WIRED

Wealth If You Want It

Downsizing? Wage stagnation? Widening income gap? According to Federal Reserve Bank of Dallas economist W. Michael Cox,the naysayers are just plain wrong: we have never been wealthier, and it's only going to get better.

By Kevin Kelly

Wages are falling. The underclass is huge and rapidly growing. Young people won't make as much as their parents. Class mobility is dead, and with it the American Dream.

Over the years, many economists have come to accept some version of this pessimistic worldview. Not W. Michael Cox. The Federal Reserve Bank of Dallas economist happily rejects the received wisdom of America's economic thinkers and proposes a sharply different version of reality. According to data assembled by Cox, wages aren't falling, they're rising. Only 5 percent of those who started out in the lowest income bracket in 1975 remained stuck there in 1991. In fact, nearly 80 percent of those who started out on the bottom made it into the middle class by the early 1990s. Almost 30 percent ascended to the top income bracket.

Cox arrived at these contrarian conclusions by studying a database many economists have overlooked: the University of Michigan's Panel Survey on Income Dynamics, which has tracked the individual earnings of 51,000 Americans since 1968. The Michigan study, Cox argues, provides a more complete picture of what's happening with wages and class because it is one of the few economic data sets that follows specific people over a long period. By taking a long-term view, Cox explains, you end up with a much more optimistic - and realistic - view of America.

Cox's America remains a land rich in opportunity. Work hard, get an education, settle down, learn something about computers, he says, and good things will follow. Instead of dwelling on the dislocating effects of technology, he believes that if workers adapt, their wages may rise faster than during any previous epoch. Cox's findings, laid out earlier this year in a Dallas Fed essay titled "By Our Own Bootstraps," has ignited a debate among economists, newspaper Op-Ed writers, and labor activists about whether American workers are as bad off as some practitioners of the dismal science recently have suggested.

Cox isn't an armchair theoretician. He speaks from personal experience. Cox, 46, began working in his father's bottling plant in Little Rock, Arkansas, at age 12. He met his wife during a high school fling as the lead guitarist in a rock band. He left behind dreams of music fame (though he still plays guitar and piano) and embraced economics, earning a PhD from Tulane University. But the halls of academia didn't provide any shelter from adversity. He was denied tenure at Virginia Tech in 1983. After a short stint sulking, he landed a job as an economic analyst for the Dallas Fed in 1984.

The move couldn't have turned out better. Thanks to a series of essays Cox has written about the changing American economy, the mild-mannered economist has attained a

prominence he probably never could have reached in the classroom. But Cox hasn't given up teaching altogether. He still lectures on economics and the nature of economic growth at Southern Methodist University, where he is an adjunct full professor.

There is no better time to be alive, Cox believes, than today. He's fascinated with today's technology. He has two computers in his small office, and he's constantly cramming them with facts he has gleaned from economic studies or the news, facts that he inevitably uses to argue that life is better today than yesterday. To back him up, his office is filled with old magazines and even 30-year-old phone books, which he employs as reference material to show how the array of goods available to the common person today is exponentially superior to that which our forefathers 20, 50, or 100 years ago could choose from.

Besides igniting controversy, Cox's favorite pastime these days is long distance running. Ever the optimist, he hopes to run in a marathon someday. *Wired* caught up with him in his office overlooking Dallas.

Wired: So much of what passes for economic and political analysis these days is unrelentingly negative. But you argue so passionately that our economic future is brighter than ever. Why?

Cox:

Ordinary folks who don't understand where we're going with the economy today are getting misinformed. People need to hear that we are going through a revolution. We're going to come out fine on the other side, but it means you're going to have to change what you do, how you do it, where you work, what you produce. You need to do this because we're moving, and it's OK.

But people aren't hearing any of that stuff. They're hearing "Life is bad, it's clearly cruel and unfair." Government is telling them that the economy is broken. From labor they're hearing it's unfair that we have so many layoffs. The media talks about "corporate killers." I can't sit there when I - like other economists - know that the kind of economic revolution we're passing through has happened only two or three times before. People need a context.

What danger does this rising pessimism pose to economic change?

There's a great danger that people will swallow these doomsday stories and believe we're becoming a nation of hamburger flippers. An uneducated population can be gullible. A lot of these forecasts say that we're going to be the first generation in US history not to do as well as their parents, that both adults have to work these days for a family to live, that there are no good jobs anymore, that we're in decline. There are people writing doom-and-gloom books who are capitalizing on the angst people feel.

I understand that people get angry about losing their jobs. I lost my job in the publish-or-perish tenure system. It was really tough on my family. I was dejected for weeks. There's a very natural feeling at that time to want protection, to feel like a helpless victim. If you get enough people feeling that way and they get together, they can stop the whole system from churning forward. Capitalism is a system of economic change - if it wasn't, then 90 percent of us would still be farmers.

Why aren't today's economists helping explain this fundamental change?

This is one failure of economics - the failure to teach people that capitalism is a system of change. Most economists who teach macroeconomics, which is supposed to be about the study of the whole economy, instead teach only about production, distribution, allocation, and equilibrium.

But economists influenced by Joseph Schumpeter, as I am, stress something entirely different. They stress that capitalism, by nature, is a method of economic change, that it never was and never can be stationary. Schumpeter said that progress destabilizes the economic world. And we're always having some kind of technological progress. Right now it's the computer chip, which, I think, is the second most revolutionary invention of mankind. The first would be electricity.

How do you measure how revolutionary an invention is? Couldn't you rank the car up with the computer?

You have to trace the spillover an invention has into other areas. The car was pretty important. About 12 million people are employed today directly because of the automobile. And so many of our jobs rely on the car just to get to work. But virtually everybody uses electricity all the time. You couldn't run a car without electricity.

The computer chip is showing up everywhere. It's in pacemakers, it's in new devices that can defibrillate your heart, it's in PCs and cellular telephones - it's in more than 1,000 products right now.

If the computer chip is so good, why is there such a backlash against it?

It's the return of the Luddites. They used to go around during the early industrial revolution breaking machines because they recognized that machines were guilty of bringing huge changes into their community. When the machines started to replace 250 people, that's when the Luddites struck.

Today we have people like the Unabomber. He hates the computer because it's throwing people out of work. That's just like the Luddites. I have a friend who designs computer systems, and he just replaced a company's system that had been destroyed by an accountant who lost his job to the computer. So they're here.

People are mad because the machine is replacing them. Of course, they're right - a group of the population will have to be retrained - but we're ahead in the long run if we accept the change.

New growth government

It isn't just the fringe that's fighting against technology. Aren't politicians like Pat Buchanan and elements of the labor movement also helping to lead the charge?

I always say politicians need a dependent populace. Their shtick goes something like this: "Life is bad, it is clearly cruel and unfair - vote for me, I'll help you." Alexis de Tocqueville warned us about this in 1840 in *Democracy in America*. He cautioned Americans against creating a government that would keep them in perpetual childhood by doing everything for them. And this has become American democracy's dark side - the government as our shepherd.

Is that just the nature of democratic government or is it how Keynesianism, with its guarantee of economic stability, has played out?

It's definitely linked to the 1930s, when the government began huge economic programs. The Depression was billed as a failure of capitalism, and that notion was accepted for a long time. According to classical economics, a depression of this magnitude wasn't suppose to happen - but it did. So we brought in government to help us. And we invented Social Security, unemployment compensation, and the minimum wage. Then welfare programs began. We began to have government that took care of people. Keynesianism won the day. Government began to intervene to stabilize the economy, to dampen cycles. Constant government regulation became ingrained. And it has grown, grown, grown. Prior to the First World War, government - local, state, and federal - was 7 percent of GNP. Now it's close to 40 percent. Federal is about 22 percent.

But what is the alternative to relying on government?

Where did all the great stuff in this country come from? It didn't come from government, it came from ordinary people who work hard every day to invent products. The little man is the big man in the capitalist system. Look at Ford. He built a car every man could afford. He brought American living standards forward more than anybody who has ever worked for government. Look at Bill Gates. Or Wrigley, who gave us chewing gum. These are the guys who deliver the goods for the masses. They are the heroes, the rags-to-riches people. And because in a capitalist society nobody can force anybody to buy anything, an entrepreneur has to figure out what you really want. The only way to get rich in America is to research, design, develop, manufacture, and then market a product at low enough cost that people don't just walk by and say, No thanks.

Look at a 1988 RadioShack catalog. A cellular phone cost $1,500. Now they're free. Whoever invented this has gotten wealthy, but now the technology is available to the masses. It used to be flying coast to coast was something only the rich did. Look at *Fortune* back in 1939: the ads glamorize air travel. Travel is for the wealthy - the "jet set." Now you find kids, teenagers, people in tennis shoes. The heroes are the people who deliver the goods for the masses.

There have always been rich people. But four out of five millionaires today are self-made. Only one in five got their money from their parents. That's compared with three out of five a generation ago. Just look at the rich today. The information age is bringing us a new set of moguls, including Bill Gates and Ted Turner. But they were nobody yesterday. These are the folks who are making it big.

So what role do you think government should play in the economy?

I think new growth theory has it right. Government needs to be subjugated to the power of the market. There are lots of things left to invent, and many of them have spillovers across industries. By encouraging research and the development of research consortia, government can help identify inventions with spillovers.

New growth theory, which teaches us the important role ideas play in driving economic progress, also teaches us that companies and people who invent things should be able to reap a profit. Government needs to develop strong patent and intellectual property laws to protect invention. Like any other institution, government has to continually evolve to keep pace with this dynamic economy. And to encourage growth, we should keep taxes low and stable.

Unfortunately, the federal government is constantly changing tax and regulatory policy, and that regular churning inhibits the ability of people and companies to plan. We've got to get beyond experimenting with the economy, always trying to figure out what the best tax policy is.

Reeducation camp

Is there any general statement we can make about the "new" rich people?

They're very entrepreneurial. You need more brainpower to succeed today. The brain is not something you can just conjure up. Your mental capacity is like a muscle. It has the ability to grow through hard work and study. And it can be harmed through things like alcohol and cocaine. Our brain is our capital today - it has eclipsed the machine.

In the past, we worked with a piece of metal, which required motor skills and dexterity. Today, it's intellectual capital that matters. I hope this generation understands that you have to protect your brain, your capital. And there's a lot you can do to build it up, including exercising, eating right, sleeping, reading. There are a lot of things people can do to become much more creative, to increase the power of the machinery they're walking around with in their head.

But the education system doesn't help kids become creative. We're still teaching them skills needed on an assembly line.

That's right. Education is way behind, it's been behind since computers came into the work force in 1980. Folks have been doing a lot more learning on the job than they have in the past. Businesses have even started teaching their new employees - you have to reeducate your college grads! We need to bring our education system into the 21st century. We need to train people so they can get jobs. Don't get me wrong. I think geography and art and history are important. I still read history and I enjoy it, and I know more about the world when I'm done with a book. But I wouldn't have time to read if I hadn't been trained to become an economist. If you're not trained to get a job, then you need so many jobs to live that you don't have time left to read or learn anything new.

What would you do to overhaul the educational system?

I have four things dear to my heart that I would do to overhaul education. First, I'd get competition into the schools. If we believe competition works to deliver the best goods in other parts of the economy, then why do we exclude it from the most important part of our society? We need choice, so I'd allow people to use vouchers to go to the school they want. We also need to link the salaries of teachers and administrators to their success, which we could measure using the test scores achieved by their students.

Second, we need to allow tax breaks for college and graduate school. We have an Iron Age tax policy in an information age world. In other words, we allow companies to deduct the depreciation on their equipment, on their physical capital. But we don't do anything for human capital, for a person's intellectual capital development, which is as important as physical capital in the information age. We should allow doctors to deduct the cost of their education from future earnings, we should allow parents to take a deduction for financing their child's education.

Third, I'd restore an emphasis on developing basic skills for those people who aren't going to develop analytic skills. I'd emphasize training in how to follow instructions, spell, do math, and how to relate to other human beings. This kind of training would help these people get into the labor pool.

Finally, I'd get rid of the tenure system. Tenure is an antiquated system. It encourages an allegiance to the status quo and a sluggish response to the market. Tenure simply allows people to go on teaching whatever they've been teaching no matter how the underlying economy has changed. Unfortunately, it's a subsidy to slackers.

But your study tells us that the recipe for success really hasn't changed much - if you get an education, work hard, get married, then good things follow.

It hasn't changed. The only change may be that you have to pay more attention to the development of your human capital. And part of that is really learning how to operate a computer.

Why hasn't the formula changed, given how radically the world has changed?

Well, think about it. It's cheaper to live together - to get married - than it is to live apart. You need to learn to get a good job. Get a good education, and then get a job. You work full time, save your money, buy a house, get married, buy a computer and learn it, and work hard. Then bide your time.

But that formula doesn't seem to apply to our current crop of success stories - Bill Gates, Steve Jobs, and Larry Ellison.

I'm trying to provide a formula that works for everyone. Anything could work for those who make 800 on the math portion of their SATs. The rules don't apply for some people.

Still, does success today require different talents than in the past?

Some personality traits have become more important. How you treat people, for instance, has become much more important now that we're in a service economy. The ability to pamper people is worth a lot more today.

When we worked in the fields or the factories you could be mean, and as long as you turned out the goods, it didn't matter. But today, how you relate to human beings is important. Things that didn't have a high rate of return in the past now have a high rate of return. Like a sense of humor. Folks like having someone to work with who can put them at ease. A personal touch is important. If you make a customer feel important, he or she is likely to buy more.

There's a whole totem of human tal-ents that begins with muscle power, which is what we've traditionally relied on. Two hundred years ago, if you had a strong back, you could work in the fields, operate a pick and shovel, or help lay a foundation for a building. People, mainly men, got paid for their muscle power. And then we got steam shovels, which diminished the need for muscle power and elevated the need for manual dexterity. You needed people to coordinate the power of machinery. And then the machines got smarter, and so we moved from the factory floor to the front office, where we filled out papers and checked forms to make sure things were done right. Those skills were called formulaic intelligence - doing the same thing over and over again. Now things that are repetitive - like the job of a telephone operator - have been programmed, so we must upgrade our skills again.

Creativity is important, so is analytic reasoning, and so is a personal touch. Managers, for instance, have to have a certain touch to help employees become more creative. A personal touch has become much more important.

Demythifying the gap

Let's talk about the economic myths you attack. Some of them aren't simply made up in the minds of commentators. For instance, isn't there truly a widening gap between the rich and the poor?

That's the most dangerous myth of all - that the rich are getting richer, the poor are getting poorer, and most of us are going nowhere. This suggests that society should turn against the rich. By definition, a minority of the population is going to get rich. It's the top 20 percent. But if we go after the rich, who are we going after? We're going after the people most of us aspire to be.

But don't people have a reason to despise the rich? After all, they're indirectly benefiting from layoffs and falling wages.

If you ask most people if they'd like to be rich, most will say yes. Then I say: Work hard, save your money, go to school, be entrepreneurial, take a risk, and then you'll have a good chance to join the top 20 percent, and maybe even join the top 1 percent. Why would you want to put in place a policy so that when you get rich, you're screwed? If you do, you're never going to want to get there. And if you don't ever want to get there, then capitalism, our whole technological revolution, will grind to a halt.

So by attacking the system, by attacking technology, you could end up with a marginalized nation, wedded to outdated and backward technology, say, like Britain in the 1970s?

That's right. People can kill the goose that lays the golden egg. What lays the golden egg is the prospect people have to get ahead. Drive is what powers the capitalist system. Achieving economic gain is a very powerful motivator for a lot of people.

Isn't it a lot harder for people to move up these days?

It's never been a zero-sum game, despite what economists like Lester Thurow say. If it were a zero-sum game we'd all be cavemen, because we wouldn't get anywhere for all our efforts. But the incentive system that drives our whole economy uses my pursuit of self-interest to maximize the social good. Because my attempt to get ahead leads me to create products that other people use to their benefit. If we put in place social and economic policies that take so much from the rich - who are always going to be a minority - then you will take all of the fuel out of the system.

But you hear so often from people in government, like Labor Secretary Robert Reich, that people are not getting ahead anymore.

Listen, people are getting ahead. Not everybody is, and not everybody is going to. And not everybody wants to. What government is trying to do is create a fail-safe economy, where nobody can fail.

People make choices every night when they are in school - will I study really hard or will I lie back and just goof off? Now, if I'm faced with that choice, why do I study? So I can get ahead, of course. Do I do drugs or choose not to do drugs? Do I treat people well or am I mean as hell to them? Do I save or do I spend like crazy?

If you create a system where you aren't penalized for making the wrong choices, then the whole society is going to come to a grinding halt. Because the people who are making the right choices will finally say, "What am I doing this for? It doesn't matter, because I am going to end up in the same place as the guys who made all the wrong choices."

So you essentially end up with a victim society?

We're already there in some respects. If you have acquired a drug or alcohol dependency, it counts under the American Disabilities Act as a disability. So if you've drank, shot up, or snorted your way into oblivion, then the government owes you money. That means you and I are paying. If we go down this road too far, and nobody is penalized for making the wrong choices, we'll end up like the Soviet Union, where the government tried to make everyone equal. It succeeded, only it made everyone equally poor.

Are wage gains or losses the correct measure to be looking for when we determine our economic well-being?

Our study shows that the proper thing to look at is not wages but total employee compensation. Employees have gone out and bargained for health care, paid vacations, and pension plans to which employers contribute. In fact, employees bargained for these benefits because they're cheaper for the employees - they're not subject to taxation. As a result, the benefit rate is up from 25 percent of income in 1965 to 44 percent today. If you look at total employee compensation, that statistic has been rising all the way along.

But did total compensation rise at the same rate after 1973, when productivity and wage gains began to falter, as it did prior to 1973?

No, it did not. It rose more slowly. But that's because total employee compensation figures leave out some forms of income, like rental income, dividends, profits, and interest. But remember that the wage data captures only 66 percent of American workers. The other third are owners and entrepreneurs who don't work on wages and salaries. People like doctors, lawyers, and businesspeople take their earnings from the profits of their business. Their "wages" have been going up faster, which is captured in per capita personal income, which is going up at the same rate as before 1973. That reflects the benefits of human capital development. An advanced degree, a CPA, has been earning more. If we include those people, wages are rising as fast or faster than ever.

So people are getting other forms of compensation that make up for slightly slower wage increases?

True. People complain all the time that they don't see wage increases, but they're getting other forms of compensation they forget about. So do we care about these benefits or don't we? Back in 1953, people didn't have many of these things - nonpay compensation was only 19 percent of wages. Today we have seven more days paid vacation than we did then. That counts. If you take your pay in the form of getting more paid time off, then that's also pay.

Still, aren't the "wages" of entrepreneurs and owners growing faster than those who simply rely on wages and benefits for their compensation?

The gap is attributable to the fact that education has a greater rate of return today. Back in 1972, a person with an advanced degree earned about 1.72 times more than a high school graduate did. Today it's 2.45 times as much.

Your report indicates that there's significant mobility between classes. Is the mobility increasing?

There is no way to statistically prove that mobility is increasing or decreasing, because statistics don't go back far enough. The data we have begins in 1968, and we're just generating the 1992 data now. Inside that date, the most consistent data is from 1975 to 1991. There's nothing comparable before 1968.

But think about it. What did it take to get ahead in the past? First, you had to have some kind of capital, either physical, financial, or human capital. Then each one of those had their own returns. And to maximize their use, you had to be as free from discrimination as possible - both gender discrimination and racial discrimination.

I would argue that in the past there was a lot more discrimination - don't get me wrong, it still exists, but it's better today. In the past you needed more financial and physical capital, and only the establishment had access to the financial capital. You had to have some kind of connection, and you had to be the right sex and also the right race. Today it's a lot easier for minorities - it might not be equal, but it's a little easier.

What does it take to be successful in today's economy? Basically it takes one thing - human capital. We all have access to books from the time we're 5, we all have access to school. I tell my students at Southern Methodist University that there's gold in their books.

It doesn't matter how poor or rich you are: if you work very hard, you will get ahead. And if you're poor, you'll probably get further ahead because you learn a lot and work harder if you've suffered. The poor often get further ahead because they have this incredible drive to get ahead. They've seen the other side.

Is an income gap between rich and poor a sign of economic failure?

It's automatically assumed to be bad. Which is completely crazy. Wealthier societies have wider income distributions, and always have. Poorer countries have very narrow income distributions.

Why the difference?

If you go back to the 1830s, you'd see that the average person worked about 76 hours a week. By the time we got up to 1890, that had been cut to about 60 hours a week. Ten hours a day, six days a week. What could we afford on 60 hours a week? Food, clothing, shelter, a little furniture - not all much, really. There wasn't much difference between most people; we were all working very hard just to pay for our food, clothing, and shelter; and we were all working around 60 hours, give or take a few hours. You couldn't tell much difference between what different human beings might want back then because there wasn't much time or money for wants.

We've come so far since then - 93 percent of Americans officially defined as being in poverty have color televisions, more than 60 percent have VCRs and microwaves. We're beginning to find out that people are different. Some people like to take progress in the form of consumer goods, while others like to take it in the form of more leisure. I've got friends back in my hometown of Little Rock who try to get off work as early as possible so they can go fishing. Other friends work hard to buy expensive watches and cars.

How do we account for the many permanently poor people, commonly called the underclass? Your study says only 5 percent who started out in the bottom income bracket are there 15 years later.

The size of the underclass is grossly overstated. There is an underclass, and it has grown. But what is the underclass? The people who stay in poverty year after year. According to data from the Census department, the median duration of a poverty spell for someone not on work disability is about seven months. There are people in poverty longer than that, which we call the underclass.

One increasingly large group is the permanently disabled. Some have fried their brains. Others have acquired their disabilities through job-related problems. One out of every eight people who were not poor in 1970 and who became poor by 1980 fell into poverty because of a disability. More often than not, disability was associated with being a high school dropout. These people start out in manual labor, with inferior health care, and hurt themselves. Or else they claim disability to get out of work.

So we should limit disability?

Human beings always respond to incentives. Why is it that 100 years ago people worked harder but you didn't see a lot of disability? People carried 100 pounds of sugar around all day and they worked without injury for many years. Human beings can be as strong or weak as we want them to be. To some degree, disability insurance may be encouraging them to be weaker.

The long march

You said we have to accept constant economic change if we're going to live in a true capitalistic economy. But do you see any acceptance of this fact from either of the major political parties during the election season?

This year I realized it's not just the Democrats who don't understand how capitalism works. The Democrats are trying to protect labor, and the Republicans are trying to protect big business. Corporations don't want change, either, like in Japan, where Fuji, Toyota, and Mitsubishi don't want American competition.

This is why Schumpeter said capital-ism ultimately wouldn't survive. He pointed out that capitalism bred natural enemies. One of them is labor, because people don't want to keep changing their jobs all the time. The other group is business, which he thought would become so successful it'd co-opt government. The government would act to impede the introduction of new technology and competition. Existing corporations don't want change - they want monopolistic markets and monopoly profits.

If this happens, we'll evolve far away from capitalism toward something like mercantilism, where the merchants have the government in their pockets. Labor would be bought off by the stability. Of course, if the rest of the world doesn't follow, a country that adopts this course risks being left behind.

As the productivity gains of new technology spread through the economy, do you think we'll see wages begin to grow again at pre-1973 levels?

That depends on whether people will listen to the scare industry and all the people who tell them that the system is now broken, or whether they understand that we're rapidly moving from the manufacturing age to the information age and they need to adapt. It all depends on whether they get the correct understanding of the world, then get educated and retrained. If so, then they'll begin to see the many benefits.

Unfortunately, the current policy debate is not being directed toward giving people the correct understanding of what's going on. Instead they're being taken advantage of - and they're being scared - for political purposes.

Certainly the worry people feel about the future isn't all due to scaremongering. With all the change happening around us, isn't there some reasonable basis to fear the future?

There is some sound basis for the angst. Technology is deeply changing the way we live and work. But rather than explaining it, doomsayers are scaring people. It's the duty of intelligent people to explain that if we make the change and adapt, then our future is far more promising.

Face it: The certainty of misery is worse than the misery of uncertainty.

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Kelly Wednesday, October 30, at 1 p.m. in the Wired Arena (www.wired.com/arena/)