

## EDUCATIONAL NOTES

### Three Contemporary Economic Myths About Income and Material Well Being

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#### **Abstract**

A major challenge facing economics educators is helping students critically assess the media coverage of economic issues. The media are often the purveyors of a variety of economic myths that simply do not stack up to the facts. Over the years, I have collected several of these myths and provided empirical data that calls them into question. In this essay, I provide data and economic analyses that undermine three of those myths: Living standards are declining, the rich are getting richer and the poor are getting poorer, and jobs are paying less than they used to.

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One of the problems we face teaching economics is combating a barrage of media reports that the world is always getting worse, when a closer look at the economic data frequently suggests just the opposite. Obviously, bad news and talk of impending doom sell more papers than the longer-run, more mundane, news that life continues to improve for the vast majority of Americans. What follows is a collection of three of the most frequently repeated economic myths of our time, followed by data and analysis that illustrate why those myths are, in fact, myths. Specifically, I offer responses to the following three contemporary economic myths: Living standards are declining, the rich are getting richer and the poor are getting poorer, and jobs are paying less than they used to.

The work below was originally developed as a web page almost ten years ago. What follows is a slight revision of that page, including some more recent data to support some of the arguments. Some of the data remain a bit old, but they are still effective. Both the original

web page and this article can be very effective teaching tools in courses dealing with current economic issues.

**Table 1: Changes in the Labor Time Cost of Various Consumer Goods**

	1920	1950	1980	1997
1/2 gal of milk	37 mins	16 mins	8.7 mins	7 mins
1lb loaf of bread	13 mins	6 mins	4 mins	3.5 mins
gallon of gasoline	32 mins	11 mins	10 mins	5.7 mins
100 miles of air travel	12 hrs	4 hrs	1 hr	1 hr
	46 min (1930)	7 mins	27 mins	2 mins
3 minute coast-to-coast long distance call	30 hrs	1 hr 44 mins	11 mins	2 mins
pair of Levis	10 hrs	4 hrs	2 hrs 48 mins	3 hrs 24 mins
3lb chicken	2 hrs	1 hr 11 mins	18 mins	14 mins
100 kw hrs of electricity	13 hrs	2 hrs	45 mins	38 mins
computing power of 1 million instructions per second (MIPS)	n/a	515,000 lifetimes	41 weeks 16 hrs 9 mins	9 mins

Source: Cox and Alm (1999, p.43)

**Table 2: Labor Time Cost of Sears Catalog Goods**

	1975	2006
Freezer	79 hrs	39.8 hrs
Answering machine	20.43	1.1
Garage door opener	20.1	8.57
High-priced work boots	11.49	8.26
Top automobile tire	8.37	2.92
Low-priced gas mower	13.14	8.56

Source: Boudreaux (2006)

**Myth 1: The cost of living steadily rose throughout the 20<sup>th</sup> century, especially in the last few decades.**

Why would people believe this on its face? Look around: the prices of most things are higher than they used to be. Of course some of this is inflation, but even if you discount the inflation, many things cost more real dollars than they used to. Does this mean the cost of living has risen? Not necessarily. Don't forget the earnings side. Don't we want to know some sort of comparison between wage levels and prices? Isn't that what really matters – how much our wages can buy us? If wages are way up, higher prices may not be a big deal.

The ultimate measure of the cost of consumption of goods is the labor time needed to purchase them. A pair of pants might cost \$20, but if the average industrial wage is \$2/hr, then those are more “expensive” than if the average industrial wage is \$10/hr. Five times more expensive, we might add. When looked at this way, the real cost of living dropped significantly and consistently over the course of the century, including the last few decades. Tables 1 and 2 provide the labor time cost of various consumer goods over the course of the 20<sup>th</sup> century and then in the 30 or so years prior to 2006. These calculations are all based on the average industrial wage in the year in question.

How does the process of progressive cheapening happen? New technologies and products spread from the rich to the masses. The rich pay the big up-front costs by purchasing products when they are very expensive. This enables firms to continue to do R&D, cut production costs, and bring down prices. Think of any technological gadget of the last 30 years. Note the way that current new technologies like LCDs and plasma TVs are going through the same process.

Also think about the variety of products available now in comparison to the past. Think of potato chips now vs., say, 30 years ago! Compare all the varieties available now vs. then. Or think about milk, or almost any good you can think of. None of this includes new products that didn't even exist however many years ago. The increase in variety is one of the best signs of increasing well-being and a rising standard of living.

Some things do cost more, even in terms of labor hours: houses and cars, to name two. Is that a problem? Probably not. Why? In both cases, the goods in question are of significantly greater quality than in the past. Compare the standard features on contemporary cars and homes with those of 20, 40, or 100 years ago. Yes, they cost

more, even in real terms, but what you get for your money is substantially more. In addition, the average new home is much bigger today than in the past.

**Myth 2: The rich are getting richer and the poor are getting poorer.**

This is a tricky one. In one very crude sense it is true: over the last 20 to 30 years or so, the top 20% of income earners have increased their share of total income substantially, while the share going to the middle 3 quintiles fell very slightly, and the share going to the lowest 20% fell more than slightly. In 1997, for example, it broke down the following way:

**Table 3: U.S. Income Distribution by Quintile, 1997**

	Top 20%	Second 20%	Middle 20%	Fourth 20%	Lowest 20%
Percent of Total Income	49.4%	23.2%	15.0%	8.9%	3.6%

Source: Cox and Alm (1999, p.70)

We can see how these numbers compare over time by looking at U.S. Treasury data comparing the top and bottom from 1975 to 1997:

**Table 4: U.S. Income Distribution to Top and Bottom Quintile: 1975 vs. 1997**

	Top 20%	Lowest 20%
1975	43.2%	4.4%
1997	49.4%	3.6%
Change in income (constant dollars)	+\$37,633	+\$207

Source: Cox and Alm (1999, p.71)

So in the following sense it is true that, and read carefully: “The people who were rich in 1997 earned a larger share of total income than those who were rich in 1975, and the folks who were poor in 1997 earned a smaller share of total income than those who were poor in 1975.” Does this show the rich are getting richer and the

poor are getting poorer? Not really. The problem with this analysis is that it's way too static, and here are at least two considerations to keep in mind:

1. Even if the relative shares of the poor declined, this doesn't take account of the overall growth in income. The first two rows above are only in percentages of total income, not absolute amounts. Would you rather have 1/6th of a pizza or 1/9th? Doesn't it depend on how large each pizza is? If the economy has grown significantly, even a drop in the relative income share of the poor might mean a jump in the absolute amount they have. In fact, if you look at the data, that's precisely the case. The U.S. economy grew substantially between 1975 and 1997, and the average income of those in the bottom quintile did rise in real terms (\$207 on average), albeit not by very much. So even though the relative share of the poor fell, their absolute income rose. However, that's not the big problem with the myth.

2. The people who were poor in one year are not the same people who are poor in a later year. It's comparing apples and oranges in some sense. The data in Table 4 do *not* say that the people who were poor in 1975 earned even less income on average when *they* made it to 1997. Why not? Because each quintile is made up of different people in each year! It turns out that most of the people who were poor in 1975 were no longer poor in 1997. What we'd like to know is how did the people who were poor in the earlier year do in the later year. We do have data that track specific households over time. Tables 5 and 6 present two such data sets.

If we compare two years, some/most of the people who were poor in the first year will not be the same people who are poor in the later year. Some highlights of Tables 5 and 6: The biggest surprise is the number of people who start in the bottom quintile and work their way out. In Table 5, more than 85% of the poorest quintile in 1979 were no longer in that quintile in 1988. In Table 6, the number is almost 95% for the longer period of 1975 to 1991. The vast majority of the people who are poor in year *x* are not going to be poor in the near future. (If you are thinking this is only a long-run phenomenon, consider this: according to the Census Bureau, between 1984 and 1985, 18.2% of families in the lowest quintile had moved up one or more quintiles. For 1985 to 1986, the number was 18.4%, and it was 17.0% for 1987 to 1988. So there are steady year-by-year gains.) Even for the rich, there are no guarantees. Granted, if you started the

period rich, you were more likely to stay in your quintile than were the poor, but even there the odds were roughly 50/50. More than a third of the top 20% of income earners in 1975 were no longer in the top quintile by 1991, and the numbers are comparable for the 1979-88 data.

**Table 5: Income Mobility, 1979 to 1988 (U.S. Treasury Data)**

	Bottom 20% (1988)	Fourth 20%	Middle 20%	Second 20%	Top 2- 20%	Top 1%
Bottom 20% (1979)	14.2	20.7	25.0	25.3	14.4	0.3
Fourth 20%	10.9	29.0	29.6	19.5	10.8	0.3
Middle 20%	5.7	14.0	33.0	32.3	14.6	0.4
Second 20%	3.1	9.3	14.8	37.5	34.8	0.6
Top 20%	1.1	4.4	9.4	20.3	59.4	5.3
Top 1%	2.2	0.4	3.8	7.7	38.6	47.3

Source: Cox and Alm (1999, p.77). Note: The key to the chart presented there is incorrect.

**Table 6: Income Mobility, 1975 to 1991  
(Panel Study on Income Dynamics Data)**

	Bottom 20% (1991)	Fourth 20%	Middle 20%	Second 20%	Top 20%
Bottom 20% (1975)	5.1	14.6	21.0	30.3	29.0
Fourth 20%	4.2	23.5	20.3	25.2	26.8
Middle 20%	3.3	19.3	28.3	30.1	19.0
Second 20%	1.9	9.3	18.8	32.6	37.4
Top 20%	0.9	2.8	10.2	23.6	62.5

Source: Cox and Alm (1999, p.73)

Table 7 is fascinating as well. This table shows the average income gains of the specific households that were tracked over the 16 year period. The dollars are all converted to 1997 dollars to take out the effects of inflation. Families who in 1975 were in the bottom 20% had an average income increase of almost \$28,000 by 1991,

while the folks in the top 20% only gained an average of \$4,354. So the rich did get richer over this period, but *the poor's income grew substantially more than that of the rich!* That is, the rich got richer, but the poor got even richer, not just in percentage terms but in absolute terms. Again, this data is tracking *specific* households.

**Table 7: Absolute Average Income Change, by Quintile  
1975-91 (1997 dollars)**

	Avg. Income 1975	Avg. Income 1991	Absolute Change
Bottom 20%	\$1,263	\$29,008	\$27,745
Fourth 20%	\$6,893	\$31,088	\$24,195
Middle 20%	\$14,277	\$24,438	\$10,161
Second 20%	\$24,568	\$34,286	\$9,718
Top 20%	\$50,077	\$54,431	\$4,354

Source: Cox and Alm (1999, p.74)

One footnote to all of this: Among those who began in the lowest quintile in 1975, 98% had higher incomes (in real terms) over the course of the next 16 years, even if not all of them got out of the lowest quintile. Two-thirds of those who were in the lowest quintile in 1975 had higher incomes in 1991 than the middle quintile had in 1975. Remember that as the economy grows, the range of the quintiles grows as well, so even those who remain in each quintile are doing better in absolute terms. It also seems appropriate to mention that all of these gains by the poor were during the so-called Decade of Greed, pilloried by those on the left for its supposed cold-heartedness and mistreatment of the poor. You can make your own call on that claim.

A good deal of this is explained by demographic factors. For example, the bottom quintile tends to be disproportionately young people. As they age, they move up the ladder. Even if that explains a good deal of what we see here, so what? It still contradicts the usual understanding of the data. The real policy question here is *income mobility*. How easy is it for folks who start poor to move their way up? The answer is "pretty easy." That paints a far different picture of how the poor are doing over time than the static and misleading idea that the poor are getting poorer that is taken from year-to-year comparisons of the quintiles.

Two final observations. One concern is that the middle class is shrinking. It is true that the number of households making between \$30,000 and \$100,000 (if we accept that as broadly middle class) has shrunk since 1979, but one reason is because the number of households with an income *above* \$100,000 grew from 12 percent of the total number of households to 24 percent. There was also *no increase* in the percentage of people in households that brought in less than \$30,000. So, yes, the middle class has shrunk, but because middle class families *got richer* (Rose, 2007).

Second, what it means to be poor has changed dramatically over the last decades. Table 8 shows the percentages of households owning various consumption items. Note the steady increase in what a lowest-quintile household had in it between 1984 and 2002. Then compare each of those years with the “all households” numbers from 1971. The bottom line is that the poor in 2002 live notably better than the average American did in 1971, as measured by what’s in their household. Again, this also does not account for other goods that didn’t exist in 1971, e.g. cell phones, iPods, DVRs, etc.

**Table 8: Percentage of Households Containing Specific Items**

	Poor 1984	Poor 1994	Poor 2002	All 1971
Washing machine	58.2	71.7	80.0	71.3
Clothes dryer	35.6	50.2	77.1	44.5
Dishwasher	13.6	19.6	58.1	18.8
Refrigerator	95.8	97.9	99.2	83.3
Freezer	29.2	28.6	30.8	32.2
Stove	95.2	97.7	98.3	87.0
Microwave	12.5	60.0	93.2	1.0
Color TV	70.3	92.5	98.2	43.3
VCR	3.4	59.7	86.9	0.0
Personal computer	2.9	7.4	59.3	0.0
Telephone	71.0	76.7		93.0
Air conditioner	42.5	49.6		31.8
One or more cars	64.1	71.8	85.7	79.5

Sources: Cox and Alm (1999, p.15) and Trumbull (2006)

**Myth 3: Wages have fallen since the mid-1970s, and the market is only creating bad jobs.**

The argument here is also a tricky one: It is true that real hourly wages fell from the mid-1970s to 1997. The claim is that this fall in real wages has made it harder for Americans to live lifestyles they are accustomed to or wish to, and that it has forced women into the labor market to make up for those falling wages. However, if this were true, especially the loss of “lifestyle,” it should show up in consumption, which it does not. If “lifestyle” is measured by the things we buy and have in our homes, people are doing better than ever, as Table 8 demonstrates. It’s apparently not the case that our standard of living as worsened. How can that be, if real hourly wages are falling? What gives here?

Here is the standard piece of data that gets reported: From 1953 to 1973, average hourly wages grew at an annual rate of 2%. From 1973 to 1978, they stagnated. And then from 1978 to 1996, average hourly wages fell by an average annual rate of 0.7%. The total decline over that last period is 15%.

What’s the problem with this apparent fact? There are three issues here (all data from Cox and Alm, 1999).

1. The wage figures include only monetary wages; they neglect other forms of compensation, including health benefits, retirement benefits, stock plans, etc. The *total compensation* from a job includes more than just the wage. Granted, this is less true for lower wage jobs, but even there, total compensation is greater than just monetary wages. This is especially true of retirement benefits. Even hourly workers have made gains from increases in the value of their pension funds. In addition, the number of workers covered by employer-provided health insurance has grown steadily over the period. Non-monetary benefits as a percentage of wages have increased by 33% since 1970. When we switch over to total compensation rather than wages, the last 25 years have seen growth, albeit slightly slower than the period prior, but growth nonetheless. The cumulative gain in total compensation since the early 1970s is 17%. Again, that’s slower growth than previous decades, but still a real gain. Later data indicate these same trends have held into the new century.

2. Even these corrected figures are problematic: People earn income in other ways than via wages. Those figures neglect interest, dividends, and capital gains and the like. When we look at *per capita income* rather than wages or total compensation, we get a continuation of the same upward trend we saw from 1953 to the mid-1970s, albeit once again at a slower rate. In the 1950s and 60s, annual increases in

per capita income averaged about 2.6%. Since 1974, that average has been 1.6%. Slower again, but still improvement. This, along with the falling costs of many goods, explains how hourly wages can fall, but consumption can be up. Again, for the poor, most of their income is wage income, so this point is somewhat less telling. Nonetheless, given the data on income mobility and household consumption, even most of the poor are doing better, so that income must be coming from somewhere.

3. But there is even a further problem. In computing the real wage data, economists take nominal wages and adjust them for inflation using the Consumer Price Index (CPI). Most economists (both left and right) think that the CPI overstates inflation by some amount. If we assume that it does so by 1.1% per year (an average of various estimates by economists), the decline in real wages since 1978 becomes a 12% increase, and the slowdown in per capita income growth disappears. It also adjusts upward almost every other measure of economic health since the mid-70s. Even a difference of 1% of year will have a large effect compounded over 20 years.

It's surely true that more women are working than before. However, this has little to do with falling wages and the like. In fact, it has everything to do with *rising* wages for women. As market opportunities have become more attractive, and as technology has reduced the need for human labor in the home (compare the microwave to a regular oven, or a washing machine to hand washing clothes), more and more women have entered the labor force. This is a sign of strength in the U.S. economy, not weakness. And, perhaps most important, the gap between women's wages and men's wages is rapidly shrinking. Data from the National Longitudinal Survey of Youth show that in 1996, women aged 28-33, who had comparable education/training, experience, and uninterrupted time on the job as their male counterparts, earned 98% of what the men did. If you control for the normal variables (like those in the previous sentence) that affect wages, you find that the gender gap in wages narrows progressively as you move from older workers to younger ones. For women in college today, there is a legitimate expectation that they will earn pretty much the same as their male counterparts, if they have the same training, etc.

Okay, say the critics, but surely the jobs we've created have been "burger flipping" jobs, no?

It's true that most of the jobs created over the last 25 years have been in the service sector, but that's part of a long term trend that is the most basic sign of economic growth: We need fewer people to produce physical stuff, freeing that labor to provide the services we wish to have with that stuff. One hundred years ago fully 50% of Americans worked in agriculture. Now that figure is less than 3%, and we manage to feed a much larger U.S. population as well as export a great deal of foodstuffs. The reduction in agricultural labor (which is the flip side of the rise of the industrial and service sectors) is the most fundamental sign of human progress there is. We need so much less labor for our sheer survival. Yes, manufacturing *jobs* have declined, but manufacturing *output* continues to grow, which is exactly the process that took place in agriculture over the past two centuries. Would we be better off today if we kept all those farm workers on the farm and bemoaned all those "machine using" jobs in the factories? Not hardly.

Consider the following example: Suppose a very poor person wishes to eat chicken. Odds are she is going to raise her own chickens or go to the store to buy the cheapest chickens they have, normally a whole uncut chicken. As wealth increases, what happens? Well, folks tend to move up to buying cut up chickens, saving them the labor of raising chickens or cutting them up themselves. Even wealthier folks will just buy the best parts, or perhaps head out to Boston Market for a prepared dinner. The very wealthiest will head to a nicer restaurant for free-range chicken in some fancy sauce. Societies go through the same process as average income rises. What's the difference between all of those chicken dinners? Services! The home-raised chicken involves no market purchase of services and hence no service-sector jobs. Each other act of chicken consumption adds an increasing amount of human labor to the process, and more skilled labor at that. Increasing wealth leads people to substitute market-bought services for their own labor (which is another reason why as wealth increases, more women work – households can purchase the things that they used to produce themselves). The rise in the number of service sector jobs is a sign of, and result of, our prosperity.

But don't those service sector jobs pay lousy? In fact, the average wage in the service sector in the late 1990s was \$11.80/hr, compared to \$13.20/hr in manufacturing. Not a huge difference, and one that is rapidly shrinking. However, if we recognize that retail jobs, often

held part-time by non-primary income earners, keep hourly wages in the services sector low, then the picture changes a bit. Take out retail jobs, and service wages are 5% higher than manufacturing wages! If you compare full-time workers in the two sectors, things look very different. Remember: Many technology jobs are actually in the service sector, and they pay very well.

Here's some other data from the 1990s: Between February 1994 and February 1996, 68 percent of the net growth in full-time employment occurred in industry/occupation groups paying above-median wages. More than half of the net growth occurred in the top 30% of job categories, mostly in non-traditional service sector jobs. The vast majority of these jobs were full-time (Cox and Alm, 1999).

More radically, we should celebrate the destruction of jobs! When jobs are destroyed, it is a sign of progress. Labor is freed to be allocated to more valuable uses. It's a *good thing* that there are no more horse and buggy makers or coopers or the like. We don't need that labor for those purposes any more. Of course, one problem here is that jobs tend to be eliminated in big chunks, while they are created in dribs and drabs. The media covers when AT&T announces that it is cutting 30,000 jobs, but it's not news when a small hi-tech firm hires five people this month and three more the next month. If you add it all up, however, the economy has created far more jobs than it has destroyed in the last decades, and firms with less than 500 employees have created most of those jobs. Between 1991 and 1995, firms of less than 500 employees created 10,846,000 new jobs. Firms between 500 and 5000 employees created 193,000 jobs. Firms of 5,000 or more destroyed 3,375,000 jobs. The total number of jobs created in the period was 7,664,000. It's also worth pointing out that the small firms that created the vast majority (84%) of the jobs had opened for business within that period. The new, small firms are creating the jobs in our economy. We hear all about the job cuts, but no one celebrates the firms that have created thousands of jobs over the last couple of decades. Table 9 honors some of the big job creators of the 1980s and 90s.

### **Conclusion**

One generally agreed upon outcome for a college education is that students should be able to think critically, especially with respect to the "conventional wisdom" of the media. As economists and educators, one of the most important tasks we can undertake is to

provide our students with the theoretical tools and data to assess critically the all-too-frequent doom-and-gloom economic punditry in the mainstream media. Not only does it help them toward a more analytical frame of mind, it also helps inculcate a much needed optimism about their own futures and that of the society in which they live. To continue the more than 200 years of improvement that the market economy has made in the well-being of the West, especially in its poor, people need to know such improvement has happened and have reason to believe they can contribute to its continuation through their own productive activities. Countering the myths as I have done above is one way to generate that result and a crucial part of educating students about the value of private enterprise.

**Table 9: Job Creating Firms, 1985-96**

Firm	Jobs created
1. Wal-Mart	624,000
2. UPS	183,500
3. Lucent Technologies	124,000
4. Lockheed Martin Marietta	102,200
5. Limited	97,800
6. Dayton-Hudson	90,000
7. Seagate Technology	82,300
8. General Dynamics	80,200
9. Viacom	79,100
10. Disney	75,000

Source: Cox and Alm (1999, p.114)

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