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An Economic Bust for the Baby Boom

After 1973, the middle-class dream faded, as median incomes declined and living costs soared. The young who aspire to their parents' goals now face dimmer futures.

A careful look at the economic data of the past decade shows that while the middle class as a group is not disappearing, the young middle class (principally the baby boomers) has experienced a dramatic decline in its ability to pursue the conventional American dream: a home, financial security, and education for children. To understand how this has come about and what the prospects are for the future, we must expand the discussion to look not only at trends in income inequality but trends in income growth.

For the last 11 years, the American economy has been in a quiet depression in which neither wages nor family incomes have grown. All around us, there are signs that the middle class is in trouble. Single persons are postponing marriage. Families are postponing having children. Good jobs in manufacturing are being lost. Young people feel substantial economic pressure. But official statistics seem to show something different. The family income distribution has roughly the same shape today as it had in 1947 (and all the years in between), while consumption spending per person rose faster in the last 10 years than it did in the fondly-remembered 1950s. In the following paragraphs, we resolve this apparent conflict.

Achieving the American dream

The material American dream is by no means a recent concept. In the middle of the 19th century, Alexis deTocqueville noted the importance of material well-being in American life:

''In America the passion for physical well-being is not always exclusive, but it is general; and if all do not

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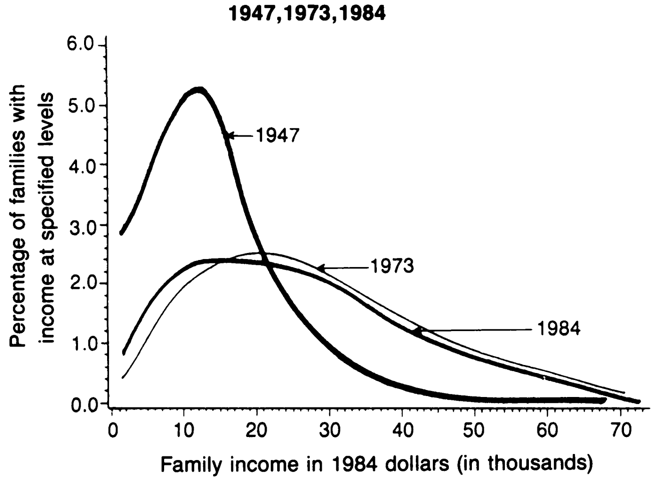
feel it in the same manner, yet it is felt by all.'' (*Democracy in America,* Chap. 29)

What was true in deTocqueville's observation is equally true today. A central theme of modern American life is the chance to enjoy a ''middle-class standard of living.'' This standard is not officially defined anywhere, but it exists in many subtle forms throughout our society, from television advertisements to casual conversations. The middle-class American dream has come to include such material goods as a single-family home, one or two cars (including a new one), a washing machine and dryer, a dishwasher, a color TV, raising and educating children, providing for a lengthy period of retirement, and so on. When economic times are good and incomes are growing rapidly, the standard dream can be easily expanded to include a certain

Figure 1 **Smoothed Histogram of the Family Income Distribution 1947,1973,1984**



Note: This smoothed histogram was created for ease of graphic presentation. Technically, the height of a given curve at a given point represents the percentage of all families who have incomes in the $1,000 interval around that point.
Source (for all figures and table): Bureau of the Census data and authors' own calculations.

amount of vacation travel, dance lessons for the children, a home workshop, a personal computer, etc., but the dream is much slower to contract when economic times are bad.

A healthy economy changes constantly, and so even in the best of times a large number of people are trying to achieve the American dream (or to achieve it again). Included in the number are young workers just starting out, retired persons seeking to replace their wages, workers who have lost jobs in declining industries, and workers who have been displaced from successful industries through technical change.

When incomes are rising rapidly, many of these people will be successful. In the United States, this was true from 1947 to 1973—real (inflation-adjusted) wages were rising 2.5 to 3.0 percent per year. Two examples translate these numbers into human scale.

Consider a man passing from age 40 to age 50. In terms of career, the big promotions are behind him, but earnings can still rise if earnings are rising throughout society. Prior to 1973, this is exactly what happened, and the average man passing from 40 to 50 saw earnings rise by about 30 percent.

Consider next a younger man passing from 25 to 35. He is in the ''fast track'' portions of a career, and receives the benefits of promotions as well as general rises in living standards. Prior to 1973, the average man passing from 25 to 35 saw earnings rise by about 110 percent.

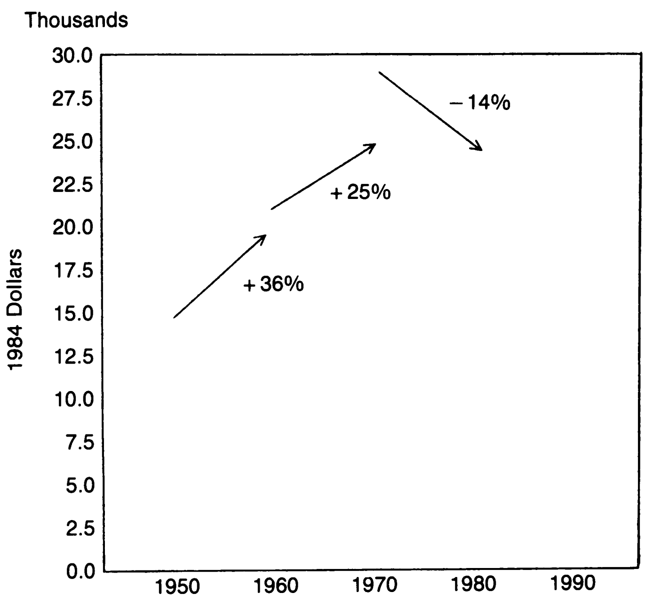
Family incomes traced a parallel pattern. During President Eisenhower's two terms in office, the economy experienced one mild and one quite serious recession, but the census measure of median family income (i.e., the income of the average family) increased by 30 percent after adjusting for inflation. During the eight years of Presidents Kennedy and Johnson, median family income increased by another 30 percent. And incomes kept growing through President Nixon's first term. Between 1947 and 1973, median family income had doubled from $14,000 to $28,000 (both figures are in 1984 dollars) and had never gone more than three years without setting a new record. During this time, measures of income inequality remained fairly constant, but the *whole income distribution* kept moving to higher and higher ground as most incomes rose (Figure 1).

But in some ways, 1973 was the last good year. After 1973, growth largely stopped, and wages and incomes showed the effects. Previously, men passing from 40 to 50 had seen their earnings grow by 30 percent. But those who were 40 in 1973 saw their earnings over the next decade *decline* by 14 percent (Figure 2). And where younger men passing from 25 to 35 had seen their earnings more than double, those who were 25 in 1973 saw their earnings over the next decade grow by only 16 percent (Figure 3). Family incomes traced a similar path. From 1974–84, median family income (in 1984 dollars) remained below its 1973 high point ($28,167), and in 1984 it stood at $26,433.

What went wrong?

Like people in the middle of the Great Depression, we are not quite sure. The large OPEC oil price increases of 1973–74 and 1979–80 each reduced purchasing power by 5 percent. More important was the way in which worker productivity suddenly stopped growing after 1973. Rising productivity—rising output per man hour—is the ultimate source of rising living standards, and its sudden halt remains something of a mystery.

Figure 2 **Average Income Gain for Men Passing from Age 40 to Age 50**

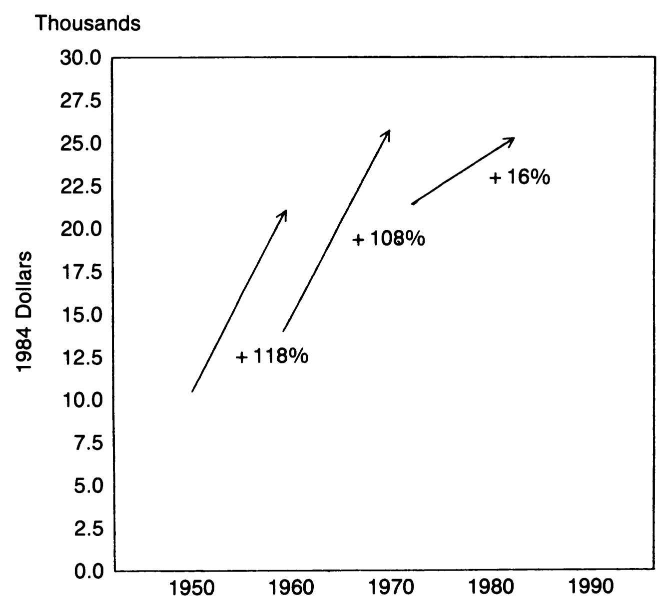


But if experts do not fully understand the productivity slowdown, most attribute it to some combination of three generalized economic problems: rapid increases in energy prices (as distinct from high, stable energy prices), a labor force that was growing very fast, and a ten-year inflation that was very hard to break and which threw a wrench into the process of making sound economic projections.

In the 1973–84 period, as in earlier postwar years, the shape of income distribution (income inequality) remained relatively constant. But income distribution stopped moving up. To the contrary, it slipped back a little (Figure 1), and this put the brakes on mobility. People who had already attained the middle-class dream found they had certain protections. One was job seniority (provided they were not working in a declining industry). Another was a fixed-payment mortgage, which kept their housing costs under control, particularly since mortgage payments stayed constant in the face of inflation. But for people who had not yet attained the middle-class standard (or who had lost the standard and were trying to regain it), it looked increasingly out of reach.

Stagnation's influence was widespread, as shown by two examples. The first depicts the growth of service-sector jobs relative to manufacturing jobs. Some commentators have argued that the explosion of low-wage service-sector jobs in the 1970s was doing us in. Implicit in this argument is the sense that service-sector jobs are something new. They are not: in the late 1940s, fully one-half of all employment (on a full-time equivalent basis) was already in the service sector, and this did nothing to stop 26 years of dramatic wage growth. During this time, service-sector jobs always paid 10–15 percent less than manufacturing jobs, but because wages were growing in *all* sectors, differences across sectors were not so important.

Figure 3 **Average Income Gain for Men Passing from Age 25 to 35**



In particular, a man could lose a good job and take a pay cut, but still have a sense that he could "grow back" to his old living standard in a few years. But from 1973 to 1984, when wages were stagnant, such thoughts of growing back were fanciful, and wage differences across sectors loomed much more importantly. A laid-off steel worker in 1984 had very little prospect of quickly restoring his former wages through promotions in a new service-sector job. His plight was thus far more serious than that of a laid-off steel worker in the 1960s.

The second example involves upward mobility across generations. In the decades prior to the 1970s, children expected early on to live better than their parents. Such is not now the case. A father-son example illustrates this dramatically. Suppose a young man of 18 or 19 is preparing to leave his parents' home. As he leaves, he sees what his father's salary would buy and he keeps the memory as a personal yardstick. In the 1950s or 1960s, the young man would have quickly measured up. By age 30, he already would have been earning one-third more than his father earned when the young man left home. But today, a 30-year-old man is earning about 10 percent less than his father earned when the young man left home. The fact that the young man's father owns a house with easy mortgage payments only sharpens the contrast in their economic status.

The demographic shift

If things have been so bad, how does one explain the fact that consumption per capita was rising? The answer largely involves demographics.

The most important demographic fact was the increasing proportion of the population who worked in the 1970s. During the decade, women of all ages entered the labor force in large numbers. Additionally, the baby-boom cohorts born in the 1950s and 1960s entered the labor force. The result was that the proportion of the population at work increased from 41 percent in 1970 to almost 50 percent today. Data on young families make this point even more dramatically. Among 25- to 34-year-old married couples, 47 percent of the wives worked in 1973. Today, two-thirds of all young wives are working. This greater proportion of workers helped prop up incomes.

In addition, many young persons in the 1970s postponed marriage or did not marry at all, a trend that continues today. Since 1973, the median age at first marriage has increased from 21 years to 22.8 years for women, and from 23.2 years to 25.4 years for men, the highest levels since the early 1900s.

Finally, the young families that were formed largely postponed having children of their own. Since 1973, the average number of children in young families (age 25 to 34) has dropped by a remarkable 27 percent. Among families with heads between 35 and 44, the decrease is only slightly less. This is a dramatic drop in the number of persons consuming goods in families, and it helped consumption per capita (i.e., per man, woman, and child) to grow faster than would have been predicted by wages alone.

On a national basis, then, consumption per head rose faster in the stagnant 1970s than it had in the booming 1950s, but the sources of increase differed between the decades. Per-capita consumption rose in the 1970s, because in aggregate terms the proportion of the population in the labor force rose from 41 percent to 48 percent. During the 1950s, the labor force remained constant at 40 percent of the population, and consumption per head rose because workers' wages rose.

The decade of the 1970s was thus the inverse of the 1950s. In the 1950s, wages were rising smartly, but per-capita income grew slowly because families were feeling sufficiently prosperous and optimistic to buy the most important consumption goods of all—children—in large quantities. In the 1970s, wage stagnation left individuals with two choices: decrease consumption or increase income through "quality of life" demographic accommodations. They chose the latter.

In sum, the 1973–84 period revealed just how much of postwar society was predicated on the assumption of rising real wages. When stagnation entered, it was clear that something was going wrong and that acquiring the middle-class dream was becoming more difficult. It was a short jump to the conclusion that income distribution was splitting apart into rich and poor. The issue, however, was not growing inequality of current income (the income distribution, after all, retained its shape) but a growing inequality of *prospects*—of the chance that one would enjoy a middle-class standard of living with a house, children, cars, retirement—the whole package. Those who already had it were largely able to retain it, while those who didn't have it saw their prospects dim.

The economic status of the young middle class

A family's economic situation depends on more than current income. Assets, savings, consumption patterns, debts, and prospects for the future are all important too. We can get a better sense of today's young middle class by examining these other variables and comparing them with the situation of young families in earlier decades. In this comparison, two variables stand out: one is wage growth; the other is the price of housing.

Begin by considering a young man who was 30 in 1949. On average he was earning $11,924 per year (in 1984 dollars), an apparently modest figure. But with the housing prices and interest rates of the time, he could carry the median-priced home for about 14 percent of his gross monthly pay. And his wages were far from their peak. Over the next ten years, his annual salary would rise by 63 percent in real terms (Table 1).

A 30-year-old man in the late 1950s faced similar circumstances. But by the early 1970s, the situation had worsened. For a 30-year-old man in 1973, carrying charges for the median-priced home would have absorbed 21 percent of monthly pay (up from 14 percent). More important, over the next decade, his annual salary (adjusted for inflation) did not rise at all (Table 1).

This man who was 30 in 1973 was born in 1943—too early to be an official member of the baby boom. How, then, did the baby boomers do? Too little time has passed to write their full story. But we know that to this point, they have faced stagnant wages, rapidly increasing housing prices, and very high interest rates. One figure is suggestive. Last year, a typical 30-year-old person who purchased a median-priced home would have had to devote *44 percent* of gross monthly income to carrying charges. The future path of his or her earnings is, of course, unknown.

Table 1 **The Economic Situation of 30-Year-Old Men, 1949–83**

Age 30 in	Average earnings at 30 (1984 dollars)	Ratio of monthly house carrying charges to monthly earnings at age 30*	Average earnings at 40 (1984 dollars)	Percent change
1949	11,924	0.14	19,475	+63
1959	17,188	0.16	25,627	+49
1973	23,580	0.21	23,395	− 1
1983	17,520	0.44	?	?

*Calculations based on median price of homes sold in that year and mortgage terms and interest rates prevalent in that year.

How did young families deal with these deteriorating circumstances? First there were the demographic adjustments we have already described: postponement of marriage, reliance on two earners, postponement of children. But other adjustments were more purely financial.

One was to get help from parents, particularly for housing. In 1980, almost one-third of all first-time home buyers got financial assistance from their relatives, compared to less than 10 percent in 1978. But this option has its limitations: not every family is comfortable enough financially to support younger members in this manner. The recent recession also affected families' abilities to transfer money to their baby-boom relatives. By 1982, the proportion of first-time buyers receiving financial assistance from relatives had dropped to eleven percent. While improving economic conditions are likely to make such assistance more feasible for many families, it appears that this strategy for buying a first home may have peaked.

Another adjustment was to buy smaller houses. Less than half of all new housing units today are single-family detached units, in contrast to more than 60 percent in the mid- to late 1970s. In the 1979 to 1983 period, the percentage of new units with garages and with two or more bathrooms declined, as did the median number of square feet per new unit.

More earners, fewer children, parental help, and smaller houses explain why home-ownership rates among young families declined only modestly. According to a recent study by the MIT-Harvard Joint Center for Housing Studies, home-ownership rates for households with heads under age 25 fell from 23.4 percent in 1973 to 19.4 percent in 1983. For households with heads in the 25-to-29 age group, the decline over this period was from 43.6 percent to 40.7 percent. (Actually, overall home-ownership rates as well as those for younger households peaked in the mid- to late 1970s, so the recent decline has been sharper than indicated here.)

Are Yuppies a myth?

When we turn from housing to other economic variables, a similar picture emerges. It contains relatively few Yuppies—those famous young couples who buy expensive imported automobiles and regularly eat at upscale restaurants. Yuppies are not a fiction. The baby-boom generation is very large, and even the small percentage who are well-to-do comprise a large enough number to make a strong impression on journalists, car dealers, and restauranteurs. But while Yuppies are not fiction, neither are they typical.

In 1984, the typical young American family (head, age 25–34) consisted of a husband and wife and a single child under age twelve. Less than half owned their own homes. Median pretax family income from all earners totalled $25,157, hardly enough to buy a

BMW and eat out regularly. If this is the case, what are young families spending their money on? The answer comes as no surprise to those families: basic necessities.

Consumption expenditure studies by the Bureau of Labor Statistics (BLS) show that between 1973 and 1981 families whose heads were 25–34 experienced a 54-percent increase in their home fuel and utility costs, and a 65-percent increase in gasoline and motor-oil costs for their vehicles. In 1984 dollars, these increases amounted to almost $1,000 per year. Add to that an average annual increase of $231 in shelter costs (for higher rent and mortgages) and young families in 1981 were devoting almost 6 percent more of their disposable income to these three basic necessities than in 1973. These increases, moreover, took place as total consumption was shrinking. The same BLS studies show that between 1973 and 1981, the consumption of young families *declined* by 4 percent, or more than $1,000 per year in 1984 dollars.

With necessities increasing and total consumption declining, other items had to give. A young family in 1981 spent 14 percent less on furniture, 30 percent less on clothes, 15 percent less on personal care, and 38 percent less on charitable contributions than had a similar young family in 1973. And, contrary to popular belief, the average young family in 1981 spent only $47 more per year on food outside of the home (because there were so many young families, they could support a growing restaurant industry even though the average family did not dramatically increase its spending).

The final item to give was savings. In 1981, young families saved less than 1 percent of their after-tax income, contrasted with 4 percent for similar young families in 1973. A recent Federal Reserve Board survey indicated that the proportion of young families holding liquid assets in 1983 had declined from 93 percent to 87 percent relative to a separate survey taken in 1979. While this seems like a small change, it implies that almost one million more young families had no savings whatever to fall back on in the event of an emergency. And while savings diminished, debt increased. The same Federal Reserve Survey mentioned above showed that in 1983, 77 percent of families in the 25–34 age group had incurred some form of installment debt, compared to 67 percent in 1970. And recent monthly Federal Reserve Board data show that consumer debt is at an all-time high.

The savings and debt figures are not to be trivialized. The less a young family is able to save, the more it must postpone its entrance into the housing market. The greater its debt, the less its ability to qualify for mortgage loans, given the affordability guidelines used by financial institutions. Furthermore, nominal interest rates on consumer loans are 50 percent higher today than in the 1970s and, combined with low inflation rates, act to increase the length of repayments and relative value of outstanding debt for young families. In the 1970s, it was easier for young families to grow out of their debts, as inflation eroded the value of the dollars they paid back.

It is also worth remembering that older families had cushions of two kinds. One was homeownership. In the early 1970s, 80 percent of the population over 35 owned their own homes, and these homeowners were shielded from an important part of the decade's inflation. As prices went up rapidly and wages went up more slowly, homeowners' mortgage payments remained constant and more money was left for other things. A fixed mortgage did not fully compensate a family for the rising price of tomato soup or their children's college tuition. But anyone who doubts its importance need only ask a group of middle-aged families the following question: "Today, could you afford to buy the home you're now living in?"

The second cushion, for retired families, was social security. As late as 1965, a quarter of all elderly persons did not qualify for social-security benefits—they had not paid into the system long enough. But by 1975, more than 90 percent were covered, and the extension of these benefits substantially raised the incomes of the elderly. This impact was further magnified by 1972 legislation, which first increased social-security benefits by 20 percent and then indexed them to the Consumer Price Index. This legislation permitted social-security benefits to stay even (and in some cases exceed) the rate of inflation even as the wages of most workers were stagnant or declining.

Here, too, the cushion was not perfect. For example, social security could do nothing about the way in which inflation eroded most private pensions. Nevertheless, over the last 15 years, while income averaged across all families remained roughly constant at $25,000 (in 1984 dollars), the average income for families over 65 rose from $13,500 to $17,130. (Averages can of course be somewhat misleading. The elderly are a heterogeneous group, and about one out of every seven still have incomes below the poverty line. Poverty is particularly high among the "older elderly"—persons above 75—whose social-security coverage is low and whose private pensions have been eroded by inflation. But there is no question that the elderly as a group have fared better economically than other groups in the last decade and a half.)

Prospects for the future

People now in their seventies began their careers in the teeth of the Great Depression. But because they worked during the 1950s and 1960s, most went on to have comfortable lives. By recent standards, today's young middle class is not doing well. But the path of their lifetime incomes depends very little on what they can extract from other generations, and a great deal on how fast their wages will grow. If the economy were to return to anything like the steady wage growth of 1947 to 1973, the future of today's young middle class would be much brighter.

Faster wage growth, however, depends on increased worker productivity, a very difficult objective to achieve. Experience seems to show that government policy has some ability to control inflation and unemployment, but the restoration of growth in worker productivity is more problematic.

We have noted that the failure of wage growth in the 1970s seemed to come from three major factors: sharp increases in energy prices, a rapidly growing labor force, and serious inflation that became embedded in the economy. These factors seemed largely responsible for the slowdown in the growth of worker productivity which, in turn, slowed the growth of wages.

By 1984, each of these three factors had reversed. Energy prices were stable. Inflation was quite low. And the labor force, having absorbed the baby boom, was again growing slowly. But despite these favorable developments, recent worker productivity growth seems to be settling down to a disappointing one percent per year.

As commentators try to understand the current perplexing economic situation, some have pointed to the role that deficits and debt play in restraining wage growth. The federal budget deficit, for example, helps keep interest rates high, and this in turn contributes to the international trade deficit. From a pragmatic political and social point of view, the deficits are understandable. By spending more than we take in and by importing more than we export, we can, for a time, live beyond our means. In this way we avoid the limits of stagnant incomes, and avoid making difficult personal and political choices. But in the process, we are creating a set of conditions that, like conditions in the 1970s, may be antithetical to productivity growth: high interest rates (which make investments more expensive); imports subsidized by a strong dollar (which make domestic investment less profitable); and so on. We are trading off long-term growth for short-run gain. And if the current generation of middle-class Americans continues to avoid the problem, it will remain for baby boomers in the twenty-first century to bear the costs of resolving not only their personal debt but the national and international debts as well.

There is no painless cure for any generation in dealing with the nation's debt problems. Closing the federal deficit requires tax increases and budget cuts, each of which lowers the living standard of American families in the short run. Just closing the $200 billion deficit requires lowering living standards by an amount equivalent to the increase that comes from two good years of economic growth.

It is hard medicine to swallow, and yet that is one of the choices we face. The issue is not young versus old or even rich versus poor, but rather all of us versus the future. And there, to paraphrase the immortal Pogo, the enemy is ourselves.