Symbolic growth and stagnant wages

By Sergio Focardi
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For decades, Western governments (and their economies) have been delivering real growth and economic well-being to their citizens. But changes that have occurred since the 1980s have made it increasingly difficult to distinguish real growth from nominal growth, while the well-being of the majority of citizens has failed to improve.

At the beginning of the 20th century, the vast majority of the population in what we now call developed countries were able to satisfy only their basic needs of food, clothing and housing; only a small percentage enjoyed a significant level of consumption, still limited by the technology available at that time.

The consumer revolution started in the US. Infrastructure works and the diffusion of cars, trains, home ownership and with it home appliances, telephones, television, heating and air conditioning, offered a natural path to growth. The Great Depression slowed down but did not stop this process. The American Dream was the dream of a nation where anyone who had the willingness to work hard could improve his/her situation and enjoy an ever-growing level of material well-being.

Europe was to experience a similar development after World War II, when a combination of the collapse of old empires and the need to rebuild after the War focused attention on domestic economies. Following in American footsteps, Europe discovered consumerism. While certainly not idyllic, what with the Cold War, the scars of totalitarian regimes and cultural clashes between the left and the right, this was a period of natural economic growth, sustained by technological innovation which translated into much-desired products manufactured and sold in increasing quantities. Quality universal education produced a rapid increase in the skills of the workforce.

Both in Europe and in the US, most of the economic growth was due to domestic output. Import-export as a percentage of worldwide GDP was only 10%-12% in 1960; its current level is about 30%.

Inequality down…and up

As the post-war period from roughly 1950 to 1980 brought increasing prosperity to Western nations with a growing middle class, income inequality was at its historical low. In the US: the share of the top 10% was in the range of 33-34%; in Europe, the share of the top decile (the 10% with the highest income) fell from 32% in 1950 to 29% in 1980.

Two critical changes occurred thereafter. First, the bargaining power of wage earners was reduced. Globalization and a changing political and cultural climate led to a change in the balance of power between capital and labor. Lower wages helped fuel corporate profits, shifting purchasing power from labor to capital. The price-to-earnings ratio of firms in the Standard & Poor's 500 index (an index of stocks issued by 500 large US companies with market capitalizations of at least $6.1 billion) was 65% to 70% higher in the post-1995 period than during the period 1935-1995; margins of S&P 500 firms have risen by about 30% compared to the pre-1997 period. The share of total (pre-tax) income of the top decile in the US shot up from under 35% in the 1970s to 47% in 2014. Similar trends occurred in Europe.

The shift in income distribution is reflected in the market. In the 1960s, the price of cars in the US ranged from $1,300 for a basic Ford or Chevrolet to $14,000 for a Cadillac Eldorado, then the most expensive. Today, the price ranges from $8,000 for basic compact to upwards of $1 million. The price range has gone from a factor of 10 to a factor of 100, paralleling the growing wealth differential.

To maintain their lifestyle, the bottom 90% of the population has reduced savings and increased borrowing. Data from the Federal Reserve Bank of Saint Louis shows that the share of debt taken out by firms progressively decreased from around 45% in the 1950s to a low of 15% in 2010 while the general public became increasingly indebted. Similarly, the share of consumption funded by wages for nine G20 countries (Australia, Canada, Germany, France, Italy, Japan, Spain, the United Kingdom and the United States) declined by more than 65% in the early 1970s to 56% by 2012.

Debt rises

Increasing consumer indebtedness in the form of bank/credit card debt creates money that circulates in the economy. This credit money has enabled corporate monetary profits to grow while wages stagnated. This fact in itself is a major source of instability as wage earners have to service an increasing debt burden with stagnant incomes. In a highly leveraged world, with complex financial products sold by an unregulated shadow banking system, a growing number of insolvencies might lead to a financial and economic crisis.

But another factor has become important: in Western economies a natural path to growth has slowed down. Consider again the automotive sector where the number of vehicles per capita in the US grew almost linearly from 300 per 1000 persons in 1950 to almost 800 per 1000 in 1990 and then remained essentially flat. Industrial growth is now being led, not by increased output, but by the addition of new features and more performance, i.e., innovation through increased complexity. Innovation is also fueled by symbolic consumption. Products and services are desirable and bought not only for their intrinsic characteristics but also for their symbolic value.

Growth is all about money

Innovation, be it technological or purely symbolic, makes it difficult to define and measure inflation, the rate at which the general level of prices of similar products and services rises. But if products change, either physically or symbolically, it is impossible to define the change in price of similar products. As a consequence, the distinction between nominal and real quantities is blurred: Growth is increasingly a monetary phenomenon.

Today's growth is concentrated in small sectors of the population that consume innovative and/or luxury products and services. This is not an insignificant phenomenon. In the US, Apple's market capitalization – the amount of money needed to buy the whole corporation – is approaching $1 trillion; that of General Motors is under $55 billion. In France the luxury sector is the largest by capitalization. With €156 billion of market capitalization, the LVMH group is larger than the flagship French energy company Total which has a market capitalization of €144bn. The joint capitalization of the two biggest luxury brands, LVMH and Hermès, is equivalent to the capitalization of the nation's three largest banks, BNP Paribas, Société Générale, and Crédit Agricole.

While traditionally associated with increases in quantities produced and sold, growth is increasingly due to adding complexity through technological innovation and symbolism. With rising flows of money generated by credit, growth can become monetary growth without exhibiting any inflationary signs. Real economies are weakened in terms of production capabilities and skill sets.

To renew with growth and their citizens' well-being, Western governments need to concentrate once again on their domestic economies, increasing the share of consumption that is financed by wages. A change in the balance of power will be required to return purchasing power to the middle class. Perhaps a cultural change that tames the power of symbolic consumption would also be welcome.

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