper earnings profile encouraging: today's young workers are likely to see their incomes rise more quickly than did their parents'.

The economy is providing opportunity—more, in fact, than ever before—but it's up to each individual to grab it. The rewards go to education, experience, talent, ambition, vision, risk-taking and just plain hard work. Success isn't random. A lucky few may make getting ahead look easy, but most of us will have to make our way upward the old-fashioned way. Young people are not guaranteed success any more than were their parents. Their chances will improve, though, if they make the right choices in life.

STILL THE LAND OF OPPORTUNITY

The American economy ranks as one of history's great success stories. By most measures, we enjoy the world's wealthiest, most productive, most technologically advanced and most competitive society.

Over the years, the driving force in creating this economic dynamo has been the prospect of upward mobility. There should be no surprise in this. Self-interest provides a powerful incentive for people to do what's necessary to make themselves better off. Our free enterprise system gives us the opportunity to act on the natural desire to improve our lot in life. It gives us the opportunity, through work, to reap the rewards of our initiative and our talents.

Striving to better oneself isn't just private virtue. It sows the seeds of economic growth and technical advancement. There's no denying that the system allows some Americans to become richer than others. We must accept that. Equality of income is not what has made the U.S. economy grow and prosper. It's opportunity.

If people are allowed to seize opportunity, many will. If rewards are there for the taking, most of us will strive to attain them. In this country, we've envied, admired and even vilified those who have made themselves better off. Yet, regardless of our views, the prosperous have provided us benefits. Our proper cultural icon is not the common man. It's the *self-made* man or woman.

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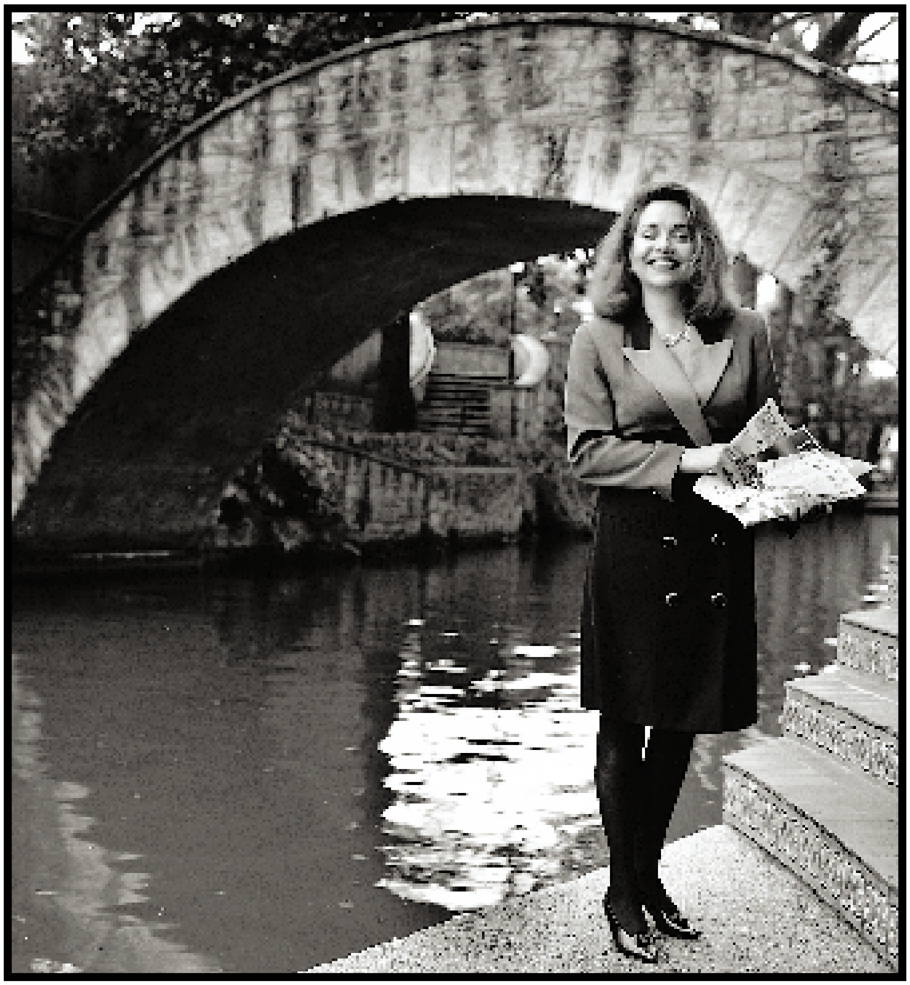
[6] More evidence on what has happened to the middle class can be found by examining tax returns. In 1993, 1,010,608 tax returns showed an income of $200,000 or more. This compares with only 53,403 as recently as 1977. (Comparisons are based on current dollars.)

[7] In 1951, only incomes for the age groups 15 to 19 and 65-plus were 25 percent or more away from average for the economy. In 1993, incomes earned for the age groups 15 to 19, 20 to 24 and 65-plus were more than 25 percent below the economy's average, whereas incomes for the age groups 35 to 44 and 45 to 54 were more than 25 percent above average.



Patricia Pliego Stout

President & Chief Executive Officer, ALAMO TRAVEL & TOURS, San Antonio, Texas

When Patricia Pliego Stout tried to get her travel agency off the ground, she ran into some major roadblocks. "I couldn't get a loan or find anyone who would lease me office space," she says. "I had three strikes against me—I was single, Hispanic and female." But Stout, who is originally from Mexico City, refused to give up. Pouring her life's savings into the venture, she worked nights and weekends, handling every aspect of the business herself. "I couldn't even afford to pay for a courier, so I would personally deliver airline tickets to all my clients before and after work." Today, Alamo Travel & Tours is one of the largest agencies in San Antonio, with Stout establishing herself in the community as a successful entrepreneur eager to help other women interested in operating a small business. In 1992, she was named the Hispanic Chamber of Commerce's "Small Businesswoman of the Year." "I have had to struggle alone as a woman in business for many years," she says. "I was raised in a culture in which women were expected to be wives and mothers—not to have a career outside of the family. My greatest desire is to be a role model for other women who may be trying to establish themselves in the business world." For Stout, America is still the Land of Opportunity. "This is the most incredible country in the world. If anybody has the desire to succeed, they can."

Exhibit 11
A CONSUMING INTEREST

The rich and the poor live differently, no doubt about that. The gap, however, narrows quite a bit if we look at consumption rather than income. The table below gives details of how much an average U.S. household spent in 1993. Top income households outearned bottom ones by a factor of 13 to 1. When it comes to consumption per person, though, the gap was only 2 to 1. Why? Richer households pay heavy taxes, give more to charity, invest more in education and allocate more to savings. At the other end of the spectrum, poorer families often supplement their consumption through food stamps, unemployment benefits, Aid to Families with Dependent Children and other programs. Workers temporarily laid off often fall back on their savings rather than sharply reduce their living standards.

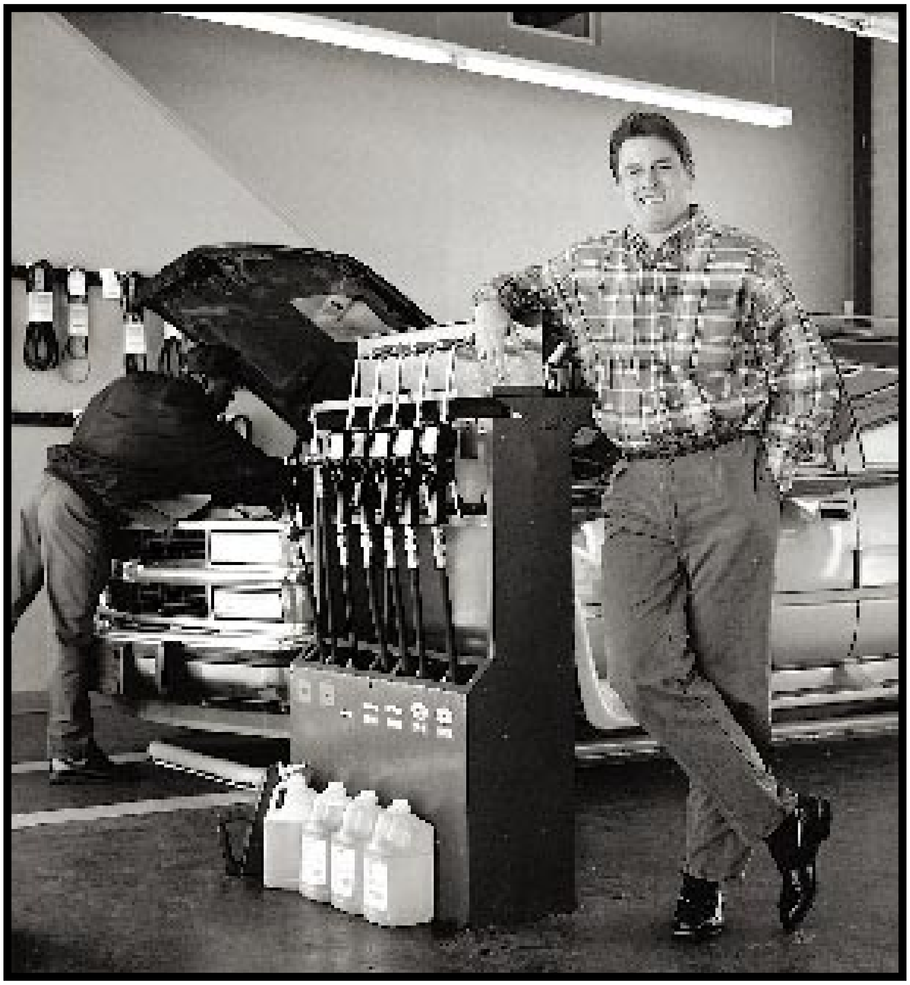
The low-income households, moreover, are smaller and have more free time—a substitute for money. Households in the top quintile average 3.1 persons, 2.1 of whom are working, whereas lower income households have only 1.8 persons, 0.6 of whom are working. What that suggests is that poorer households have more time to meet their needs through home production—cooking, housecleaning, maintenance, child care, yard work, laundry and much more. Though these activities make families better off, they typically aren't included because studies measure consumption in money. When top income earners pay others to perform these services, it gets captured in the statistics on consumption, making them look better off than they are.

	Income Quintile		
	Lowest	**Middle**	**Highest**
Household money income (before taxes)	$ 6,395	$ 26,037	$ 84,753
Household consumption			
Food	2,505	4,116	7,296
Clothing	864	1,493	3,079
Shelter	2,359	3,871	8,174
Telephone, utilities	1,431	2,026	2,965
Transportation	2,087	4,760	10,355
Health care	1,080	1,733	2,396
Other	2,320	4,509	10,859
Total consumption	$ 12,646	$ 22,508	$ 45,124
Average household size	1.8	2.5	3.1
Consumption per person	$ 7,026	$ 9,003	$ 14,556
Other uses of income			
Taxes	$ 558	$ 3,883	$ 16,416
Cash contributions	308	896	2,541
Education	382	427	1,331
Financial flows*	(7,499)	(1,677)	19,341

* Insurance, pensions, investment expenses, saving, and dissaving or government transfers.

Even these numbers don't tell the whole story of living standards or consumption. Low-income households can benefit from several noncash programs, such as subsidized housing and school lunches. They also consume a variety of public goods—bus service, schools, roads and parks.

There are those who would deny that America is still providing opportunity for most of its citizens. There's ample evidence to refute them. Upward mobility is alive and well. Even lower income households usually aren't left out of the country's progress: the consumption of those in the bottom fifth of the income distribution has shown improvement over the past two decades. (See Exhibits 11 and 12.)



TODD BURNS

Founder & Owner, TIME-IT LUBE, Shreveport, Louisiana

TODD BURNS WAS EXPECTING TO JOIN HIS FATHER IN THE OIL BUSINESS after he finished college in the early 1980s. The oil bust and a devastating bankruptcy that left his father with practically nothing quickly put an end to those plans. Instead, Burns found himself leaving college a year early so he could work nights at a freight shipping company and complete his education at a local school. ❡ Two and a half years later, Burns finally got his chance to get into the oil business—albeit not the one he originally thought he'd be in—when he heard from the man who owned the oil-change shop where Burns had worked as a teenager. The man told Burns he'd sell out for $15,000—about $15,000 more than Burns had at the time. Unable to get a loan, but not wanting to pass on the opportunity, Burns and his wife took out a second mortgage. ❡ That was in 1987, when Burns was 25. Last year, he opened his sixth Time-It Lube location and was offered $2 million for the company. Along the way, he had to refinance his home and car for operating capital and pay to repair 80,000 gallons worth of flood damage to his second store. "I didn't know what else to do but keep going," says Burns. "My wife and kids were counting on me, and there was no way I could let them down. To make it, you sometimes just have to take a leap of faith and then work as hard as you can."

Exhibit 12
PROGRESS AND POVERTY

Historically, economic growth, not welfare, has been the remedy for poverty. An expanding economy pays its dividends in rising incomes, lower prices and better products, all of which enable families to satisfy their basic needs with smaller and smaller portions of their income.

For households in the bottom income quintile, spending on food, clothing and shelter was 45 percent of consumption in 1993, compared with 52 percent two decades earlier, 57 percent in 1950 and 75 percent in 1920. As a result, today's poorest households have more discretionary income than ever before.

That helps explain why today's poorer households are more likely than those of a decade ago to own appliances and motor vehicles. Their consumption of these modern-day conveniences even compares favorably with that of all American households as recently as 1971.

	Poor households*		**All households**
Percent of households with	**1984**	**1994**	**1971**
Washing machine	58.2	**71.7**	71.3
Clothes dryer	35.6	**50.2**	44.5
Dishwasher	13.6	**19.6**	18.8
Refrigerator	95.8	**97.9**	83.3
Freezer	29.2	**28.6**	32.2
Stove	95.2	**97.7**	87.0
Microwave	12.5	**60.0**	<1.0
Color television	70.3	**92.5**	43.3
VCR	3.4	**59.7**	0
Personal computer	2.9	**7.4**	0
Telephone	71.0	**76.7**	93.0
Air conditioner	42.5	**49.6**	31.8
One or more cars	64.5	**71.8**	79.5

* At or below the poverty line, as defined by the Census Bureau.

As consumption patterns show, many of today's poorest households have more than yesterday's, and more, even, than the general population had two decades ago. By today's consumption standards, the majority of Americans were once poor.

When, from their perch of the future, historians look back upon today, what will they conclude? Uncovering merely the fact that four out of five of today's 400 richest Americans are self-made, certainly they will pause to question today's popular rhetoric of snuffed opportunity, unfairness and trampled economic rights.

Without a doubt, the problem of poverty amid plenty continues in the United States, and we should help those who have difficulties grasping even the lowest rungs on the ladder. To be sure, many people have tried and failed, only to try again and fail again. There are no guarantees in life. Even so, hard data suggest that the popular view of America as a Land of Opportunity Lost—a caste society with strong class lines between the "haves" and the "have-nots"—is just plain wrong.

Capitalism is by nature an anti-establishment system. Its essence is change: destruction of the old, creation of the new and better. (See Exhibit 13.) Today's American society is almost certainly more fluid than ever, even less establishment-based and more entrepreneurial than yesterday's. In the information age, the barriers of wealth and status are disappearing. Knowledge and effort alone can open doors, and both are available to us all.

The statistics strongly suggest that the American Dream still comes true for many, if not most, citizens. Perhaps even more powerful, though, is the experience of members of our own community who have proven that our country is still the Land of Opportunity.

Among them are—Eddie Diaz, partner in New Mexico Chili Products, a company in Deming, New Mexico, that processes and distributes chili-based products.

Ron and Pam Jones, owners of Handy Andy Janitorial, a commercial cleaning company in Plano, Texas.

Liz Coker, chief executive of Minco Technology Labs in Austin, a processor and tester of semiconductors for the aerospace, medical and defense industries.

Le Thi and Hai Minh Huynh, founders of Fulton Seafood in Houston, one of the country's largest distributors of fresh seafood.

Phil Hagans, owner of three McDonald's franchises in Houston.

Patricia Pliego Stout, president and chief executive of Alamo Travel & Tours in San Antonio.

And Todd Burns, founder and owner of Time-It Lube, a quick oil-change and lube service business in Shreveport, Louisiana.

	Number of *Forbes 400* members	
	1984	**1994**
Winners		
Technology*	15	35
Retailing	19	37
Finance**	48	65
Entertainment***	8	22
Losers		
Inheritance	146	82
Real estate	71	26
Oil and gas	74	37
Heavy manufacturing	95	69
Media****	59	38
Agriculture	21	13

* Includes communications.
** Banking, commodities, investments, insurance.
*** Includes gambling, lodging, restaurants.
**** Includes publishing, cable TV.

SOURCE: *Forbes 400*, "Vision's the Thing," October 17, 1994.

Exhibit 13
CREATIVE DESTRUCTION

Only 82 of America's richest 400 people—one in five—got their fortune from inheritance. Four out of five are self-made, an increase from three out of five in 1984. As the economy continues to move away from the manufacturing and agrarian eras and toward the information and service age, new fortunes are emerging in technology, retailing, finance and entertainment, eclipsing those made yesteryear in real estate, oil and gas, heavy manufacturing, media and agriculture.

The End

ACKNOWLEDGMENT

"By Our Own Bootstraps: Economic Opportunity & the Dynamics of Income Distribution" was written by W. Michael Cox and Richard Alm. The essay is based on research conducted by W. Michael Cox, vice president and economic advisor, Federal Reserve Bank of Dallas.

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DATA SOURCES

Exhibits 1 and 2 U.S. Census Bureau ("Share of Aggregate Income Received by Each Fifth and Top 5 Percent of Households").

Exhibits 4, 5, 6 and 8 Institute for Social Research.

Exhibit 7 U.S. Department of the Treasury, Office of Tax Analysis.

Exhibit 10 U.S. Census Bureau ("Age: Persons 15 Years Old and Over").

Exhibit 11 U.S. Department of Labor, Bureau of Labor Statistics (Consumer Expenditure Survey).

Exhibit 12 Eller and Fraser.

Exhibit 13 *Forbes*.

THE YEAR
IN REVIEW

IN 1995, THE FEDERAL RESERVE BANK OF DALLAS FOCUSED ON ESTABLISHING a leadership position in the increasingly global banking industry, offering financial products with the most up-to-date technology and strengthening the Bank's relationship with its various constituents. In addition, the Bank built upon its relationship with Eleventh District financial institutions and a local clearinghouse to promote use of electronic payments. Hallmarks during the year also included advancements in customer service in conjunction with the Bank's quality initiative.

ECONOMIC OVERVIEW

The Eleventh District continued its strong economic growth in 1995, posting its ninth consecutive year of expansion and again outperforming the national average. As in past years, a strong construction sector contributed to employment growth in Texas, Louisiana and New Mexico.

However, nonfarm employment growth in Texas, Louisiana and New Mexico slowed in 1995 to 3 percent from 4.6 percent in 1994.

Strong growth in the *maquiladora* industries and in exports to countries other than Mexico allowed Texas to avoid the potentially large negative effects of the Mexican peso devaluation and Mexico's sharp recession. While exports to Mexico declined at an annual rate of 13.8 percent during the first three quarters of 1995, Texas' exports to other countries increased at an annual rate of 23.1 percent, resulting in an overall gain of 8.4 percent.

Despite suffering some setbacks in 1995, the gaming industry remained the driving force behind employment growth in Louisiana. A reviving energy sector also contributed to Louisiana's employment growth. A decline in defense industry employment in New Mexico was more than offset by the strong expansion of the state's high-tech manufacturing industry.

DALLAS FED FINANCIAL SERVICES

In 1995, the Dallas Fed financial services area continued its efforts to enhance reliable, cost-efficient products in keeping with technological advancements in the changing financial industry. In check collection, the Bank expanded its image products and services to provide customers with innovative paperless payments alternatives, including electronic check presentment and truncation. The Dallas Fed established the capability of supporting the software offered by a number of image service providers. Through this versatility in image support, the Bank can better serve customers using its check imaging services, such as total image delivery, selected image delivery and a money management image product.

In the currency and coin area, the Bank began and neared completion of the currency vault expansion at its headquarters. The project will triple the storage capability of the currency vault and will enable the Bank to provide currency warehousing services for other Federal Reserve Banks.

The Bank also continued the installation of high-speed currency processing machines. The machines, which have faster throughput, contributed to the Bank's being ranked second in the Federal Reserve System in terms of the number of notes processed each hour.

To facilitate the introduction of security-enhanced, redesigned currency in 1996, the Bank and its branches hosted a series of currency seminars throughout the Eleventh District. The seminars familiarized financial institutions with the features of the new notes and explained procedures for the currency introduction.

The Bank also began to phase out receiving, crediting and destroying food coupons as the state of Texas makes the transition from the paper food-coupon system to an electronic debit card system.

The first phase of the Alliance 98 initiative began in 1995. Alliance 98, a partnership among the Dallas Fed, SouthWestern Automated Clearing House Association and financial institutions in the Eleventh District, seeks to encourage the transition from paper check payments to electronic payments. The Alliance's progress was reflected in a 23-percent increase in commercial ACH transactions in the District, which exceeded the national growth rate. The Bank also supported a nationwide effort to increase electronic payments in government ACH transactions, such as electronic delivery of Social Security payments.

In the securities area, the transfer of funds application converted to a centralized system at the East Rutherford Operations Center in New Jersey. The transition will improve reliability and disaster recovery capabilities as well as make it easier for the Federal Reserve System to implement software changes.

BANKING SUPERVISION; DISCOUNT AND CREDIT

In 1995, aggregate financial data reported by Eleventh District banks reflected a thriving industry. Continued loan growth combined with stable net interest margins produced a solid return on banking assets. Asset quality ratios remained favorable, and capital levels approached historic highs.

Consolidation and merger activity reduced the number of District banks from 1,078 in 1994 to 1,030 in 1995, and one new bank charter was granted. Many banks were converted to branch offices, and the number of branches increased from 2,814 to 2,985. The Dallas Fed processed 255 applications—compared with 245 in 1994—for mergers and acquisitions, changes in control and management, and other actions requiring regulatory approval.

As the supervisor of state member banks, bank holding companies and foreign agencies in the District, the Dallas Fed is responsible for conducting examinations for safety and soundness and for compliance with consumer protection laws as well as the Community Reinvestment Act. Reflecting the continued solid condition of the industry, the Dallas Fed conducted 367 examinations, only one examination more than in 1994. Of the 367 examinations, 37 were reviews for compliance with consumer and civil rights legislation.

Because of a small increase in the use of seasonal lending to meet the temporary liquidity demands of financial institutions throughout the District, the number of loans extended by the Dallas Fed's discount window increased from 400 in 1994 to 419 in 1995. Although discount window loans increased, total credit extended decreased from $884 million in 1994 to $791 million in 1995 due to the highly liquid position of a substantial number of District banks.

The 56 state-chartered banks under the Dallas Fed's supervision in 1995 represented 5.4 percent of all insured commercial banks in the District and held about 3 percent of insured commercial bank assets. The 517 bank holding companies under Dallas Fed supervision last year controlled 618 insured commercial banks that held approximately 24 percent of all insured commercial bank assets in the District. Thirty-six foreign banks from 13 countries operated 20 state-licensed agencies and 25 representative offices.

RESEARCH AND PUBLIC AFFAIRS

Economic research and public affairs activities in 1995 continued to focus on promoting free enterprise research and education. The Bank sponsored a major conference that explored private enterprise solutions to public policy problems and the ways in which key policies affect the nation's economic growth and stability. In conjunction with the free enterprise efforts, the Bank introduced and sponsored three Economic Insights lectures for the business community. The series' first speaker, Congressman Dick Armey, House majority leader, spoke about his flat tax proposal. José Piñera, former minister of labor and social welfare in Chile, discussed his involvement in overseeing Chile's transition to a private pension system, and House Ways and Means Committee Chairman Bill Archer talked about his national sales tax proposal.

Exchange rates, capital flows and monetary policy in a changing world economy were examined during an international conference hosted by the Bank. Other issues studied during the year included the peso devaluation and how the expansion of the high-tech industry is transforming the Eleventh District economy. The Bank also researched the border economy, exports and energy prices.

Research on the effects of the North American Free Trade Agreement continued with a conference hosted by the Bank's El Paso Branch. Speakers and participants discussed international trade and investment in the NAFTA countries, as well as financial interdependencies and industrial development.

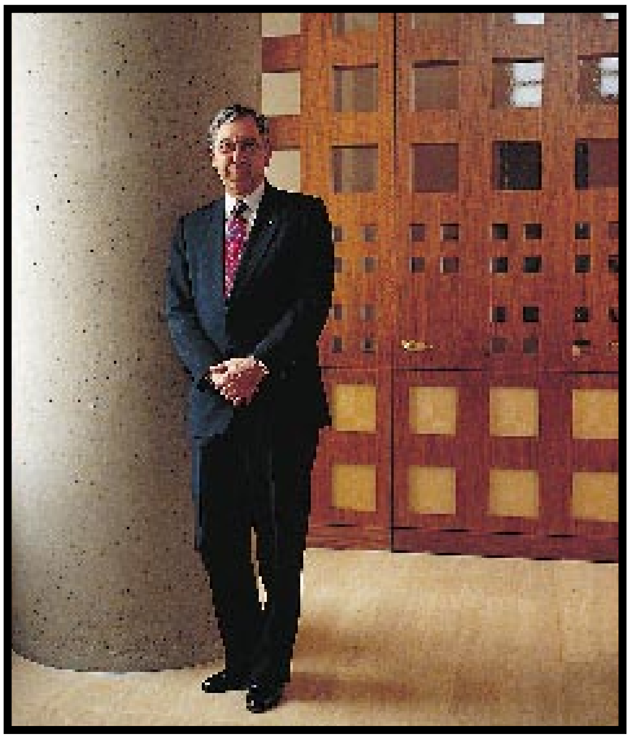
Numerous publications were produced for a variety of Eleventh District audiences in support of the Bank's research and economic education efforts. In addition to regular issues of *Economic Review*, *The Southwest Economy*, *Financial Industry Studies*, *Financial Industry Issues*, *Houston Business*, *Financial Industry Trends* and *Business Frontier*, the Bank introduced a new publication, *Economic Insights*. *Economic Insights* serves as a forum for the Dallas Fed president to explore current economic issues, and it features essays by leaders and decisionmakers in economic education and public policy.

The Bank also produced a new publication, *Money, Banking and Monetary Policy*, in its Everyday Economics series. The publication and other efforts support the Bank's goal of educating teachers, students and the general public about economics, monetary policy and the role of the Federal Reserve.

As part of its efforts to encourage and promote community development in the region, the Bank hosted a community investment conference and produced a beginner's guide for nonprofit housing developers.

All the activities during 1995 show the Federal Reserve Bank of Dallas' strong commitment to serving its many customers. Although the Bank's objectives are unchanging—to provide quality and efficient financial services while fostering sound banking and economic growth—the Dallas Fed will strive to meet its customers' ever-evolving needs.

A Fond
FAREWELL



ON APRIL 1, 1996, TONY SALVAGGIO WILL RETIRE FROM THE FEDERAL RESERVE Bank of Dallas after almost 40 years of distinguished service. Tony has been first vice president and chief operating officer since May 1, 1991. Prior to then, he served in various capacities in most of the Bank's operating and service areas. He has also been active in Federal Reserve System work, culminating in his service in 1995 as chairman of the Federal Reserve System's Conference of First Vice Presidents.

During my five years as president of the Federal Reserve Bank of Dallas, I have had the good fortune of being able to rely on Tony's vast experience and excellent judgment. I will miss him very much, as will all his colleagues at the Dallas Fed.

Robert D. McTeer, Jr.

CORPORATE EXECUTIVES

From left: Roger R. Hemminghaus (Deputy Chairman), Chairman, President and CEO, Diamond Shamrock, Inc.; Robert D. McTeer, Jr., President and CEO, Federal Reserve Bank of Dallas; Cece Smith (Chairman), General Partner, Phillips–Smith Specialty Retail Group; Tony J. Salvaggio, First Vice President and COO, Federal Reserve Bank of Dallas.

SENIOR MANAGEMENT

Standing (*from left*): Sam C. Clay, Vice President in Charge, El Paso Branch; Helen E. Holcomb, Senior Vice President, Financial Planning and Control, Personnel Services, Public Affairs and Graphic Arts; J. Tyrone Gholson, Senior Vice President, Cash, Protection, Securities and Services; James L. Stull, Senior Vice President in Charge, San Antonio Branch; Robert D. Hankins, Senior Vice President, Banking Supervision, Discount and Credit, and Financial Industry Studies; Robert Smith, III, Senior Vice President in Charge, Houston Branch; Larry J. Reck, Senior Vice President, Check Collection and Data Services. Seated (*from left*): Millard E. Sweatt, General Counsel, Secretary to the Board and Senior Vice President, Operations Analysis, Purchasing and Legal; Robert D. McTeer, Jr., President and CEO; Tony J. Salvaggio, First Vice President and COO; Harvey Rosenblum, Director of Research and Senior Vice President, Research and Statistics.

FEDERAL RESERVE BANK OF DALLAS

Standing (*from left*): J. B. Cooper, Jr., Farmer; James A. Martin, Second General Vice President, International Association of Bridge, Structural and Ornamental Iron Workers; Eugene M. Phillips, Chairman and President, First National Bank of Panhandle; Milton Carroll, Chairman and CEO, Instrument Products, Inc. Seated (*from left*): Gayle M. Earls, President and CEO, Texas Independent Bank; Cece Smith (Chairman), General Partner, Phillips–Smith Specialty Retail Group; Kirk A. McLaughlin, President and CEO, Security Bank; Roger R. Hemminghaus (Deputy Chairman), Chairman, President and CEO, Diamond Shamrock, Inc.
Not Pictured: Peyton Yates, President, Yates Drilling Co.

EL PASO BRANCH

Standing (*from left*): Wayne Merritt, President, Norwest Bank, Texas—Midland; Patricia Z. Holland-Branch (Chairman Pro Tem), President / Director of Design, PZH Contract Design, Inc.; Alvin T. Johnson, President, Management Assistance Corp. of America; Ben H. Haines, Jr., President and CEO, First National Bank of Dona Ana County. Seated (*from left*): W. Thomas Beard, III (Chairman), President, Leoncita Cattle Co.; Veronica K. Callaghan, Vice President and Principal, KASCO Ventures, Inc.
Not Pictured: Hugo Bustamante, Jr., Owner and CEO, CarLube, Inc., ProntoLube, Inc.

HOUSTON BRANCH

Standing (*from left*): Walter E. Johnson, President and CEO, Southwest Bank of Texas; Robert C. McNair (Chairman Pro Tem), Chairman and CEO, Cogen Technologies, Inc.; T. H. Dippel, Jr., Chairman and President, Brenham Bancshares, Inc.; J. Michael Solar, Managing Partner, Solar & Fernandes L.L.P. Seated (*from left*): Judith Craven, President, United Way of the Texas Gulf Coast; I. H. Kempner, III (Chairman), Chairman, Imperial Holly Corp.; Judy Ley Allen, Partner and Administrator, Allen Investments.

SAN ANTONIO BRANCH

Standing (*from left*): H. B. Zachry, Jr. (Chairman Pro Tem), Chairman and CEO, H. B. Zachry Co.; Calvin R. Weinheimer, President and COO, Kerrville Communications Corporation. Seated (*from left*): Gregory W. Crane, President and CEO, Broadway National Bank; Carol L. Thompson (Chairman), President, The Thompson Group; Douglas G. Macdonald, President, South Texas National Bank. Not Pictured: Juliet V. Garcia, President, University of Texas at Brownsville; Erich Wendel, President and CEO, Maverick Markets, Inc.

FINANCIAL INSTITUTIONS

James A. Altick
President and Chief Executive Officer
Central Bank
Monroe, Louisiana

Jack Antonini
President and Chief Executive Officer
USAA Federal Savings Bank
San Antonio, Texas

Robert G. Greer
Chairman
Tanglewood Bank, N.A.
Houston, Texas

Ron Humphreys
Senior Vice President
Marketing and Operations
First Savings Bank FSB
Clovis, New Mexico

Don Powell
Chairman, President and Chief Executive Officer
Boatmen's First National Bank of Amarillo
Amarillo, Texas

Jimmy Seay
President and Chief Executive Officer
The City National Bank
Mineral Wells, Texas

Sandra M. Smith
President and Chief Executive Officer
Texas Federal Credit Union
Dallas, Texas

Hayden D. Watson
Executive Vice President
First Interstate Bank of Texas, N.A.
Houston, Texas

SMALL BUSINESS AND AGRICULTURE

Stephen K. Balas
Owner and Pharmacist
Eagle Lake Drugstore and Home Health Care
Owner
Balas Farming Co.
Eagle Lake, Texas

Robert D. Dooley
Partner
KPMG Peat Marwick
Dallas, Texas

T. Mike Field
Agriculture and Real Estate
Lubbock, Texas

Gilbert D. Gaedcke
Chairman and Chief Executive Officer
Gaedcke Equipment Company
Houston, Texas

Robert D. Josserand
President
AzTx Cattle Company
Hereford, Texas

Robert W. Latimer
President
Latimer International
San Antonio, Texas

Joe D. Mitchell
Shareholder, Director and President
Mitchell & Jenkins, P.C., Attorneys and Counselors at Law
Dallas, Texas

J. Jay O'Brien
Cattleman
Amarillo, Texas

Lois Farfel Stark
President
Stark Productions, Inc.
Houston, Texas

Charles R. Tharp
Partner / Manager
Tharp Farms
Las Cruces, New Mexico

L. C. Unfred
Farmer
L. C. & N. Unfred Farms
New Home, Texas

Jeffrey W. Wilson
President
Cattle Baron Restaurant, Inc.
Roswell, New Mexico

FEDERAL ADVISORY COUNCIL MEMBER

Charles R. Hrdlicka
Chairman and Chief Executive Officer
Victoria Bankshares, Inc.
Victoria, Texas

Effective December 31, 1995

DALLAS

Robert D. McTeer, Jr.
President and
Chief Executive Officer

Tony J. Salvaggio
First Vice President and
Chief Operating Officer

J. Tyrone Gholson
Senior Vice President

Robert D. Hankins
Senior Vice President

Helen E. Holcomb
Senior Vice President

Larry J. Reck
Senior Vice President

Harvey Rosenblum
Senior Vice President and
Director of Research

Millard E. Sweatt
Senior Vice President, General Counsel,
Ethics Officer and Secretary

Earl Anderson
Vice President

Basil J. Asaro
Vice President

Lyne H. Carter
Vice President

W. Michael Cox
Vice President and
Economic Advisor

Billy J. Dusek
Vice President

Kermit S. Harmon, Jr.
Vice President

Joel L. Koonce, Jr.
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Vice President and
General Auditor

Rebecca W. Meinzer
Vice President and
Administrative Officer

Genie D. Short
Vice President

Larry M. Snell
Vice President

W. Arthur Tribble
Vice President

Gloria V. Brown
Assistant Vice President and
Community Affairs Officer

Stephen P. A. Brown
Assistant Vice President and
Senior Economist

Terry B. Campbell
Assistant Vice President

Robert G. Feil
Assistant Vice President

Johnny L. Johnson
Assistant Vice President

Joanna O. Kolson
Assistant Vice President

C. LaVor Lym
Assistant Vice President

James R. McCullin
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Gayle Teague
Assistant Vice President

Michael N. Turner
Assistant Vice President

Stephen M. Welch
Assistant Vice President

Marion E. White
Assistant Vice President

Bob W. Williams
Assistant Vice President

Emilie S. Worthy
Assistant Vice President

Meredith N. Black
Supervisory Information Officer

John V. Duca
Research Officer

KaSandra M. Goulding
Public Affairs Officer

William C. Gruben
Research Officer

Evan F. Koenig
Research Officer

William C. Morse, Jr.
Operations Officer

Sharon A. Sweeney
Associate Counsel and
Associate Secretary

Evelyn LV. Watkins
Accounting Officer

EL PASO

Sam C. Clay
Vice President in Charge

J. Eloise Guinn
Assistant Vice President

Javier R. Jimenez
Assistant Vice President

HOUSTON

Robert Smith, III
Senior Vice President in Charge

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Richard J. Burda
Assistant Vice President

René G. Gonzales
Assistant Vice President

Luther E. Richards
Assistant Vice President

Robert W. Gilmer
Research Officer

Kenneth V. McKee
Audit Officer

SAN ANTONIO

James L. Stull
Senior Vice President in Charge

Taylor H. Barbee
Assistant Vice President

Richard A. Gutierrez
Assistant Vice President

D. Karen Salisbury
Operations Officer

Effective January 1, 1996

	December 31, 1995 (Thousands)	December 31, 1994 (Thousands)
ASSETS		
Gold certificate account[1]	$ 405,000	$ 453,000
Special drawing rights certificate account[2]	376,000	377,000
Coin	48,527	27,997
Loans to depository institutions	400	0
Securities:		
Federal agency obligations	85,402	137,539
U.S. government securities	12,262,257	13,786,009
Total securities	$ 12,347,659	$ 13,923,548
Items in process of collection	333,456	512,950
Bank premises (net)	157,645	157,398
Foreign currencies	1,414,232	1,594,453
Other assets	319,236	344,238
Interdistrict settlement account	3,287,239	(1,303,041)
TOTAL ASSETS	$ 18,689,394	$ 16,087,543
LIABILITIES		
Federal Reserve notes	$ 15,569,986	$ 12,916,808
Deposits:		
Depository institutions	2,177,532	2,139,587
Foreign	9,449	10,200
Other	20,950	28,466
Total deposits	$ 2,207,931	$ 2,178,253
Deferred credit items	257,842	331,862
Other liabilities	160,739	166,958
TOTAL LIABILITIES	$ 18,196,498	$ 15,593,881
CAPITAL ACCOUNTS		
Capital paid in	$ 246,448	$ 246,831
Surplus	246,448	246,831
TOTAL CAPITAL ACCOUNTS	$ 492,896	$ 493,662
TOTAL LIABILITIES AND CAPITAL ACCOUNTS	$ 18,689,394	$ 16,087,543

[1] This Bank's share of gold certificates deposited by the U.S. Treasury with the Federal Reserve System.

[2] This Bank's share of special drawing rights certificates deposited by the U.S. Treasury with the Federal Reserve Bank of New York.

		For the year ended December 31, 1995 (Thousands)		For the year ended December 31, 1994 (Thousands)
CURRENT INCOME				
Interest on loans	$	239	$	298
Interest on government securities		803,700		749,205
Income on foreign currency		52,808		64,548
Income from priced services		49,093		49,451
Other income		571		306
Total current income	$	906,411	$	863,808
CURRENT EXPENSES				
Current operating expenses	$	119,750	$	116,091
Less expenses reimbursed		8,878		8,164
Current net operating expenses	$	110,872	$	107,927
Cost of earnings credits		18,071		10,151
Current net expenses	$	128,943	$	118,078
CURRENT NET INCOME	$	777,468	$	745,730
PROFIT AND LOSS				
Additions to current net income:				
Profit on sales of government securities (net)	$	110	$	0
Profit on foreign exchange transactions (net)		67,326		175,247
Other additions		31		28
Total additions	$	67,467	$	175,275
Deductions from current net income:				
Loss on sales of government securities (net)	$	0	$	893
Loss on foreign exchange transactions (net)		0		0
Other deductions		15,037		11
Total deductions	$	15,037	$	904
Net additions (deductions)	$	52,430	$	174,371
Cost of unreimbursable Treasury services	$	2,613	$	2,111
Assessment by Board of Governors:				
Expenditures	$	10,755	$	10,490
Federal Reserve currency costs		12,534		12,950
NET INCOME AVAILABLE FOR DISTRIBUTION	$	803,996	$	894,550

Surplus

	For the year ended December 31, 1995 (Thousands)	*For the year ended December 31, 1994 (Thousands)*
Surplus, January 1	$ 246,831	$ 246,035
Net income available for distribution	803,996	894,550
LESS:		
Dividends paid	14,866	14,638
Payments to the U.S. Treasury	789,513	879,116
Net amount transferred to (from) surplus	$ (383)	$ 796
Surplus, December 31	$ 246,448	$ 246,831

VOLUME OF OPERATIONS

	Number of items handled (Thousands)		*Dollar amount (Millions)*	
	1995	1994	1995	1994
SERVICES TO DEPOSITORY INSTITUTIONS				
CASH SERVICES				
Currency received from circulation	1,328,681	1,213,082	20,022	17,956
Coin received from circulation	931,406	764,179	153	113
CHECK PROCESSING				
Commercial—processed	1,071,311	1,134,612	614,465	649,689
Commercial—fine sorted	291,637	341,570	87,105	97,238
U.S. government checks	31,411	29,971	30,497	29,523
ELECTRONIC PAYMENTS				
Automated Clearing House	282,453	230,672	788,381	682,331
Transfers of funds	6,962	6,581	10,405,869	9,207,060
Book—entry securities	400	356	5,169,920	5,257,600
LOANS*				
Advances made	418	397	789	885
SERVICES TO THE U.S. TREASURY & GOVERNMENT AGENCIES				
Issues and redemptions of government securities	60,767	56,837	97,531	71,483
Food coupons destroyed	255,714	447,938	1,325	2,359

* Individual loans, not in thousands

ABOUT *the* DALLAS FED

The Federal Reserve Bank of Dallas is one of 12 regional Federal Reserve Banks in the United States. Together with the Board of Governors in Washington, D.C., these organizations form the Federal Reserve System and function as the nation's central bank. The System's basic purpose is to provide a flow of money and credit that will foster orderly economic growth and a stable dollar. In addition, Federal Reserve Banks supervise banks and bank holding companies and provide certain financial services to the banking industry, the federal government and the public.

Since 1914, the Federal Reserve Bank of Dallas has served the financial institutions in the Eleventh District. The Eleventh District encompasses 350,000 square miles and comprises the state of Texas, northern Louisiana and southern New Mexico. The three branch offices of the Federal Reserve Bank of Dallas are in El Paso, Houston and San Antonio.

By Our Own Bootstraps: Economic Opportunity and the Dynamics of Income Distribution
Design: Daniel Sanchez *Photography:* Robin Sachs *Chart Design:* Laura J. Bell

Federal Reserve Bank of Dallas
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301 East Main Street   El Paso, Texas 79901   (915) 544-4730

Houston Branch
1701 San Jacinto Street   Houston, Texas 77002   (713) 659-4433

San Antonio Branch
126 East Nueva Street   San Antonio, Texas 78204   (210) 978-1200