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Running To Just Keep Up
Or
Stuck on a Treadmill

By W. Michael McBride, J.D

As the first decade of the 21st century concludes, many reflect on issues, events, progress, or the lack thereof. Rather than review the last year or the even the last decade, let's take a look at the last 40, dialing back to 1970 places us strategically ahead of the 1971 action by President Nixon closing the gold window and ending the convertibility between U.S. Dollars and gold. From that moment forward the value of the U.S. Dollar was a floating abstract determined not by some inherent backing, but rather by supply and demand.

So how exactly has the average American family progressed since 1970? Superficially many would say quite well. We have more cars per household, more televisions, more convenience items, larger homes, and we take better vacations. In essence, the average American household has more "stuff" now than it did in 1970. But a closer look reveals it came at a price and we have not progressed in "real" terms as far as we think. Throughout this article we will use 2008, as the most recent year for comparison.

So how has the average American family progressed since 1970? Superficially quite well… in "real" terms not as far as we think

In 1970 the median household income was a tad over $8,700. According to the Census Bureau's Annual Report on Income, Poverty and Health Insurance issued in September of 2009, the median household income for 2008 was a bit over $50,000. Of course these figures need to be adjusted for inflation to gain proper perspective. Using the Bureau of Labor Statistics (BLS) official inflation calculator, we find that $8,700 in 1970 is roughly equivalent to $48,000 in 2008. So according to the government, household income has kept pace with inflation. No real gains, no losses either. Or was there?

In the past we have written about the degradation in the integrity of the inflation figures over the years. The figure has become a political statistic instead of an economic statistic. John Williams of Shadow Government Statistics (SGS), (we have no affiliation, just a subscriber) calculates inflation the old-fashioned way. That is, by calculating it as a cost to maintain a level standard of living rather than a cost of living. The latter allows for interruptive manipulation by the political interests. Using the SGS formula, $8,700 in 1970 is equivalent to $140,000 in 2008. In other words, according to SGS figures, the average household is under water in real purchasing terms by $92,000.

Let's assume you think the folks at SGS are suffering from some type of anti-government affliction that is affecting their economic judgment. Looking at another standard of measure can help us validate or at least provide additional perspective. Gold has been money for thousands of years. Recall that the U.S. Dollar has been around for significantly less time than gold and has only been floating independent of gold for less than 40 years. In 1970, the average price of gold was $35.94. If we divide the median household income of $8,700 by $35.94 we get 242 ounces. Thus the median household in 1970 earned 242 ounces of gold. In 2008 the average price of gold was $871.96. So dividing the 2008 median income of $50,000 by $871.96 indicates the average household earned only 57.34 ounces of gold, a deficiency of 184.66 ounces or $161,016.

At this point an uncomfortable anger and anxiety creeps in as you digest these figures. Looking for a flaw, you might point out that it is inappropriate to use the most recent price of gold after its significant run up in price. Fair enough. Let's use the yearly average price of gold since 1970 to smooth out the recent volatility. From 1970 to 2008 the average annual price of gold was $340.14 per ounce. If you believe the most recent 10 years is more instructive of where we may be going, that yearly average is $521.99.

The table below summarizes the data as follows:

	1970	**2008**	**Household Gain/Loss**
Median Household Income	$8,700	$50,000	
Inflation adjusted per BLS	**$48,000**	$50,000	$2,000
Inflation adjusted per SGS	**$140,000**	$50,000	($90,000)
Average Price of Gold	$35.94	$871.96	
Ounces of Gold earned	**242**	57.34	(184.66)
Gold Adjusted dollars, 2008 price, (242 ounces X $871.96)	**$211,014**	$50,000	($161,014)
39 year annual average Gold price = $340.14			
Gold Adjusted Dollars, 39 year ave, (242 ounces X $340.14)	**$82,314**	$50,000	($32,314)
2000-2009 annual average Gold price = $521.99			
Gold Adjusted Dollars, 2000-09 ave, (242 ounces X $521.99)	**$126,322**	$50,000	($76,322)

According to the government (BLS) the average American household earning $50,000 has kept pace with inflation over the last 40 years and in fact is ahead by $2,000. According to the SGS folks and the way they measure inflation, the average household should be earning $140,000 to stay even. Gold at 2008 prices says the household needs $211,014. A 30 year average of gold tells us

$82,314 is necessary, while the recent 10 year average calls for $126,322. If we assume each of our gold adjusted Dollar calculations is both a little right and a little wrong and we average all three we generate a figure of … drum roll please … $139,883 putting it right in line with the SGS figure. This again demonstrates how gold as money retains its purchasing power on average over long periods of time. One has to love the symmetry.

Accepting that the average household income has not keep pace in terms, of real inflation and purchasing power, how has the average family survived let alone acquire more "stuff?" The answer can be found in four material changes that occurred inside the average household over the past 40 years.

Increase in two income households

Since 1970, according to the U.S. Census Bureau, the labor force participation rates of married women with children under age 18 has increased by nearly 75 percent moving from 40 percent of households to nearly 70 percent. This figure is correlated by noting that median family spending on child care increased 100 percent from the 1970s to 2004.

Decrease in population per household

A 1970 household consisted of an average of 3.14 persons. In 2007, that average figure dropped to 2.56 reflecting, among other things, an increase in single parent households. The average population per family in 1970 was 3.58 and in 2007 dropped to 3.13. Over the last 40 years, the average American household has reduced the number of people it needs to support.

Expect a continued assault on the American standard of living

Increase in household debt

The balance sheet of the average American household fundamentally changed over the last 40 years. The expansion in availability of consumer credit as well as the continued extraction of home equity, (until recently) to make consumer purchases allowed individuals to consume much more than what traditional savings would have allowed. In the 1970s, an average of 3 percent of household income was dedicated to consumer debt payments. By 2004, that figure had exploded to 13 percent. In addition, a single income family in the 1970s had 54 percent of its income dedicated to fixed costs (mortgage, child care, health insurance and taxes) yet by the early 2000s, a dual income family had 72 percent of its income committed to fixed costs. These figures indicate a material reduction in discretionary income for the average family which necessitated more reliance on debt.

Migration of consumer goods manufacturing offshore

Over the last 40 years, manufacturing as a percentage of GDP in the United States has declined from over 20 percent in 1970 to less than 12 percent today. The predominant component has been consumer goods where the average American household benefited from cheaper prices as a result of leveraging less expensive third world and emerging markets labor rates.

The Treadmill

Taking all four of these elements, as well as others, together, and you create an environment whereby the average household was able to adapt to a stagnate, if not declining, income environment based in real terms.

This presents an interesting challenge for the economy going forward. If the financial pundits are correct, and the U.S. is a consumer driven economy, where will the fuel come from to re-energize the economy? Unless we revert to the agrarian days and put our kids to work, there are no more earners to add to the household. Further reductions in population per household, assuming this occurs, will take years to manifest. The credit bubble has burst and households are in the process of de-leveraging. Reliance on expansion of credit to fuel the economy is no longer an option. Finally, it would appear we have run the course on extracting the maximum benefits of using emerging market labor to make "stuff" for us. If recent movements in the currency markets and the decline in the U.S. Dollar are any indication, these changes may be on our doorstep.

Expect a continued assault on the American standard of living for the average American household. It will have economic and political ramifications. **So what does this have to do with your investment strategy?** In a word, **everything**, unless of course you are comfortable on a treadmill increasing in speed.

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