Commentary
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The New Wealth of Nations

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THE NATIONS of North America, Western Europe, Australia, and Japan are wealthier today than they have ever been, wealthier than any others on the planet, wealthier by far than any societies in human history. Yet their governments appear to be impoverished—saddled with large accumulated debts and facing annual deficits that will grow explosively over the coming decades. As a result, government spending programs, especially the big social-insurance programs like Social Security and Medicare in the United States, are facing drastic cuts in order to avert looming insolvency (and, in France and some other European nations, in order to meet the Maastricht treaty's criteria of fiscal rectitude). American politics has been dominated for several years now by contentious negotiations over deficit reduction between the Clinton administration and the Republican Congress. This past June, first at the European Community summit in Amsterdam and then at the Group of Eight meeting in Denver, most of the talk was of hardship and constraint and the need for governmental austerity ("Economic Unease Looms Over Talks at Denver Summit," read the *New York Times* headline).

These bloodless problems of governmental accounting are said, moreover, to reflect real social ills: growing economic inequality in the United States; high unemployment in Europe; an aging, burdensome, and medically needy population everywhere; and the globalization of commerce, which is destroying jobs and national autonomy and forcing bitter measures to keep up with the bruising demands of international competitiveness.

How can it be that societies so surpassingly wealthy have governments whose core domestic-welfare programs are on the verge of bankruptcy? The answer is as paradoxical as the question. We have become not only the richest but also the freest and most egalitarian societies that have ever existed, and it is our very wealth, freedom, and equality that are causing the welfare state to unravel.

II

THAT WE have become very rich is clear enough in the aggregate. That we have become very equal in the enjoyment of our riches is an idea strongly resisted by many. Certainly there has been a profusion of reports in the media and political speeches about increasing income inequality: the rich, it is said, are getting richer, the poor are getting poorer, and the middle and working classes are under the relentless pressure of disappearing jobs in manufacturing and middle management.

Although these claims have been greatly exaggerated, and some have been disproved by events, it is true that, by some measures, there has been a

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recent increase in income inequality in the United States. But it is a very small tick in the massive and unprecedented leveling of material circumstances that has been proceeding now for almost three centuries and in this century has accelerated dramatically. In fact, the much-noticed increase in measured-income inequality is in part a result of the increase in real social equality. Here are a few pieces of this important but neglected story.

• First, progress in agriculture, construction, manufacturing, and other key sectors of economic production has made the material necessities of life—food, shelter, and clothing—available to essentially everyone. To be sure, many people, including the seriously handicapped and the mentally incompetent, remain dependent on the public purse for their necessities. And many people continue to live in terrible squalor. But the problem of poverty, defined as material scarcity, has been solved. If poverty today remains a serious problem, it is a problem of individual behavior, social organization, and public policy. This was not so 50 years ago, or ever before.

• Second, progress in public health, in nutrition, and in the biological sciences and medical arts has produced dramatic improvements in longevity, health, and physical well-being. Many of these improvements—resulting, for example, from better public sanitation and water supplies, the conquest of dread diseases, and the abundance of nutritious food—have affected entire populations, producing an equalization of real personal welfare more powerful than any government redistribution of income.

The Nobel prize-winning economist Robert Fogel has focused on our improved mastery of the biological environment—leading over the past 300 years to a doubling of the average human life span and to large gains in physical stature, strength, and energy—as the key to what he calls "the egalitarian revolution of the 20th century."* He considers this so profound an advance as to constitute a distinct new level of human evolution. Gains in stature, health, and longevity are continuing today and even accelerating. Their outward effects may be observed, in evolutionary fast-forward, in the booming nations of Asia (where, for example, the physical difference between older and younger South Koreans is strikingly evident on the streets of Seoul).

• Third, the critical *source* of social wealth has shifted over the last few hundred years from land (at the end of the 18th century) to physical capital (at the end of the 19th) to, today, human capital—education and cognitive ability. This development is not an unmixed gain from the standpoint of economic equality. The ability to acquire and deploy human capital is a function of intelligence, and intelligence is not only unequally distributed but also, to a significant degree, heritable. As Charles Murray and the late Richard J. Herrnstein argue in *The Bell Curve*, an economy that rewards sheer brainpower replaces one old source of inequality, socioeconomic advantage, with a new one, cognitive advantage.

BUT AN economy that rewards human capital also tears down far more artificial barriers than it erects. For most people who inhabit the vast middle range of the bell curve, intelligence is much more equally distributed than land or physical capital ever was. Most people, that is, possess ample intelligence to pursue all but a handful of specialized callings. If in the past many were held back by lack of education and closed social institutions, the opportunities to use one's human capital have blossomed with the advent of universal education and the erosion of social barriers.

Furthermore, the material benefits of the knowledge-based economy are by no means limited to those whom Murray and Herrnstein call the cognitive elite. Many of the newest industries, from fast food to finance to communications, have succeeded in part by opening up employment opportunities for those of modest ability and training—occupations much less arduous and physically much less risky than those they have replaced. And these new industries have created enormous, widely shared economic benefits in consumption; I will return to this subject below.

• Fourth, recent decades have seen a dramatic reduction in one of the greatest historical sources of inequality: the social and economic inequality of the sexes. Today, younger cohorts of working men and women with comparable education and job tenure earn essentially the same incomes.† The popular view would have it that the entry of women into the workforce has been driven by falling male earnings and the need "to make ends meet" in middle-class families. But the popular view is largely mistaken. Among married women (as the economist

* Here and elsewhere in the article I draw heavily on Fogel's research, much of which will appear in his forthcoming book, *The Fourth Great Awakening: The Political Realignment of the 1990's and the Future of Egalitarianism*, University of Chicago Press.

† See Diana Furchtgott-Roth and Christine Stolba, *Women's Figures: The Economic Progress of Women in America*, Independent Women's Forum and American Enterprise Institute (1997).

Chinhui Juhn has demonstrated), it is wives of men with high incomes who have been responsible for most of the recent growth in employment.

• Fifth, in the wealthy Western democracies, material needs and desires have been so thoroughly fulfilled for so many people that, for the first time in history, we are seeing large-scale voluntary reductions in the amount of time spent at paid employment. This development manifests itself in different forms: longer periods of education and training for the young; earlier retirement despite longer life spans; and, in between, many more hours devoted to leisure, recreation, entertainment, family, community and religious activities, charitable and other nonremunerative pursuits, and so forth. The dramatic growth of the sports, entertainment, and travel industries captures only a small slice of what has happened. In Fogel's estimation, the time devoted to nonwork activities by the average male head of household has grown from 10.5 hours per week in 1880 to 40 hours today, while time per week at work has fallen from 61.6 hours to 33.6 hours. Among women, the reduction in work (including not only outside employment but also household work, food preparation, childbearing and attendant health problems, and child rearing) and the growth in nonwork have been still greater.

There is a tendency to overlook these momentous developments because of the often frenetic pace of modern life. But our busy-ness actually demonstrates the point: time, and not material things, has become the scarce and valued commodity in modern society.

III

ONE IMPLICATION of these trends is that in very wealthy societies, income has become a less useful gauge of economic welfare and hence of economic equality. When income becomes to some degree discretionary, and when many peoples' incomes change from year to year for reasons unrelated to their life circumstances, *consumption* becomes a better measure of material welfare. And by this measure, welfare appears much more evenly distributed: people of higher income spend progressively smaller shares on consumption, while in the bottom ranges, annual consumption often exceeds income. (In fact, government statistics suggest that in the bottom 20 percent of the income scale, average annual consumption is about twice annual income—probably a reflection of a substantial underreporting of earnings in this group.) According to the economist Daniel Slesnick, the distribution of consumption, unlike the distribution of reported income, has become measurably *more* equal in recent decades.

If we include leisure-time pursuits as a form of consumption, the distribution of material welfare appears flatter still. Many such activities, being informal by definition, are difficult to track, but Dora Costa of MIT has recently studied one measurable aspect—expenditures on recreation—and found that these have become strikingly more equal as people of lower income have increased the amount of time and money they devote to entertainment, reading, sports, and related enjoyments.*

Television, videocassettes, CD's, and home computers have brought musical, theatrical, and other entertainments (both high and low) to everyone, and have enormously narrowed the differences in cultural opportunities between wealthy urban centers and everywhere else. Formerly upper-crust sports like golf, tennis, skiing, and boating have become mass pursuits (boosted by increased public spending on parks and other recreational facilities as well as on environmental quality), and health clubs and full-line book stores have become as plentiful as gas stations. As some of the best things in life become free or nearly so, the price of pursuing them becomes, to that extent, the "opportunity cost" of time itself.

The substitution of leisure activities for income-producing work even appears to have become significant enough to be contributing to the recently much-lamented increase in inequality in measured income. In a new AEI study, Robert Haveman finds that most of the increase in earnings inequality among U.S. males since the mid-1970's can be attributed not to changing labor-market opportunities but to voluntary choice—to the free pursuit of nonwork activities at the expense of income-producing work.

Most of us can see this trend in our own families and communities. A major factor in income inequality in a wealthy knowledge economy is age—many people whose earnings put them at the top of the income curve in their late fifties were well down the curve in their twenties, when they were just getting out of school and beginning their working careers. Fogel again: today the average household in the top 10 percent might consist of a professor or accountant married to a nurse or secretary, both in their peak years of earning. As for the stratospheric top 1 percent, it includes not only

* *Less of a Luxury: The Rise of Recreation since 1888*, National Bureau of Economic Research, Working Paper 6054 (June 1997).

very rich people like Bill Cosby but also people like Cosby's fictional Huxtable family: an obstetrician married to a corporate lawyer. All these individuals would have appeared well down the income distribution as young singles, and that is where their young counterparts appear today.

That more young people are spending more time in college or graduate school, taking time off for travel and "finding themselves," and pursuing interesting but low- or non-paying jobs or apprenticeships before knuckling down to lifelong careers is a significant factor in "income inequality" measured in the aggregate. But this form of economic inequality is in fact the social equality of the modern age. It is progress, not regress, to be cherished and celebrated, not feared and fretted over.

IV

WHICH BRINGS me back to my contention that it is our very wealth and equality that are the undoing of the welfare state. Western government today largely consists of two functions. One is income transfers from the wages of those who are working to those who are not working: mainly social-security payments to older people who have chosen to retire rather than go on working and education subsidies for younger people who have chosen to extend their schooling before beginning work. The other is direct and indirect expenditures on medical care, also financed by levies on the wages of those who are working.* It is precisely these aspects of life—nonwork and expenditures on medical care and physical well-being—that are the booming sectors of modern, wealthy, technologically advanced society.

When the Social Security program began in America in the 1930's, retirement was still a novel idea: most men worked until they dropped, and they dropped much earlier than they do today. Even in the face of our approaching demographic crunch, produced by the baby boom followed by the baby bust, we could solve the financial problems of the Social Security program in a flash by returning to the days when people worked longer and died younger. Similarly, a world without elaborate diagnostic techniques, replaceable body parts, and potent pharmaceutical and other means of curing or ameliorating disease—a world where medical care consisted largely of bed rest and hand-holding—would present scant fiscal challenge to government as a provider of health insurance.

Our big government-entitlement programs truly are, as conservatives like to call them, obsolete. They are obsolete not because they were terrible ideas to begin with, though some of them were, but because of the astounding growth in social wealth and equality and because of the technological and economic developments which have propelled that growth. When Social Security was introduced, not only was retirement a tiny part of most people's lives but people of modest means had limited ability to save and invest for the future. Today, anyone can mail off a few hundred dollars to a good mutual fund and hire the best investment management American finance has to offer.

In these circumstances it is preposterous to argue, as President Clinton has done, that privatizing Social Security (replacing the current system of income transfers from workers to retirees with one of individually invested retirement savings) would be good for Warren Buffett but bad for the little guy. Private savings—through pension plans, mutual funds, and personal investments in housing and other durables—are *already* a larger source of retirement income than Social Security transfers. Moreover, although there is much talk nowadays about the riskiness of tying retirement income to the performance of financial markets, the social developments I have described suggest that the greater risk lies in the opposite direction. The current Social Security program ties retirement income to the growth of wage earners' payrolls; that growth is bound to be less than the growth of the economy as a whole, as reflected in the financial markets.

Similarly, Medicare is today a backwater of old-fashioned fee-for-service medicine, hopelessly distorted by a profusion of inefficient and self-defeating price-and-service controls. Over the past dozen years, a revolution has been carried out in the private financing and organization of medical care. The changes have not been unmixed blessings; nor could they be, so long as the tax code encourages people to overinsure for routine medical care. Yet substantial improvements in cost control and quality of service are now evident throughout the health-care sector—except under Medicare. These innovations have not been greeted by riots or strikes at the thousands of private organizations that have introduced them. Nor will there be riots

* Direct expenditures in the U.S. include Medicare for the elderly (financed mainly by a payroll tax) and Medicaid for the poor. Indirect expenditures, amounting to about $100 billion annually, are implicit in the exclusion from taxable income of employer-provided health insurance, which most middle- and upper-income Americans receive. The effect of this tax anomaly is to reduce wages and salaries in return for a subsidy toward the purchase of health insurance—the higher one's tax bracket, the greater the marginal subsidy.

in the streets if, in place of the lame-brained proposals for Medicare "spending cuts" and still more ineffective price controls currently in fashion in Washington, similar market-based innovations are introduced to Medicare.

V

IN SUM, George Bush's famous statement in his inaugural address that "we have more will than wallet" was exactly backward. Our wallets are bulging; the problems we face are increasingly problems not of necessity, but of will. The political class in Washington is still marching to the tune of economic redistribution and, to a degree, "class warfare." But Washington is a lagging indicator of social change. In time, the progress of technology and the growth of private markets and private wealth will generate the political will to transform radically the redistributive welfare state we have inherited from an earlier and more socially balkanized age.

There are signs, indeed, that the Progressive-era and New Deal programs of social insurance, economic regulation, and subsidies and protections for farming, banking, labor organization, and other activities are already crumbling, with salutary effects along every point of the economic spectrum. Anyone who has been a business traveler since the late 1970's, for example, has seen firsthand how deregulation has democratized air travel. Low fares and mass marketing have brought such luxuries as foreign travel, weekend getaways to remote locales, and reunions of far-flung families—just twenty years ago, pursuits of the wealthy—to people of relatively modest means. Coming reforms, including the privatization of Social Security and, most of all, the dismantling of the public-school monopoly in elementary and secondary education,* will similarly benefit the less well-off disproportionately, providing them with opportunities enjoyed today primarily by those with high incomes.

I venture a prediction: just as airline deregulation was championed by Edward Kennedy and Jimmy Carter before Ronald Reagan finished the job, so the coming reforms will be a bipartisan enterprise. When the political class catches on (as Prime Minister Tony Blair has already done in England), the Left will compete vigorously and often successfully with the Right for the allegiance of the vast new privileged middle class. This may sound implausible at a moment when the Clinton administration has become an energetic agent of traditional unionism and has secured the enactment of several new redistributive tax provisions and spending programs. But the watershed event of the Clinton years will almost certainly be seen to be not any of these things but rather the defeat of the President's national health-insurance plan in the face of widespread popular opposition.

The lesson of that episode is that Americans no longer wish to have the things they care about socialized. What has traditionally attracted voters to government as a provider of insurance and other services is not that government does the job better or more efficiently or at a lower cost than private markets; it is the prospect of securing those services through taxes paid by others. That is why today's advocates of expanding the welfare state are still trying to convince voters to think of themselves as members of distinct groups that are net beneficiaries of government: students, teachers, women, racial minorities, union members, struggling young families, retirees, and so forth. But as the material circumstances of the majority become more equal, and as the proficiency and social reach of private markets increasingly outstrip what government can provide, the possibilities for effective redistribution diminish. The members of an egalitarian, middle-class electorate cannot improve their lot by subsidizing one another, and they know it.

With the prospects dimming for further, broad-based socialization along the lines of the Clinton health-care plan, the private supply of important social services will continue to exist and, in general, to flourish alongside government programs. Defenders of the welfare state will thus likely be reduced to asserting that private markets and personal choice may be fine for the well-off, but government services are more appropriate for those of modest means. This is the essence of President Clinton's objection to privatizing Social Security and of the arguments against school choice for parents of students in public elementary and high schools. But "capitalism for the rich, socialism for the poor" is a highly unpromising banner for liberals to be marching under in an era in which capitalism has itself become a profound egalitarian force.

VI

WHERE, THEN, will the battlegrounds be for the political allegiance of the new middle class? Increasingly, that allegiance will turn on poli-

* See "A Report Card on School Choice," by Paul E. Peterson, beginning on p. 29—ED.

cies involving little or no redistributive cachet but rather society-wide benefits in the form of personal amenity, autonomy, and safety: environmental quality and parks, medical and other scientific research, transportation and communications infrastructure, defense against terrorism, and the like. The old welfare-state debates between Left and Right will be transformed into debates over piecemeal incursions into private markets that compete with or replace government services. Should private insurers be required to cover annual mammograms for women in their forties? Should retirement accounts be permitted to invest in tobacco companies? Should parents be permitted to use vouchers to send their children to religious schools? Thus transformed, these debates, too, will tend to turn on considerations of general social advantage rather than on the considerations of social justice and economic desert that animated the growth of the welfare state.

Political allegiance will also turn increasingly on issues that are entirely nonmaterial. I recently bumped into a colleague, a noted political analyst, just after I had read the morning papers, and asked him to confirm my impression that at least half the major political stories of the past few years had something to do with sex. He smiled and replied, "Peace and prosperity."

What my colleague may have had in mind is that grave crises make all other issues secondary: President Roosevelt's private life received less scrutiny than has President Clinton's, and General Eisenhower's private life received less scrutiny than did that of General Ralston (whose nomination to become chairman of the Joint Chiefs of Staff was torpedoed by allegations of an extramarital affair). There is, however, another, deeper truth in his observation. The stupendous wealth, technological mastery, and autonomy of modern life have freed man not just for worthy, admirable, and self-improving pursuits but also for idleness and unworthy and self-destructive pursuits that are no less a part of his nature.

And so we live in an age of astounding rates of divorce and family break-up, of illegitimacy, of single teenage motherhood, of drug use and crime, of violent and degrading popular entertainments, and of the "culture of narcissism"—and also in an age of vibrant religiosity, of elite universities where madrigal singing and ballroom dancing are all the rage and rampant student careerism is a major faculty concern, and of the Promise Keepers, over a million men of all incomes and races who have packed sports stadiums around the United States to declare their determination to be better husbands, fathers, citizens, and Christians. Ours is an age in which obesity has become a serious public-health problem—and in which dieting, fitness, environmentalism, and self-improvement have become major industries.

It is true, of course, that the heartening developments are in part responses to the disheartening ones. But it is also true that *both* are the results of the economic trends I have described here. In a society as rich and therefore as free as ours has become, the big question, in our personal lives and also in our politics, is: what is our freedom for?