

Wage Policy, Income Distribution, and Democratic Theory

Oren M. Levin-Waldman



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Wage Policy, Income Distribution, and Democratic Theory

This book explores the relationship between wage policy, distribution of income, and ultimately how that distribution impacts on democratic theory. In doing so, it examines the types of policies that are critical to the maintenance of a sustainable democracy. Wage policy, long the domain of economists (particularly neo-classical economists whose focus has been their impact on labor markets and income distribution), has largely been ignored by democratic theorists. Levin-Waldman argues that because wage policy can shape overall income distribution, it has a significant effect on equality levels and is therefore core to democratic theory. Its potential to enhance individual autonomy, which is a necessary condition for democratic participation, is another reason why wage policy should be at the centre of democratic theory.

This book argues that the evolution in wage policy has paralleled economic transformations, which democratic theory has evolved to accommodate. Through a careful analysis of democratic theory and empirical analysis of the impact of wage policy on income distribution, this book concludes that wage policy is an important component in the maintenance of democratic society. A wage policy that raises the wages of those at the bottom can give workers more independence and power as they are placed on more equal footing with managers. This, in and of itself, can be a source of empowerment, effectively enhancing their autonomy. By doing so, workers feel less exploited and income inequality is reduced.

This significant contribution explores the meaning of democratic theory and how it has evolved along with the meaning and specific forms of wage policy, providing invaluable new insights into their connections. This book will be of interest to postgraduates and researchers in economics and political science, as well as policy practitioners interested in issues of income inequality or democratic theory.

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Preface

As this book goes to press, the US economy is in the throes of a deep recession. Unemployment still remains close to 10 percent, people have lost their homes to foreclosure, and many more are “under water” – meaning that their mortgages exceed their homes’ value. Although there are claims of beginning signs of recovery, most companies aren’t hiring. The newest phrase to enter our lexicon has become the “jobless recovery.” The government stimulus plan, perhaps modeled in part on the 1930s Work Progress Administration (WPA), has not yielded the promised results, mostly because much of the stimulus money remains unspent. And that which has been spent, has gone to pork-barrel projects rather than construction and repair of infrastructure. A jobs program might appear to be a logical response to sustained unemployment, but it ultimately fails if it cannot account for the causes of unemployment – that people aren’t demanding goods and services. Arguably, more people working will result in an increased demand for goods and services. And yet, the simple cause, and often overlooked because it is so simple, is that people lack sufficient income and so are unable to demand goods and services. Although John Maynard Keynes (1964) has been out of fashion for years, on this he was correct. In response to the neoclassical model that held unemployment in a competitive market to be due to wage rigidity, Keynes was able to state the obvious: If consumers are not demanding goods and services, it really does not matter how low workers reduce their wage demands. Firms will not hire because they have no need to.

The current recession was precipitated by the financial meltdown beginning in the fall of 2007, and this was precipitated by the sub-prime mortgage crisis. In a nutshell, many consumers were sucked into mortgages for whatever reason, they couldn’t afford to make their payments, and the banks foreclosed. The glut of houses only reduced the value of others’ homes. In some cases, mortgages were made at low teaser rates on the assumption that as the variable rate mortgages rose, so too would the consumer’s income. In many cases, consumers were led to believe that they would be able to afford these mortgages when they could not. In all fairness to borrowers, many may have believed that according to the natural order of things their incomes would rise and that they in turn would be able to afford the payments as their adjustable rate mortgages increased. Historically, this was the natural order of things. It is only in the last

few decades that wages have been stagnant. Almost all the mortgages were securitized, meaning the loans were sold to investors as securities. As a consequence of this practice, mortgage companies had no incentive to work out payment plans with struggling consumers. Rather, having already made their money up front they had every incentive to simply foreclose and try to unload the housing stock in fire sales. Intuitively, the answer would appear to again have been simple: provide workers with the wherewithal to pay off their mortgages.

Public policy in the United States and elsewhere is anything but simple. Fraught with interest groups and the inability to reach agreement, at best we attain incremental policy. Charles Lindblom (1959; 1965) famously referred to this as the science of muddling through. Moreover, it was good for democracy because it meant that government could not move precipitously on anything, meaning that individual rights couldn't easily be trampled on. And yet, because the outcome would be the result of partisan mutual adjustment, it was assumed that the policy process would involve the broadest participation of the public through policy networks, organizations, and interest groups. In the end, then, everybody would be broadly represented. The case of the sub-prime crisis, however, is perhaps an example of policy not being made in this fashion. Rather, the response was for the US Treasury, in conjunction with the Federal Reserve Board (Fed), to offer banks a bailout for the purposes of shoring up the financial system. The approach was top-down as opposed to bottom-up. It also followed an elitist approach to policy in that it was assumed that issues were so technical in nature that only the so-called experts could understand the issues. Consequently, there couldn't be any room for the input of others.

A policy from the Fed in the service of the financial industry should come as no great surprise. By statute, the Fed's primary constituency is the banking industry. Employment has only become a secondary ideal, and only by default. Because Congress would rather not take responsibility for fiscal policy, it has fallen to the Fed as an implied responsibility, whose basis lies in the Employment Act of 1946. That Act established that it would be the "continuing policy and responsibility of the Federal Government to use all practicable means ... to promote maximum employment, production, and purchasing power" (Employment Act 1946, p. 23). A "practicable means" of fulfilling its maintenance function might be accomplished through monetary policy, especially as the principal maintenance function was to control for both inflation and recession. The Act clearly implied a role for monetary policy.

My purpose here is not to argue the failure of American economic policy, or even to argue how democratic governance effectively failed to be responsive to the needs and interests of ordinary citizens. Rather it is to focus on a long neglected topic, and one which has bearing on the current state of the economy. While there is discussion about minimum wages and wage rigidity from time to time and plenty of discussion about the fairness of the current tax system, there is precious little discussion about substantive wage policy. The idea is nothing new. Sidney Weintraub (1972) almost four decades ago argued that an income policy would serve as a necessary complement to the fiscal and monetary tools

traditionally used to manage the economy. The argument was actually quite simple: It wouldn't matter how many jobs might be created either through tax reductions or lowering of interest groups if people's incomes failed to keep up with inflation. My purpose in this book is to take the argument a step further. Not only would a wage policy, if it resulted in arresting wage stagnation, better provide workers the wherewithal to demand more goods and services, it would also result in less income inequality, which over the last few decades has increased tremendously, and be in the service of enhancing democracy.

Therefore, I assume a couple of things: First, the stagnation of wages which we have observed over the last three decades, would not have happened had there been a viable wage policy. Second, if we had a credible wage policy, the level of income inequality would be considerably less. Many European countries have lower levels of inequality because they have more social provision and centralized wage setting mechanisms, i.e. wage policies. I would even suggest that had there been a viable wage policy, the financial meltdown following the sub-prime crisis might not have occurred, or would have been less likely to have, because people would have been in a better position to pay off their mortgages.

In the pages that follow, I argue that wage policy is essentially a middle class issue and ultimately is critical to sustaining democratic society. Consider that rising wages throughout the distribution will have the intended macroeconomic effects of increasing demand for goods and services. If the wages of those at the bottom rise along with those at the top, or even increase at a higher relative percentage, the gap between the top and the bottom will be narrower, thereby resulting in less income inequality. Obviously, this will not mean that we all have the same thing, but a narrowing of the gap between the two extremes of the top and the bottom means that there are fewer people at the very bottom and the very top, and more concentration in the middle. Less income inequality effectively means a broader middle class, and a broad middle class is critical to democratic governance. It isn't just a question of achieving a more equitable distribution of income; it is ultimately about enhancing personal autonomy. As workers see their wages rising, rather than eroding through stagnation, their morale is boosted, and they in turn become more productive. But that they are less likely to become dependent, means that they have achieved greater independence. Therefore, I argue that wage policy is essential to enhancing the personal autonomy of individuals, which is a fundamental prerequisite to participating in democratic society.

In previous works, I have focused on both the minimum wage and the living wage, both of which are examples of wage policy. Both, however, have been limited policy responses to poverty and insufficient wages. Here I focus on the broader topic of wage policy as a concept that policy makers ought to give greater thought to. Wage policy would ultimately be a middle class issue, as it would effectively bolster the wages of those in the middle class. But wage policy is critical to democracy because it would accomplish three necessary objectives. First, by enabling workers to earn livable wages they are better able to be self-sufficient and keep themselves and their families out of poverty. This then

becomes a matter of individual autonomy. While democratic society is one that allows its members to live autonomous lives, it also requires that they be autonomous so that they can think critically and be active participants in the political process. Second, to the extent that wage policy reduces income inequality, it effectively makes society more equal insofar as the result is a broader middle class. And third, to the extent that it serves to bolster the middle class, it becomes a necessary ingredient in the continued economic development of society. Democratic society requires autonomy, equality, a broad middle class, and a measure of economic development.

As I have spent much of my academic career grappling with these issues, this project might well represent the culmination of my work. In that vein, it certainly has been many years in the making. I actually had the opportunity in the fall of 2007 to participate in a workshop on work and social justice at the University of Zurich where I was able to explore the relationship between a minimum wage and democratic ethos. The paper for that workshop was later published in *Advances in Industrial and Labor Relations*, and it forms the basis for some of the arguments in this book. I thank Carsten Kollmann for organizing the workshop, as well as his gracious invitation to participate. Portions of this manuscript were read by Charles Whalen and Aryeh Botwinick. Working in the area of democratic theory this time actually afforded me the opportunity to rekindle a relationship with Aryeh Botwinick who many years ago taught me political philosophy in graduate school. The theoretical pieces of this work are no doubt better because of his input. I wish to thank Thomas Sutton, my editor at Routledge, for seeing this as a worthy project. I also benefitted from the comments of several anonymous reviewers. All comments received have no doubt made this a better manuscript, but I bear sole responsibility for the errors or omissions remaining. I also would like to thank the editors of the *Journal of Socio-Economics*, the *International Encyclopedia of Public Policy*, and *Advances in Industrial and Labor Relations* – Morris Altman, Phil O’Harra, and David Lewin and Bruce Kaufman respectively – for permission to reprint pieces that first appeared in their pages. “Urban Path Dependency Theory and the Living Wage: Were Cities that Passed Ordinances Destined to Do So?” constitutes the core of Chapter 5 and was first published in the *Journal of Socio-Economics* 38, 4 (August 2009). “Income Inequality and the Distribution of Power” of which portions are reprinted mostly in Chapter 7 was first published in *Volume 2: Economic Policy* (GPERU: Perth 2008). And “The Minimum Wage and Competing Ethical Conceptions” was first published in *AILR* 16 (2009). I also thank the Emerald Publishing Company, the publisher of *AILR*, for its permission to reprint.

A work like this is always a solitary enterprise, but it nonetheless would not have been possible without my family’s support. My two sons Avi and Ariel, of course were themselves. Though both grown now, they still provide their father a sense of purpose. And my wife Renee provided the love and support necessary to see this project through to completion. Finally, just a few months before this work went to press, my mother Saula Waldman passed away. My mother was

raised in an environment where social justice was a core value. She was at heart a socialist, although never a pure Marxist. Her father, although he loved Franklin Roosevelt, nonetheless voted for Norman Thomas three times. I am sure that whatever values are contained in this work owe to her influence. She was certainly passionate in the view that communities have a responsibility to take care of their members, whether it is done privately through charitable organizations or publicly through public policy. Therefore, it is in loving memory of my mother, *Z'Chrona L'Vrocha*, that I dedicate this book.

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