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Capitalism's Endless Opportunities

By W. Michael Cox and Richard Alm

The Great Depression of the 1930s can teach us a great deal about the perils of protectionism, the high costs of misguided monetary policy and the unintended consequences of government interventions. One more takeaway, seldom noted but far more important, concerns the nature of capitalism itself.

For the U.S. economy, the Depression was the worst of times—massive unemployment, bread lines, soup kitchens and shanty towns nicknamed Hoovervilles. Despite the hardships, capitalism kept delivering progress as ingenuity and the pursuit of profit energized entrepreneurs and up-and-coming industries.

Air travel soared from 129,000 passengers in 1929 to 2.8 million in 1941. Bus production shot up 600 percent. Phonographs brought recorded music into millions of households. New vaccines hit the market. Electricity, natural gas, radio and trucking were growth industries. Entertainment weathered the storm and flourished—notably, sports and movies (*see chart right*).

Automobile registrations rose from 26 million to 32 million, and miles driven increased from 198 million to 302 million. The spread of electricity stimulated demand for appliances. Ownership of refrigerators, clothes washers, radios and stoves surged strongly.

In the 1930s, far-sighted entrepreneurs and companies, undaunted by the hard times, introduced frozen vegetables, color film, home movies, canned beer, ballpoint pens, scotch tape, electric mixers, dishwashers, photocopiers, teletypes, and jukeboxes. Mobile homes went into mass production. DuPont introduced synthetic rubber and nylon, which soon showed up in toothbrushes and stockings. Movies became colorful toward the end of the decade. A new board sensation had an ironic name for the times—*Monopoly*.

Most of today's Americans weren't even alive in the 1930s, but they shouldn't dismiss what happened eight decades ago as the stale stuff of history books. The Great Depression's pockets of progress provide assurance that free enterprise create opportunities for new enterprises and profit even in the worst of times.

INGENUITY AND INNOVATION

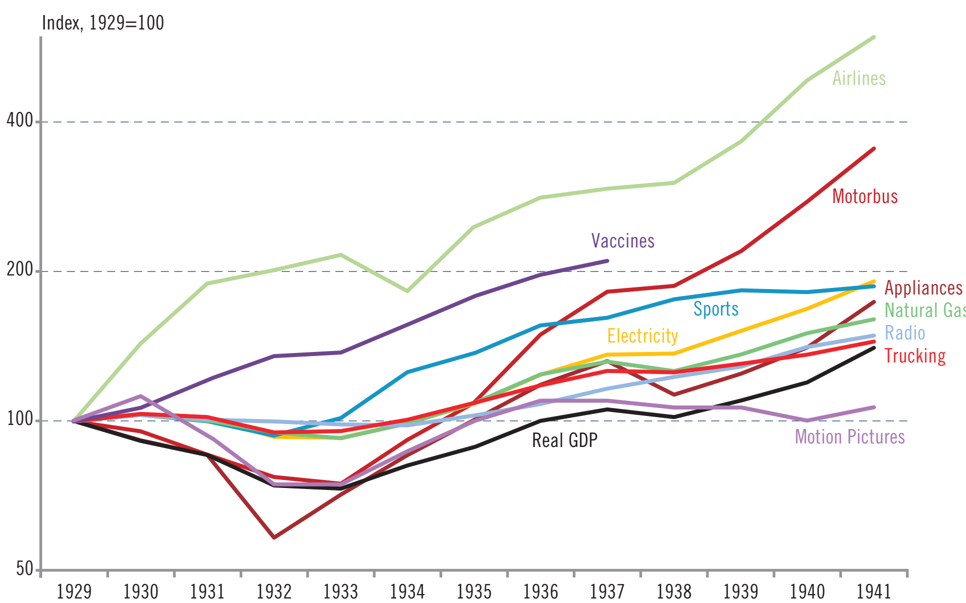
We may not be living in the worst of times, but they're surely not the best.

Measured by the yardstick of recent decades, U.S. economic growth has been slow for nearly a decade. Incomes have been stagnant for the typical middle-class household. Many Americans trudge off to work worrying about losing their jobs. Even if they avoid getting laid off, they wonder whether their paychecks will continue to support their families' living standards. Doubts have eroded the traditional American belief that the next generation will live better than the current one.

To an extent, the prevailing pessimism reflects a diminished faith in the economic system responsible for our prosperity. We can take a step toward restoring faith in American capitalism by reminding ourselves how free enterprise works to make us better off.

In *Capitalism, Socialism and Democracy* and other works, economist Joseph Schumpeter identified the key to economic progress—the capitalist process that relentlessly remakes the economy, not just occasionally but routinely and repeatedly. This constant

In Great Depression, Some Industries Thrived in Harsh Times



Source: Census Bureau historical data

churning of resources and production takes place in good times and bad—as our trip back to the 1930s reminds us.

Capitalism's price competition among existing firms benefits consumers—as an astute economist, Schumpeter recognized that. What he emphasized, however, is that most progress comes from *another* type of competition that's inherent in capitalism and driven by human ingenuity and innovation.

New ideas, new products, new technologies, new forms of industrial organization and the opening of new markets challenge the existing economic order. The companies that bring the new and better products to the marketplace will earn higher profits, which provide incentives to expand production and add workers.

As demand shifts toward these new and better products, consumers spend less on the old goods and services. The companies that no longer produce what consumers want see their prospects turn sour and, in many cases, go out of business. The workers employed by these companies often lose their jobs.

The telephone doomed the telegraph; the automobile eclipsed the horse and buggy; the refrigerator made ice delivery obsolete; music morphed through records, several incarnations of audio tape, compact discs and streaming downloads; the Internet has taken a heavy toll on once-thriving industries, including travel agencies and newspapers.

These changes spelled doom for the livelihoods for millions of Americans—from telegraph operators to newspaper reporters and editors. On the upside—and often ignored in the brooding over lost jobs—the economy created new enterprises, new jobs and new investment opportunities to replace those that no longer made economic sense.

Capitalist economies don't grow, they evolve. Schumpeter coined the immortal phrase "creative destruction" to describe the way capitalism's perpetual gales of change deliver progress. The phrase recognizes that the pain of bankruptcies and job losses are part of an ongoing process that improves living standards for most people.

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We can sympathize with those who suffer job losses and other hardships because of capitalism's relentless embrace of new and better products. At the same time, it's important to recognize that attempts to prevent creative destruction's downside will impede progress by preventing the movement of resources from producing what consumers once wanted to what they want now.

SPREADING THE WEALTH

Capitalism's relentless churn doesn't just improve everyday life with new and better products. It also makes most goods and services cheaper when measured by the currency that matters most—the time and effort it takes to earn the money to buy them.

Companies compete by using ingenuity and innovation to reduce the cost of making their products. They invest in new plant and equipment, including computers and software. They streamline production processes. They hire workers with better skills or train them on the job. The upshot is greater productivity—more output from each hour of work.

Wages rise when workers become more productive, providing the impetus for higher living standards. The best way to show this is work-hour prices, calculated by dividing the dollars-and-cents cost of goods by the average wage workers earn.

Suppose a loaf of bread costs $1.43—its average price in 2015. In the same year, average hourly wages (not including

Rising Productivity, Higher Wages Yield Lower Work-Hour Prices

Product	Early Year	2015 v. Early Year (%)	Product	Early Year	2015 v. Early Year (%)
7-day Cruise	1972	40.5	Dryer	1940	5.5
Pizza	1970	59.2	DVD player	1997	3.9
New home	1920	69.4	Chicken	1919	7.6
Movie	1917	74.6	Microwave	1967	1.8
Auto rental	1970	28.7	Coke	1900	5
Suit	1927	38.6	Range	1910	2.9
Dry cleaning	1946	36.8	Dishwasher	1913	2.6
Levi's	1897	16.9	Air travel	1926	3.3
Automobile	1908	26.0	Color TV	1954	2.1
Camcorder	1987	5.7	Calculator	1972	0.7
Gasoline	1920	20.5	Refrigerator	1916	1.2
Food basket	1919	16.9	Cell phone	1984	0.5
Room A/C	1952	10.8	Computing	1984	0.009
Mattress	1929	10.1	Electricity	1902	0.5
Washer	1911	2.4	Phone call	1915	0.0005
Hershey bar	1900	9.4	iPad	2010	85.3

Source: Authors' calculations

employee benefits such as health care, paid time off, etc.) were $22.17, or 37 cents a minute. The typical worker needed 3 minutes and 52 seconds to earn the $1.43 for his daily bread.

A hundred years ago, the money price of bread was cheaper—just 7 cents a loaf. However, the average hourly wage was just 23 cents. So bread's work-hour cost back then was 18 minutes—more than four times what it is today.

Work-hour prices have declined for a wide range of consumer goods (*see previous page*). When measured in work time at the average wage, for example, a Ford sedan today costs just 26 percent of Ford's 1908 Model T. Consumers are getting an even better deal because the Ford sold in 2015 had many more features (e.g., air-conditioning) and required less maintenance.

Gasoline to power our cars and trucks costs just 20 percent of what it did in 1920. Electricity to power our homes costs just 0.5 percent of what it did in 1902.

A 32-inch flat-panel TV costs just 2 percent of what the first 12-inch color TV cost in 1954—and the picture is light years' better. Long-distance telephone calls are nearly free compared to their work-hour cost in 1915, when human operators paid by the telephone companies had to complete all our connections using land-line technology.

Declining work-hour prices are what give more and more households the ability to afford new and better products.

Economy-wide data confirm the grand truth behind these examples. Since 1900, the cost of living measured in dollars has gone up by a multiple of nearly 20, but the cost of living measured in hours and minutes of work has fallen by 87 percent. The *real* cost of living, measured in work-hour prices, is just 13 percent of what it was back then.

These sharp, widespread declines in work-hour prices—i.e., wages generally increasing faster than the prices of goods and services—are a routine part of capitalism's success. Declining work-hour prices are what give more and more households the ability to afford new and better products.

Take, for example, DVD players. When introduced in 1997, they cost about $550, or 39.5 hours of work at the prevailing average hourly wage. In the first few years, only a handful of households owned one. Today, DVDs with more features sell for about $35, the equivalent of less than 2 hours of work. By 2011, 95 percent of households owned their own.

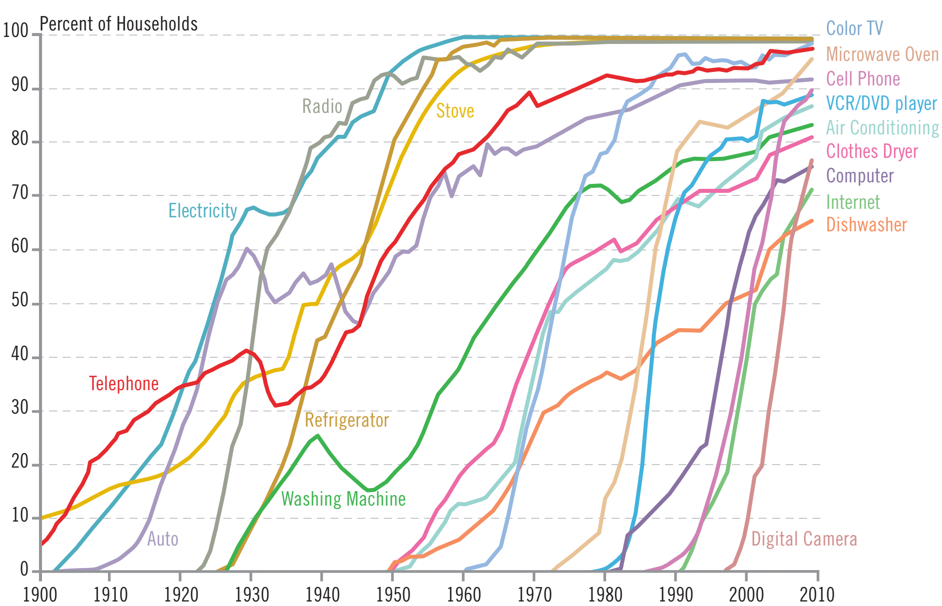
The same story holds for a wide variety of the goods and services Americans consume. What once was affordable only among society's wealthiest households has become commonplace among the middle classes and even the poor.

In the early decades of the 20th Century, the cutting-edge innovations of the times spawned such products as telephones, cars, electricity, radio and refrigeration (*see chart below*). Next came an array of household appliances, air-conditioning and color televisions. Each followed a path from starting as a niche product to becoming an everyday staple in the American household's consumption bundle.

The spread of products continued even during the 1930s as more American households acquired washing machines, refrigerators, radios, stoves and electricity. After initial declines early in the decade, telephones and autos resumed their upward climb as consumer staples.

In more recent times, computers, the Internet, cell phones and digital cameras have stood out among the ascendant products. With each new generation of innovations, the spread of products into households has sped up. It took decades for half of U.S. households to own washers. However, it took just a few years for computers, cell phones and digital cameras.

Spread of New Products—How Capitalism Delivers Progress



Source: Census Bureau, industry associations

FAITH IN CAPITALISM

American capitalism is still delivering progress, and we can expect new waves of innovation to remake the economy. Entrepreneurs have never had more knowledge and technology to exploit, so prospects for significant progress are vast. Thanks to globalization, markets are bigger and more diverse than ever, creating added competition and the potential rewards for success.

People want to be healthier, and

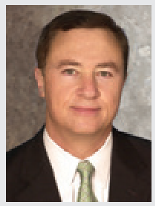
biotechnology, genomics and other medical technologies promise new treatments for what ails us. Nanotechnology has begun delivering new materials that are cheaper and better. Such emerging technologies as drones and 3-D printing are opening new vistas. The microprocessor, Internet, wireless communications and artificial intelligence have come a long way but they're far from being played out. Within a generation, advances in technology may give us self-driving cars.

Looking at the facts over the long haul, the case for capitalism remains strong—so why do so many Americans seem to worry these days about the economy and their futures? We can only speculate, but many Americans may be fuzzy on capitalism's record of progress. Yet, they may be fully aware of recent struggles to create jobs and raise incomes, either through personal experience or through opinions expressed by politicians and analysts.

The focus today seems to be on the downside of Schumpeter's creative destruction rather than the progress and opportunity that occurs in the natural course of capitalist development.

By itself, this pep talk won't restore America's faith in capitalism. That will require a revival of the economy, with ingenuity and innovation leading to higher productivity, falling work-hour prices and rising standards of living for average families.

Retreating from capitalism won't do the economy any good—it didn't in the 1930s and it won't today. What the country needs is more capitalism, not less. It will continue to give us endless opportunities.



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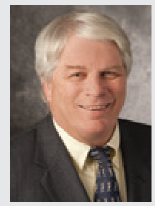

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CHARTING THE ECONOMY

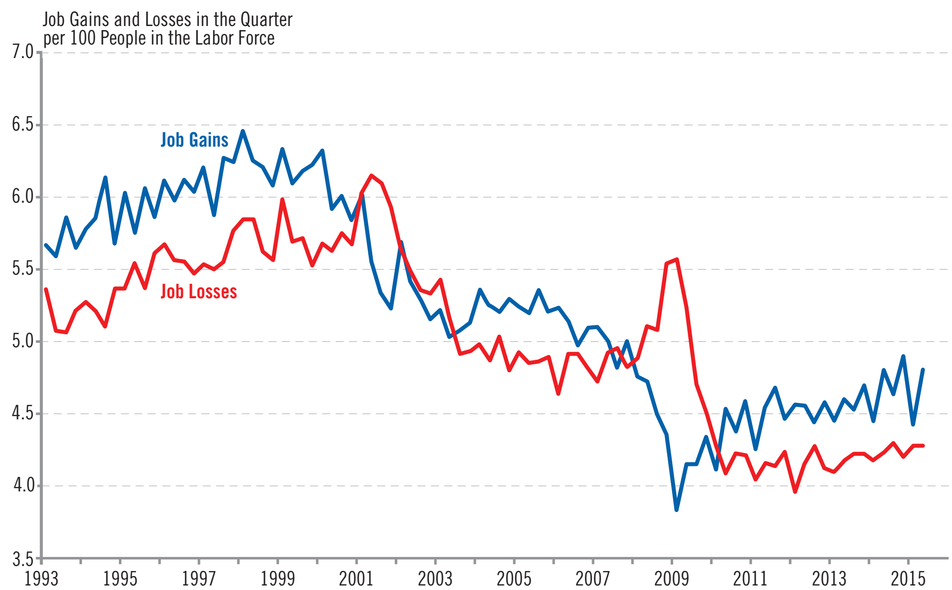
In U.S. Labor Market, a Slower Pace for Both Job Gains and Losses

The U.S. labor market doesn't show the dynamism it once did. In the fast-growing 1990s, roughly six jobs were created quarterly for every 100 people in the labor force (*blue line*); meanwhile, 5.5 jobs were destroyed (*red line*). On net, employment grew by 0.5 percent a quarter.

Since December 2007, the average quarterly changes per 100 people have been 4.48 for job creation and 4.41 for job destruction —a net gain (0.075) that's just one-seventh of what it was in the 1990s.

Reduced labor market dynamism means a slower rate of U.S. job growth.

Looking at the 10-year average of annualized employment growth, the economy has been creating just one job for every 200 employees in recent years. In previous decades, the rate of job growth was three to four times faster.



Source: Bureau of Labor Statistics