Henry Ford, the American Experience, and Why and How the Distribution of Income Affects Growth in the Modern Economy

One hundred years ago Henry Ford dropped the price of his Model T to $550. Having adopted new and successful engineering and assembly techniques, the company's sales expanded exponentially, approximately tripling between 1911 and 1914 alone. Henry Ford bragged that his car would be "so low in price that no man making a good salary will be unable to own one."

On the American Experience (January 29, 2013) PBS covers the biography of Henry Ford. That story has application to our own time in explaining how the distribution of income affects economic growth.

Ever since the Industrial Revolution, economies of scale—mass production with lower cost for the last items produced than for the first—have been the primary engine of income growth for nations and workers. Ford's talent at mass production not only made him extraordinarily rich, it helped increase the effective incomes of workers throughout the country since their earnings could go farther. While massive rewards did accrue to entrepreneurs, inventors, and those gaining temporary monopolies, the rising tide lifted all boats; it even leveled out the gains as the forces of competition limited how much leading capitalists could garner for their efforts of yesteryear.

Henry Ford's fight with unions to the side, he did recognize from the start that workers needed to earn enough to buy his products. I'm not suggesting that the cart of workers' incomes leads the horse of profits, but rather that they move forward together. Ford at least knew that he and some of the other rich people he tended to detest could use only so many cars themselves; if the everyday citizen couldn't buy them, he could never get rich.

So how did we move toward a society where today profits seem to be rising but workers' incomes remain stagnant? The main answer, I believe, is that while economies of scale have expanded extraordinarily since Ford's day, the necessary purchasers of the new products lie within a global economy. The growth of U.S. workers' incomes is less necessary for the producers of new goods and services to become wealthy.

Consider how many modern-day Henry Fords produce goods and services with limited physical content: pharmaceutical drugs, electronic software, technology, movies, and other forms of entertainment and information. These "industries" provide much of the growth of the modern U.S. economy.

Many products within these growth industries can be produced at almost no cost for the next or marginal purchaser. How much does it cost Hollywood producers to let one more person watch a movie? For the drug manufacturers to produce one more pill? For Microsoft or Apple to make software available to one more person? Almost nothing in many cases, other than marketing. As economies of scale expanded as we moved through the 20th to the 21st century, so, too, have the possibilities for growth when more people have enough money to buy these new products. If the costs of a pill or movie can be shared among 10 million people, rather than 1 million, then the world economy can expand quickly when 9 million more people can afford to buy the product.

These economies extend beyond production to transportation, storage, and similar costs. It doesn't cost much to "transport" a movie to Monaco, a pill to Paris, or software to Sofia.

Modern capitalists seek their buyers within a world population of 7 billion, not a U.S. population of 300 million. When creating products with extraordinary economies of scale that are easily transportable, at low weight or even with the click of a mouse button, the new American entrepreneur still wants
purchasers whose incomes rise enough to buy these new goods and services. It's just less necessary that those purchasers reside in the United States.

Does this mean that income becomes increasingly unequal? It depends partly upon whom you count and what type of measure you use. Almost no one could have guessed even a few decades ago the rise of hundreds of millions of middle-class people in China and India. At the same time, it's also possible that incomes will rise initially for U.S. and Indian entrepreneurs and for workers in Bangalore, but not for large portions of the population in either the United States or India.

I am not arguing that all the consequences of this world order are sanguine. But only by defining its characteristics can we identify our opportunities.

First, consider how substantial economies of scale make higher growth rates possible when incomes rise across the board. Productivity just doesn't rise as quickly when we build and subsidize McMansions for the few rather than employ workers to provide goods and services with greater economies of scale for the many.

Similar calculations can affect welfare policy. It may not cost us very much directly to give lower-income people the ability to buy goods and services with large economies of scale. For instance, if we give a household $1,000 that it uses to buy a television subscription that at the margin costs a cable company only an additional $100 to provide, then the net cost to the non-welfare part of society may also be only $100 despite the transfer of $1,000. At the same time, if the $1,000 subsidy at a $100 marginal cost of production results in plus $900 to a monopoly cable company and minus $1,000 to the taxpayer, then both the welfare recipient and the taxpayer may have reduced incentive to work. Private income (before welfare) also becomes more unequal.

Or consider antitrust policy. Tying it to its 19th century moorings may be inadequate for a 21st century economy. International competition may lessen any concern over having only four major American automobile manufacturers, but what about the concentration of accounting practices among the Big Four? Did the breakup of Arthur Andersen for its accounting indiscretions promote or reduce competition?

What about our current multi-tiered pricing of drugs, higher at home and lower abroad? Without any compensating mechanism, does this increase net output from the United States but at an unfair cost to U.S. consumers?

To answer all these questions, we need to concentrate correctly on causes, not inveigh interminably on impressions. One conclusion from Henry Ford's day still stands out in my mind: promoting greater growth means both a favorable climate for entrepreneurship and a sharing of its rewards broadly with workers.

The Government We Deserve is a periodic column on public policy by Eugene Steuerle, an Institute fellow and the Richard B. Fisher Chair at the nonpartisan Urban Institute. Steuerle is also a former deputy assistant secretary of the Treasury. The opinions are those of the author and do not necessarily reflect those of the Urban Institute, its trustees, or its sponsors.

Note to Editors: Publication of this column is encouraged and permission is hereby granted, provided that the author is properly cited. To link to the blog posting or make comments, visit http://blog.governmentwedeserve.org/2013/01/29/henry-ford-the-american-experience-and-why-and-how-the-distribution-of-income-affects-growth-in-the-modern-economy/.