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Pessimists vs. Optimists: Who's Right on American Capitalism?

By W. Michael Cox and Richard Alm

One characteristic that defines Americans is optimism. It's part of our DNA—we *expect* a brighter future. In no small part, American optimism has been built on a capitalist economy that delivered steady progress in raising living standards decade after decade—each generation doing better than the one before.

The optimism that marked much of our history seems in short supply today. It may be a hangover from the financial crisis of 2008, it may be our poisoned politics, it may be that bad news sells, but Americans seem downright glum. The pessimism lingers even though the second quarter saw stock markets soaring to record highs and the current economic expansion passing its seven-year milestone.

The downcast mood inevitably leads to questions about American capitalism. A multitude of voices are declaiming that the U.S. economy can no longer deliver what it once did. They tell us the past decade and a half left many American families worse off. They tell us the middle class is disappearing.

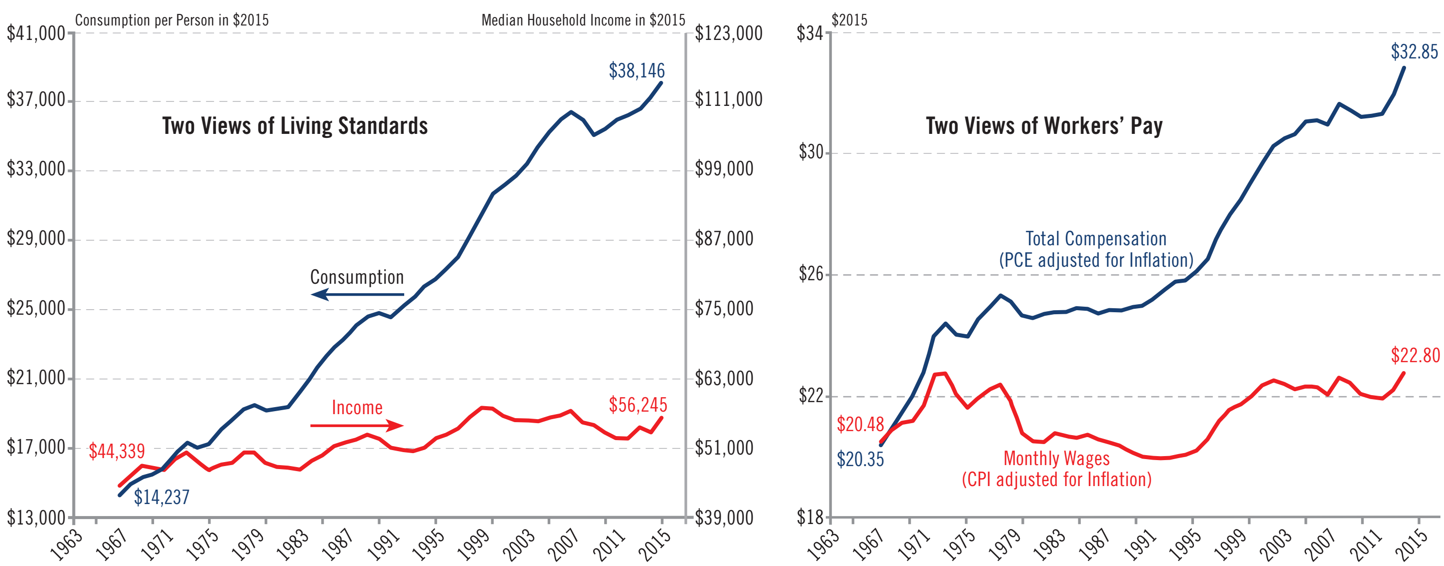
The pessimists tell us not to count on progress anymore, writing obituaries for the American Dream and its promise of opportunity and upward mobility. Today's young people—the so-called Millennials, the pampered offspring of good times—reportedly doubt whether they'll ever achieve the living standards of their parents' generation.

Is the pessimists' view of America fashion or fact? No one can know what the future holds. However, we gain some perspective on what might be ahead by looking backward at the performance of the U.S. economy in recent decades. The record points us to a more optimistic view: American capitalism still possesses the power to make us better off.

COMPETING NARRATIVES

The pessimists' narrative of capitalism on the ropes seems to get support from recent trends in median household income. Adjusted for inflation, it rose 25 percent over three decades, going from $44,339 in 1967 to $57,915 in 1999. After that, it declined by 3 percent to $56,245 in 2015 (*see chart below, left panel*). With their incomes shaky, American households have struggled to maintain their living standards—or so the narrative goes.

Dueling Data on American Capitalism: Pessimist See Stagnation, Optimists Find Progress



Sources: Bureau of Economic Analysis, Bureau of Labor Statistics

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Per capita consumption tells a starkly different story, with a far more encouraging ending. From an inflation-adjusted low point of $5,588 in 1934—the depths of the Great Depression—the average American saw annual consumption rise to $14,237 in 1967. Since then, consumption per capita has marched steadily upward, dipping only briefly during four recessions. In 2015, U.S. consumption per capita stood 168 percent above its 1967 level at an all-time high of $38,146—a number that refutes the narrative of a failing economy.

The two numbers are both reliably collected by reputable statistical agencies; yet, they reach very different verdicts on American capitalism. Capitalism's detractors are likely to latch onto the household income data; those who favor free enterprise might find per capita consumption persuasive. Ideological shouting matches won't tell us which view makes more sense. We need to look at the real-world factors shaping the numbers.

There are many reasons to believe the household income data don't tell us what's been happening in the U.S. economy. The story centers on a life-cyle view of the post-World War II Baby Boom generation, an outsized cohort that has been dominating economic trends for decades.

From their 20s to their 40s, the Boomers started careers and families. With expenses rising and college tuition looming, both parents often worked to increase household income. Americans' labor force participation rate (LFPR) rose from less than 60 percent in the 1960s to more than 67 percent from 1989 to 2008, when Boomers had their peak income-earning years.

In the past few years, with the kids grown, the aging Boomers have begun to reach retirement age. As some of them kick back, the LFPR has fallen to under 63 percent. So median household income has begun to sag as a result of demographics, not a flawed economic system.

> Consumption is more evenly distributed than income both across the population and over time—a fact rarely mentioned in the debate over the rising inequality.

CONSUMING INTEREST

Changes in society have helped keep consumption data on an upward path, supporting a more optimistic view. With more people living alone and fertility rates falling, American households have been shrinking, averaging 2.5 members in 2015, compared with 3.2 in 1967. Spreading each household's income over fewer people keeps per capita consumption on the upswing and raises questions about the disappointing income data.

What's more, households don't just finance consumption with today's income. The Baby Boom generation held consumption down while saving for the kids' college and retirement decades ago; more recently, as this outsized cohort entered retirement years, the Boomers have begun to draw down savings to support their current consumption.

Consumption data reflect the goods and services American families buy and use, so they offer the most direct measure of living standards. Wealthier Americans consume below their income levels, with big chunks of their incomes going to taxes and savings. Poorer Americans consume above their income levels because they receive transfer payments or rely on savings. Consumption is more evenly distributed than income both across the population and over time—a fact rarely mentioned in the debate over the rising inequality.

> These data are most likely ignored because they don't support the pessimistic narrative that American capitalism isn't performing the way it once did.

Acknowledging household income's shortcomings won't discourage the pessimists. Their narrative can turn to another dark cloud over the U.S. economy—average hourly wages, adjusted for inflation. The data show that the typical worker earned $22.80 in 2015, up an underwhelming 19 cents since 2003 (*see chart on first page, right panel*). If work doesn't pay like it used to, the path to upward mobility will be a much steeper climb for many Americans—or so the pessimists tell us.

Two main factors keep real hourly wages from measuring the true value of work. First, the data ignore employer-provided benefits, such as health care, savings plans, Social Security, paid time off and other non-cash compensation. These benefits have risen from 19 percent of wages in 1951 to 44 percent today. Second, the consumer price index (CPI), typically used to compare wages over time, overstates inflation and makes data on real wages artificially low.

Total compensation addresses both of these shortcomings. It includes employer-paid benefits, and we can adjust for inflation using the Bureau of Economic Analysis' price deflator for personal consumer expenditures (PCE). The PCE deflator differs from the CPI by an average of only 0.4 percentage point a year, but over the long haul the difference adds up.

Total compensation lagged in the 1980s and early 1990s, but it has gained 17.5 percent since 1999. Over the longer run, compensation is up 61 percent since 1967, compared with 11 percent for real hourly wages.

The public discourse rarely includes the trends in per capita consumption or

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total compensation. These data are most likely ignored because they don't support the pessimistic narrative that American capitalism isn't performing the way it once did.

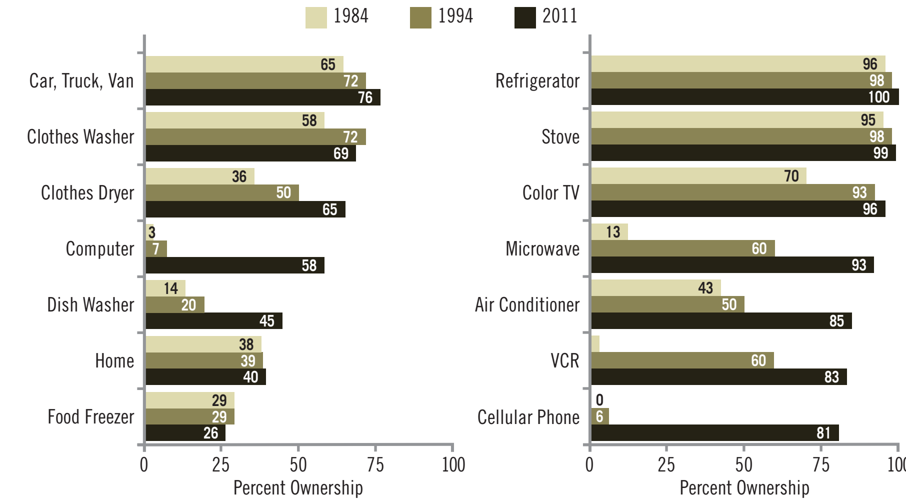
STILL MAKING PROGRESS

More positive signs for American capitalism are out there—if you take the time to look for them. We did. An admittedly incomplete sample, comparing 1980 and 2015, suggests that most Americans are living better than ever (*see chart below*). They're consuming more. They've made gains in health, safety and security. They've even got it better at work.

Consumption per capita doubled since 1980. The share of income going to food, clothing and shelter declined, leaving more money in the household budget for entertainment and recreation. The shift from basics to luxuries has long been a hallmark of societies that are growing wealthier.

Houses are larger. Their garages are more likely to have space for two cars. It takes fewer hours on the job to afford many goods and services—for example, 1,000 miles of travel by airplane or car. New products have quickly become commonplace, such as home computers, smart phones and Internet-connected devices. Americans even added to their nest eggs, with net worth rising.

Even the Poor Have More: Gains by Households Below Poverty Line



The gains in wealth play a role in the disconnect between rising consumption and sagging household incomes. Unrealized capital gains make households feel better off, so they're more comfortable saving less and spending out of current income. Consumption gets a boost.

Between 1980 and 2015, progress didn't end with consumption and wealth. Life expectancy at birth rose by five years. Death rates fell, including those for heart disease, cancer and accidents. Risk tends to decline while health and security rise as societies grow wealthier.

Americans saw working conditions improve in the decades leading up to 1980. The gains continued. The average workweek shortened a bit. Americans retired about a year earlier. Worker productivity nearly doubled. Each hour on the job bought more goods and services.

Pessimists still have at least one more beef. They lament that the rich are getting richer, implying that the poor haven't shared in the benefits of American progress. With the economy recovering from recession in 1984, the official poverty rate was 12.4 percent. Two decades later, it was 13.5 percent—perhaps a reason for pessimism.

Before concluding that the poor are worse off, let's look at a snapshot of what's happening to the living standards of households falling below the poverty threshold for a family of four, now at

From 1980 to 2015, Signs of Better Days for Most Americans

CONSUMPTION AND WEALTH	1980	2015
Consumption per capita ($2015)	$19,182	$38,146
Share of Household Budget spent on:		
Food Clothing, Shelter & Utilities	35.6	27.6
Entertainment and Recreation	8.9	14.3
Adults owing a smart phone	0%	68%
Average size of a new home	1595	2701
Median size of a new home	1740	2515
Households with computers	0.2%	84%
Households with 3+ internet-connected devices	0%	90%
Households with two or more vehicles	51.5%	57.0%
Work hours required for 1000 miles of air travel	8.3	4.3
Work hours for the gasoline to drive 1000 miles	6.1	2.7
Median family net worth ($2015)	$47,037	$92,334
Mean family net worth ($2015)	$121,361	$607,791
Market capitalization of all listed U.S. firms ($2015)	$3.4 trillion	$25.1 trillion
HEALTH, SAFETY AND SECURITY		
Life expectancy at birth	73.7	78.8
Overall death rate (per 100,000)	1007.3	724.6
Death rate: Heart disease	517.0	218.6
Death rate: Cancer	206.4	161.2
Automobile deaths per billion miles driven	32.9	11.1
Airline deaths per 100 billion miles flown	53.9	0.2
Overall accident death rate	43.4	40.5
WORKLIFE		
Average work week (Index: 1980 = 40)	40.0	38.5
Output per hour worked (Index: 1980 = 100)	100.0	198.3
Work-hour cost of CPI bundle (Index: 1980 = 100)	100.0	64.4
Employee benefits as a percent of money wages	37.3	44.1
Mean retirement age	63.7	62.9
Work-related deaths per million workers	134	31
Work-related non-fatal accidents per 1000 workers	85	34

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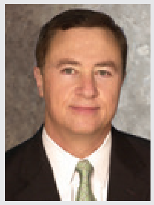
$24,036 a year. Nearly all of these low-income households now have refrigerators, stoves, color TVs, and microwaves (*see chart above*).

In 1984, only a few poor families had computers; now, 58 percent do. Poverty households living in air-conditioned dwellings went from 43 percent to 75 percent. Cell-phone ownership among America's poor is up to 81 percent and video recorders to 83 percent. The poor are more likely to own vehicles, clothes dryers and dish washers. In terms of consumption, today's poor households have it better than the middle class of just four decades ago.

How can living standards improve for the poor? Market competition, innovation and productivity growth make most goods and services more affordable over time—not just for the rich but for the poor as well (see *The MPACT Report*, second quarter 2016). It's what capitalism has been doing since the early days of the Industrial Revolution.

The past decade hasn't been the best of times for the U.S economy. Since the end of the recession, growth and job creation have been below the standards set by previous post-World War II recoveries. The prevailing pessimism, however, isn't justified by what's actually happened to living standards in the past few decades. American capitalism has continued to raise living standards despite the burdens of high corporate taxes, large federal budget deficits and increasingly meddlesome regulators. These are the biggest impediments to further economic progress.

Remove these barriers to free enterprise. Let American capitalism work. We might all become optimists.



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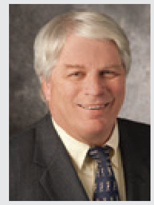

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CHARTING THE ECONOMY

Multi- or Single Family? Big Metros Vary in Mix Of Housing Permits

Among the nation's 25 largest metropolitan areas (MSAs), New York led in building permits in 2015 with 86,424, followed by the Dallas-Fort Worth (DFW) area at 57,146 and Houston at 56,901.

In terms of building permits per 1 million people, Houston finished second to Orlando (*see chart*). DFW wasn't far behind, coming in fourth in a virtual tie with Charlotte. MSAs at the top of the rankings had more than four times the housing starts as those at the bottom.

The Top 25 MSAs differ in the composition of building activity as well as its pace. San Antonio has the highest share of single-family houses at 82.8 percent. Riverside (78.7 percent) and Phoenix (74.2 percent) also skewed toward single-family.

Multi-family building dominates in the New York area (87.1 percent), Los Angeles (75.2 percent), Miami (69.5 percent), Boston (67.8 percent) and San Diego (67.4 percent).