Wage Policy as an Essential Ingredient in Job Creation

Oren Levin-Waldman

Monetary policy has shown that it is not sufficient to stimulate economic activity to produce full employment. But the author argues that fiscal policy would not be enough, either. We need a robust wage policy specifically designed to increase what people make on the job.

Since the start of the recession that began with the financial meltdown in the fall of 2007, two things have become clear. First, this recession, unlike many others, has been so deep that it has produced a substantial degree of long-term unemployment. And second, despite an extensive reliance on monetary policy, including quantitative easing and interest rates that are at their lowest, jobs have not been created. Despite these realities, policymakers persist in relying heavily on monetary policy, in large part because it is administered by an institution independent of the political process and the pressures attendant to it.

It is true that some in Washington believe the answer to job cre-

***OREN LEVIN-WALDMAN** is a professor of public policy at the Metropolitan College of New York. He is the author of* Wage Policy, Income Distribution, and Democratic Theory *(Routledge, 2011),* The Political Economy of the Living Wage: A Study of Four Cities *(M.E. Sharpe, 2005), and* The Case of the Minimum Wage: Competing Policy Models *(State University of New York Press, 2001).*

Challenge, vol. 55, no. 6, November/December 2012, pp. 26–52.

ISSN 0577-5132 (print)/ISSN 1558-1489 (online)
DOI: 10.2753/0577-5132550602

ation lies in massive public works programs à la the Works Progress Administration (WPA) during the 1930s, while others believe that the answer lies in reducing taxes and eliminating regulation. Added to the latter is the belief, well grounded in neoclassical economics, that labor needs to be flexible. In truth, both approaches might be said to represent two sides of the same coin that falls under the purview of fiscal policy.

This approach, however, is limited because it is missing an essential ingredient—that which would enable individuals to effectively demand goods and services. The problem with monetary policy intended to pump more money into the economy is that it is essentially a top-down approach that assumes that if interest rates can be lowered enough, investment will be stimulated and jobs created. But this would appear to be a faulty assumption. In and of itself, pumping more money into the economy will not create jobs. Job creation requires a more grassroots approach. For there to be job creation, there needs to be aggregate demand for goods and services. Therefore, it matters not how much interest rates are lowered. If there is insufficient aggregate demand because individuals lack the financial wherewithal to demand goods and services, nothing is going to happen. And the problem with fiscal policy that is also intended to put money in people's pockets through lower taxes is that the political process that produces it is simply too robust. Politically it is easy to lower taxes, but it is not so easy to raise them again once the recession is over.

In this article I argue for a third approach, a wage policy that should also be in place alongside both fiscal and monetary policy. I have argued previously in these pages that a wage policy designed to boost incomes would have positive welfare benefits. It would shore up the middle class by ensuring that it has the wherewithal to demand goods and services in the aggregate, and it would effectively arrest the type of wage stagnation to which the country has been subjected for more than three decades.[1] Consider that the recession was precipitated by the financial meltdown beginning in the fall of 2007, which was precipitated by the subprime mortgage crisis. Many consumers, in short, were sucked into mortgages, for whatever reason, that they could not afford to pay, and banks responded by foreclosing. 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 variable-rate mortgages rose, so, too, would consumers' income. In many cases, consumers were led to believe that they would be able to afford these mortgages when they really could not. In all fairness to borrowers, many may also 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. Indeed, this historically was the natural order of things, but in the last few decades, wages have been stagnant. And yet, one has to wonder whether this meltdown would have occurred had there been a wage policy in place.

My purpose in this article is not to argue the failure of U.S. economic policy, which may have been responsible for one of the greatest recessions the country has experienced. Rather, it is to focus on a long neglected topic that does have bearing on the economy. There has been little discussion about wage policy. The idea, however, is not new. Almost four decades ago, Sidney Weintraub argued that an income policy would serve as a necessary complement to the fiscal and monetary policy traditionally used to manage the economy.[2] His argument was actually quite simple, and in many respects it echoed the thought of John Maynard Keynes and John R. Commons before him. That is, it does not matter how many jobs might be created either through tax reductions or lowering of interest rates if people's incomes fail to keep up with inflation. Or for that matter, it does not matter how much workers reduce their wage demands as competitive market theory suggests. It is increases in effective demand for goods and services derived from rising incomes that ultimately drives the need to expand facilities, which results in the creation of new jobs.

Causes of Unemployment

Before considering models of job creation, it would be useful to review the neoclassical economics understanding of what causes unemployment, because much of the policy debate feeds off it either directly or indirectly. The neoclassical synthesis suggests that unemployment is a function of wage rigidity, or simply inflexible wages. In a perfectly competitive market, there really is no such thing as unemployment because workers can simply lower their wages to the point that employers will demand more of their services.

Market-clearing wages are achieved when the demand for labor is exactly equal to the supply of labor. This is considered a full employment economy. In such a market, there is no such thing as unemployment because wages either rise or fall until the demand for labor is exactly equal to the supply of labor. At the wage at which demand equals supply, all those willing and able to work at that wage will be employed. More people willing to work leads wages to fall, thereby inducing firms to hire more workers, with the result that the supply of labor will once again equal demand. And when firms are unable to hire as many workers as they would like, wages rise to induce additional people to enter into the workforce until supply and demand are once again equal. As Assar Linbeck and Dennis Snower explain: "When incumbent workers have some power in wage determination, then (i) there may be no natural rate of unemployment, and (ii) both supply-side and demand-side policies may have lasting effects on the unemployment rate."[3]

It is when workers become inflexible in their wage demands that unemployment results. Their inflexibility may stem from membership in unions that refuse to offer concessions, or it may result from wage floors, such as minimum wages, that prevent workers from lowering their wages below a certain point. The competitive-market model assumes that unemployment results from interventions, whether it be institutions that artificially raise wages or other regulatory policies that result in efficiencies. The problem with this model is that at best it represents a theoretical construct with characteristics that simply do not exist in the real world. Underlying the competitive market model is an assumption that as wage demands drop, overall prices will drop, too. Assuming that workers in response to a downturn in the business cycle drop their wage demands in order to prevent unemployment, each firm that has reduced its labor costs will be able to lower prices so that workers earning lower wages will be able to continue to maintain effective demand for goods and services.

Yet this would appear to assume that labor is indeed the principal factor of production. All firms have fixed costs that cannot be reduced. There may indeed be a limit to how much prices can be reduced in response to wage flexibility. No single supply-and-demand curve exists to explain what is happening in the marketplace as a whole; rather, there are multiple supply-and-demand curves because the overall market consists of multiple submarkets. Assuming that wage rigidity is the principal cause of unemployment, or even if unemployment is initially caused by the business cycle, and wage rigidity is a key ingredient of long-term unemployment, how low would wages have to fall in order for the supply and demand for labor to intersect? What happens, after all, when wages completely bottom out? Is this not ultimately the source of market instability? This was indeed the problem during the Great Depression.

John Maynard Keynes argued in *The General Theory* that the introduction of more labor—in excess of the supply—only leads to a decrease in money wages, which only results in lower incomes of employed workers.[4] Hyman Minsky also noted that "there is no presumption that a fall in money wages will lower price-level-deflated wages. Thus the effects of changes in labor market variables upon the labor supply and demand relations are such that an initial excess supply of labor may not be eliminated."[5] Neoclassicals accept the Keynesian formulation that the demand for labor is determined by aggregate demand, but independent of price level–deflated money wages, they assume the market will achieve full employment. That is, the labor market is not the determinant of employment and output.

On the contrary, overall levels of employment and output are determined by the aggregate levels of demand for a firm's goods and services. In a survey of business executives during the 1930s and 1940s, Richard Lester observed that business executives, unlike economists, tended to think of costs and profits as dependent upon the rate of output, and not the other way around. In other words, employment levels were not determined by wage rates, but by the rate of output. Therefore, it ought not to matter how much labor voluntarily deflates its wages in order to be employed. If there is no demand for goods and services, there is no need to hire more workers, regardless of how flexible they may be in their wage demands.[6]

Attempts to explain high unemployment rates that have characterized the economy since the mid-1950s have nonetheless centered around two alternative hypotheses. The first is the inadequate-aggregate demand hypothesis, which maintains that unemployment increases when the rate of growth of final demand for goods and services fails to keep pace with the rate of growth in supply that is made possible by increases in productivity and in the stock of productive resources. The second is the rise-in-structural-unemployment hypothesis, which holds that unemployment has increased despite the presence of a generally adequate demand and a totally sufficient number of job possibilities. That is, because of the changing structure of the economy, the demand for certain types of workers, mainly blue-collar and goods-producing workers, is less. Each of these hypotheses leads to different policies. If the former, fiscal-monetary policy ought to be enough to reduce unemployment. But if the latter, then fiscal-monetary policy unaccompanied by labor market policies that would effectively restore the skills of the unemployed will not succeed in reducing unemployment.[7]

Mainstream economics also draws a sharp distinction between short- and long-run unemployment. According to the conventional view, short term unemployment is strongly influenced by monetary policy and other determinants of aggregate demand. In the long run, unemployment returns to a natural rate, which is determined by labor market frictions. But the conventional view, Laurence Ball suggests, may not be correct. Rather monetary policy and other determinants of aggregate demand have strong effects on long-term as well as short-term unemployment. According to the conventional view, unemployment is determined by institutions such as labor unions, unemployment insurance, and firing restrictions. But the conventional wisdom may actually overstate these factors. From the 1960s through the mid-1980s, unemployment trended upward throughout the member countries of the Organization for Economic Cooperation and Development (OECD). When jobs are destroyed by recession, short-term unemployment is initially created, but if employment remains low, then short-term unemployment becomes long-term unemployment.[8] What is needed is an expansion of demand. While labor market reforms may complement demand expansions, it is only when the unemployed are given incentives to seek work that unemployment is most likely to decrease. A strong economy creates jobs for them to find.

Still, the conventional view persists in the belief that unemployment is a function of wage rigidity. Higher unemployment in Europe than in the United States, for instance, is typically accounted for by wage inflexibility. Although the policy mix with regard to employment policy has traditionally focused on the interaction between monetary and budget policies, there are those who believe that given the high level of unemployment in Europe, it is also necessary to bring wage developments into the picture. Unemployment remained abnormally high during the 1980s and 1990s. Equilibrium is generally achieved when both actors settle for a wage share consistent with their expectations. What brings about this result is unemployment. The persistence of high unemployment is then due to the rigidity in the labor market, which prevents wage setters from lowering real wages to the "consistent" level. From a short-term perspective, unemployment is the problem of inflexible labor markets. Flexibility in wages is assumed to be necessary in part because capital stocks are assumed to be fixed. And yet these assumptions beg the question of just how flexible wages can be. Workers fix their living standards and various commitments based on the wages they have been earning.[9] Let us assume that wage rigidity is the problem. Workers are not going to be flexible if they believe that the maintenance of those living standards requires having comparable wages, or the absence of assurance that wage flexibility will result in aggregate price reduction.

Although it is commonplace to assume that unemployment is the ultimate result of wage rigidity, the evidence may not support some of these commonplace assumptions. Susan Hansen, for instance, observes that in the American federal system, the competition among the states has resulted in a steady downward pressure on the cost of labor. But those states with high labor costs are actually doing better with respect to economic growth, exports, and foreign direct investment, not to mention higher rates of productivity.[10] While her analysis of labor costs on a state-by-state basis does reveal higher levels of unemployment in high-labor-cost states, there are clearly consequences to reducing labor costs. Whereas the conventional wisdom would suggest that the need to compete in a global marketplace would not only necessitate lower labor costs but actually drive down state labor costs, she concludes that the global marketplace really has little, if any, effect. Rather, the main force driving down labor costs on a state-by state-basis is competition between the states. This might then imply that a more centralized wage policy that removed state-level disparities would indeed have a different effect.

Traditional Approaches to Job Creation

On one level, the notion that wage rigidity is a key determinant of unemployment would imply that in the absence of this rigidity, there really would be no need for a jobs policy because wage rigidity derived from competitive market theory assumes full employment. But on another level, the depth of the 2007 recession, the significant increases in long-term unemployment, and that a variety of different policies pursued by the Fed have had little effect, would suggest that a jobs policy is critical. Neoclassical economists will no doubt respond that were all interventions removed, the economy would come to life, but that, too, is an untested theory. Although different ends of the ideological spectrum will advance different proposals, short of the government becoming the employer of last resort there is perhaps a consensus that job creation requires devising circumstances conducive to it. Over what those circumstances are, however, there is disagreement. There are perhaps three models that have been employed for job creation: stimulus, fiscal policy, and monetary policy.

Stimulus

Stimulus policy often means different things to different people. During the Great Depression, stimulus encompassed government works projects like the Works Progress Administration and the Civilian Conservation Corps. These were government-sponsored jobs programs intended to put people back to work, and many of these jobs focused on building infrastructure. Although it helped, these programs by no means brought the country out of the depression. But they did reflect a view that the greatest assistance that one could be provided with was a job. Advocates of this approach take the view that the government should be the employer of last resort. While private-sector proposals centered on increasing aggregate demand, increasing human capital, and increasing incentives to employers to hire are desirable, they nonetheless fall short of ensuring a right to work. The idea that government should be the employer of last resort is really a moral argument that holds that the state has a responsibility to ensure that all those who want to work are able to do so. If the private sector is unable to provide sufficient opportunities to work, then government has a responsibility to directly create jobs for the purpose of relieving unemployment.[11] And yet this approach poses some problems. First, it is expensive and requires huge deficit spending. Second, it challenges the traditional American distinction between the public and private sectors. It is one thing for government to regulate the economy, but quite another for government to encroach upon the private sector by actually creating public-sector jobs. In terms of stimulus spending, this may be the most extreme.

Stimulus spending in recent years has assumed different forms as well. Congress did pass the American Recovery and Reinvestment Act (ARRA), a stimulus bill in 2009, in an effort to create jobs. The Act included direct spending in infrastructure, education, health, and energy, federal tax incentives, and expansion of unemployment benefits and other social welfare provisions. The Act also included many items not directly related to economic recovery, such as long-term spending projects (e.g., a study of the effectiveness of medical treatments). The rationale for ARRA is derived from Keynesian macroeconomic theory, which argues that, during recessions, the government should offset the decrease in private spending with an increase in public spending in order to save jobs and stop further economic deterioration. Stimulus money also went to state and local governments on the verge of bankruptcy. The stimulus may not have actually created too many new jobs; rather its success is that by going to state and local governments, it may have prevented others from losing their jobs.

But Congress has also tried other stimulus packages. Congress twice passed a temporary reduction of Social Security payroll taxes, which was intended to put more money in the hands of workers so they would spend it. Similarly, in 2003, Congress offered a $300 tax rebate to individuals and $600 tax rebate to couples as a one-time boost to the economy. This type of stimulus is particularly beneficial to low-income households because they are most likely to spend the money right away. Although the federal government, as perhaps another version of stimulus, did bail out General Motors, bailouts are not as much about creating jobs as they are about attempting to prevent further increases in unemployment. Even so, the goal is to keep money flowing through the economy. Nevertheless, it begs the question of whether government is merely taking steps to create favorable conditions for job creation, or whether it is taking more active steps. In this vein, a stimulus could be said to fall under the purview of fiscal policy because it is attempting to stimulate job creation through budgeting adjustments, whether by massive spending or small tax rebates intended to provide people more purchasing power so they can increase their aggregate demand for goods and services.

Fiscal Policy

Fiscal policy centers around the raising of taxes during inflation as a means of contracting individuals' purchasing power, and the lowering of taxes during recessions as a means of putting more money into people's pockets so that they will demand more goods and services. A reduction in taxes can be helpful during a recession, but these tax reductions are not always targeted. Tax reductions to all do not guarantee that the money will be spent in the economy. Targeted tax reductions, by contrast, might be given to specific socioeconomic groups with the expectation that the money will be spent, and right away. The other policy centering on taxes relies on the political branches of government to act.

Although lowering taxes will always be politically popular, the issue of paying for the taxes is still present. It was proposed that the last temporary reduction in Social Security payroll tax be paid for by higher taxes on the wealthy. When couched in these terms, such a proposal is viewed less as a tool of job creation and more as a form of redistribution. Staunch market purists still maintain that to tax the wealthy is to effectively tax job creators. In the end, these tax holidays were granted, but they were not really paid for. Rather the shortfall in revenue only adds to the deficit. In the case of Social Security, reducing the payroll tax by two percentage points from 6.2 percent to 4.2 percent resulted only in a greater shortfall to the Social Security Trust Fund. Even conceding the reality that the Trust Fund is a fiction, the end result is a shortfall to the U.S. Treasury or, in effect, deficit spending. Again, while it is easy to lower taxes, it is next to impossible to raise them again during a period of economic growth so as to prevent inflation.

Monetary Policy

Monetary policy essentially entails control of the money supply or the flow of money within the economy. Through control of the money supply, the Fed attempts to macromanage the economy, with the object being a stable economy through sound money. By increasing the amount of money a member bank must pay to borrow from the Fed or by raising the prime interest rate—the rate charged to its best customers—the Fed can effectively drive up interest rates, thereby making it more costly to borrow. An effective tool to this end has simply been to increase money aggregates, with the effect being a reduction in the amount of money and capital in the economy.[12] The effect of either is to contract the money supply, thereby inducing a recession to control inflation. Conversely, by reducing money aggregates or lowering rediscount rates, the Fed pumps more money into the economy for the express purpose of stimulating production. By allowing greater amounts of money to flow during times of recession, the government hopes to stimulate new investment that will yield greater growth and prosperity. It increases the supply of capital for economic expansion by devaluing the dollar, printing up more money, or lowering the interest rates. If successful, the economy expands, guaranteeing lucrative returns to investors and new jobs for the otherwise unemployed.

While monetary policy's intellectual foundations are found in the work of Milton Friedman and the Chicago school of economics, its institutional grounding is in the Federal Reserve System, and in many respects it derives its ultimate authority from the Employment Act of 1946. The Employment Act, which created the Council of Economic Advisers (CEA) in the White House, 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."[13] Monetary policy effectively became a means by which government would use "practicable means" to fulfill a general maintenance function, the principal maintenance function being to control for both recession and inflation. As the Employment Act established that government would play a role in the overall management of the economy, it appeared to imply monetary policy. Also because the Federal Reserve Act of 1913 did not establish a mandate for policy stabilization, it was only from the Employment Act that any real contemporary purpose could be inferred.[14]

Because the Fed is politically independent of both Congress and the president, policymakers have relied heavily on it to stimulate the economy during recessionary periods, even though its primary obligation, statutorily speaking, has been to serve the banking industry. The problem with this approach is that it assumes that if money flows from the top through lower interest rates, jobs will ultimately be created. But it does not speak to the issue of whether individuals will have the financial ability to demand more goods and services. Also, because the Fed primarily serves the banking industry, it has often been hesitant to lower interest rates for fear that it would spark inflation. And yet, during this recession, it has continuously lowered interest rates and engaged in quantitative easing, but to little avail. That there has not been the expected rebound in the economy despite the easy money supply created by the Fed would suggest that a key ingredient in the policy mix is missing.

The Wage Policy Model

The long-neglected piece of the puzzle appears to be wage policy. Weintraub referred to this as an incomes policy. Macroeconomic policies predicated on the need to boost the purchasing power of individuals are what is needed. In other words, the solution lies in a grassroots effort to get people buying things again. With the rise of neoclassical economics, primarily since the 1980s, Keynesian economics has fallen into disfavor. But as Franco Modigliani suggests,[15] Keynes has been greatly misunderstood. For Modigliani, the classical model is really a special case of the *General Theory*. It assumes an economy in which wages are highly flexible and that they will decline quickly in the face of unemployment. That is, in the face of an excess supply of workers, their wage prices will decline toward the equilibrium level, thereby reducing the excess supply. The fundamental problem with the classical model, however, is that it is manifestly counterfactual. Consequently, it is unable to provide a systematic explanation of unemployment or any guidance on how to control it. On the contrary, the *General Theory* begins by rejecting the presence of the classical postulate that wages and prices are sufficiently flexible in both directions—so that the demand for money quickly adjusts to any given supply. Wages are actually "downward rigid" and will not fall in the presence of excess supply of labor, and if they do fall, it will be very slowly. In the classical model, there are two alternative ways of characterizing market equilibrium: when demand equals supply and when price has reached a stable level. When prices do not fall in spite of the presence of an excess supply, the two definitions are not equal. Keynes chose the second definition of equilibrium, which would be applicable regardless of whether prices were rigid or flexible. A market simply achieves equilibrium at a point where the quantity and price stop adjusting.

At the heart of Keynes's contribution is the proposition that savings equals investment. This follows from a distinction that can be made between two components of demand: consumption, which is responsive to current income, and investment, which is not related to current income but responds to interest rates. Keynes concluded that it was investment that largely determined aggregate output and employment. A return to full employment can only be achieved through appropriate policies, specifically an increase in the money supply, which creates an excess supply of money-lowering interest rates toward full employment. But in the spirit of savings equals investment, one might want to increase the money flowing through the economy by increasing wages. In other words, real wages, and increasing wages, would increase demand, which would increase spending, resulting in more growth and profits that would then become savings that could be reinvested. This might actually be more concrete than investment based on lower interest rates, which is still borrowed rather than saved.

A wage policy that bolstered the middle class might be a means by which individuals could be assured that they will continue to have purchasing power. This idea does have some roots in institutional economics. John R. Commons, in particular, took the view that a decline in prices and wages during recessions and depressions would only aggravate them by reducing purchasing power and in turn leading to bankruptcy. For Commons, the answer lay in redistributing income from profits to wages through collective bargaining agreements. Collective bargaining would both prevent over-savings and under-consumption, thereby assisting in maintaining purchasing power and aggregate demand. Although he recognized that unions do have defects that might hinder economic efficiency in various ways, he also believed that in most cases the benefits to society would outweigh their costs.[16] The same argument could easily apply to a more general wage policy, of which unionism is only one component.

A wage policy could be broadly defined as a set of institutions designed to bolster the wages of the middle class. A wage policy could assume the form of a wage floor that guarantees a minimum wage. It could be a policy that encourages greater collective bargaining as a means of ensuring higher wages so that workers' incomes keep pace with inflation. It could also manifest itself in the form of centralized wage-setting institutions, which is the case in some European countries. Whatever form wage policy assumes, it can best be defined as a mechanism that at a minimum not only bolsters the wages of those at the bottom, but also results in those wages rising on a regular basis, whether it is because they are tied to inflation or increases in productivity or simply reflect a certain percentage of average hourly wages. Historically, these institutions assumed the form of labor policies that allowed for unionization and collective bargaining, and specific wage floors. Traditionally, wage floors assumed the form of federal and state minimum wage legislation. More recently, they have assumed the form of living-wage ordinances at the local level, and also broader proposals for basic and/or minimum incomes.[17] All these approaches could be said to fall within the general purview of wage policy, and when coupled with wage contour effects, its benefits can be expected to reach the middle class as well.

For Weintraub, an "incomes policy" would serve as an essential complement to both monetary and fiscal policy. The term "incomes policy" was often used as a euphemism for wage restraint. Milton Friedman, for instance, called for a steady growth of roughly 3 percent in the money supply to maintain a balance, because he assumed that money wages would be constrained. Wages would increase to match productivity (which was rising at roughly 3 percent per year overall), but faster wage growth would be harder to achieve. For Weintraub, the traditional tools of economic growth were insufficient by themselves. The problem with fiscal policy was that it involved huge expenditures of public monies, and unless it was properly targeted, it was not going to have the desired effects. Moreover, increased spending would only necessitate new taxes. And the problem with monetary policy was that it, too, had a cost, because it was implemented by the Fed, whose primary constituency is the banking industry. The Fed could generally be relied upon in response to rising inflation to apply the brakes with higher interest rates and reserve requirements, thereby causing unemployment. But increased taxes due to increased spending only leads workers to seek higher wages to pay the increased tax, thereby exacerbating inflation. Although economists were often quick to apply the brakes to control for inflation, they were not the ones who would lose their jobs as a result. Rather, "The unemployed are thus the innocent lambs led to slaughter through conventional tactics."[18] If wages could be stabilized, then price stability would avert economic damage resulting from convenient stabilization tools. An incomes policy, in other words, would be a necessary complement to these traditional tools.

While Weintraub saw wage policy as a complement to other economic policy aimed at achieving greater employment, it stands to reason that wage policy could at a minimum serve to prevent long-term unemployment, if not form the basis of a jobs policy in its own right. A wage policy that bolsters the income of those at the bottom can through wage contour effects also bolster the middle class. A wage policy, then, would be critical for several reasons: first, through higher wages it offers workers, especially those at the bottom of the distribution, additional income, thereby enhancing their personal security. Second, if the effect is to raise the wages of those at the bottom of the distribution at a percentage rate relative to the top, it will reduce income inequality, thereby resulting in less social strife. In many European countries where there are centralized wage-setting institutions, income inequality is less than in the United States. And third, wage policy is part and parcel of economic development. Because individuals earning higher wages will have increased purchasing power, they will be able to demand more goods and services, which in time may fuel investment and economic expansion.

Economic development is central because it is the basis of a broad middle class, which in and of itself militates against a dual distribution consisting of those at the very top and those at the very bottom. Wage policy is about maintaining the middle class. Part of the problem with primarily relying on monetary policy with some fiscal policy to supplement is that it takes the presence of a middle class for granted. But the middle class has been shrinking, and we have been left with a dual economy with highly paid and highly skilled workers at the top and low-wage and low-skilled workers at the bottom. 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.

Finally, to pursue a wage policy is to effectively reject the neoclassical view of wage determination, which lies at the heart of the wage rigidity thesis and has underpinned much of American economic policy over the years. Wage policy rejects the argument that flexible labor markets will result in full employment on the premise that wage setting is affected by institutions. Moreover, it recognizes that externalities do arise from markets that are allowed to operate completely unfettered. One such externality may be income inequality, which also affects people's ability to demand goods and services. Active wage policy also categorically rejects the premise that individuals are free to negotiate over wage rates. On the contrary, through their market power, employers set rates, and the only negotiation open is to either accept or reject. Wage policy, by contrast, recognizes the asymmetrical power balance between employers and workers. By boosting wages, especially at the low end of the distribution, a wage policy can effectively give workers a share of monopoly power they otherwise would not have had.[19]

Yet wage policy also seeks to complement the market economy by enabling individuals to demand goods and services. And when wage policy is seen through the prism of wage contours, we can then see how wage policy benefits a broader segment of the labor market than only those at the bottom of the distribution.

Elsewhere, for instance, I looked at census data from 1962 to 2008 and divided the income distribution into wage contours. Wage contours, initially developed by John Dunlop in the 1950s, can be defined as a group of workers with similar characteristics working in similar industries and earning similar wages. For each group there would be a group of rates surrounding a key rate—such as the statutory minimum wage—and these group rates would be affected by changes in the key rate.[20] The key rate within an industry is essentially any rate serving as the reference point for that industry. As key rates are specific to industries, there would also be variation from industry to industry. Starting from the statutory minimum wage to 25 percent above as the first contour, I constructed nine additional contours.[21]

As Table 1 suggests, between 1962 and 2008, median wages in each contour increased in years when there was an increase in the federal minimum wage. In years when there was no increase, median wages for the most part remained unchanged. During periods when there had been no increases in the minimum wage, such as from 1981 to 1989, there had been no increases in median wages. This would suggest that the minimum wage has broader effects than commonly supposed. Contrary to the neoclassical model, which holds that the minimum wage has adverse employment consequences, the minimum wage also has positive welfare benefits for the middle class. Arguably, other factors might explain increases in median wages, especially in the upper contours. Yet those other factors do not appear to be present in years when there was no increase in the minimum wage. That there were no increases in median wages during those years when there were no minimum wage increases suggests that wage stagnation may well be attributable to the absence of a wage policy. Although Hansen demonstrates that declining state labor costs have been the result of competition between the states for investment, which in the aggregate would also be a source of wage stagnation, it is also reasonable to infer that a serious wage policy might have blunted the competitive struggle between the states, thereby preventing the decline in wages.

It should also be noted that, beginning in 1964, more than 57 percent of the labor market was earning through these ten contours, and in 2008 more than 70 percent was earning through the ten contours. This, too, might attest to the broad-based welfare benefits of a wage policy, which in this case assumes the form of a minimum wage. But I also tested for adverse employment consequences due to minimum-wage increases in each contour, by conducting a logistical regression analysis. The purpose was to test the probability that certain explanatory factors were more likely than others to have an independent effect on the likelihood of being unemployed. In most cases the minimum wage variable was not statistically significant. Both in the 1960s and the 1970s, the minimum wage was not statistically significant, but in the 1980s, when it was statistically significant, there was a very strong negative effect that those earning a wage higher than the median wage in the first contour were more likely to be unemployed. In the 1990s, when it again was statistically significant, the effect, although positive, was small relative to other variables, and in the 2000s, the positive effect of the minimum wage variable was even smaller than during the 1990s. Even though there were positive effects, it would be difficult to establish that wage policy was such a critical factor in the rise of unemployment. On the contrary, the analysis suggests that a wage policy actually achieves a measure of Pareto optimality. Wage inequality appeared to be reduced and unemployment did not really appear to be increased following minimum wage increases. Moreover, minimum wage increases appeared to have contour effects.[22]

Job Creation

To the extent that this is true, had a viable wage policy been in place, not only might wage stagnation have been arrested, but the financial meltdown following the subprime crisis might not have occurred, or would have been less likely to occur because people would have been in a better position to pay off their mortgages. Although a wage policy would most likely have no impact on the regular business cycle, it is quite possible that a policy in place that enables individuals to maintain purchasing power, without necessarily having to resort to credit card debt, will likely prevent the depths of a recession that we have been witness to since 2007. A wage policy will not necessarily

Table 1

Individual Income in the United States by Contour

	MW	1st	2d	3d	4th	5th	6th	7th	8th	9th	10th
1962	$1.15	$1.25	$1.59	$2.00	$2.45	$3.13	$3.85	$4.81	$5.77	$7.21	$9.62
1963	$1.25	$1.44	$1.78	$2.27	$2.74	$3.37	$4.09	$4.95	$6.73	$8.17	$10.10
1964	$1.25	$1.44	$1.78	$2.26	$2.76	$3.37	$4.09	$5.05	$6.73	$8.17	$9.61
1965	$1.25	$1.44	$1.78	$2.26	$2.79	$3.37	$4.09	$5.05	$6.73	$8.17	$9.62
1966	$1.25	$1.44	$1.78	$2.28	$2.79	$3.37	$4.09	$5.05	$6.73	$8.17	$9.76
1967	$1.40	$1.54	$1.92	$2.40	$3.08	$3.85	$4.81	$5.77	$7.21	$9.13	$12.01
1968	$1.60	$1.85	$2.36	$2.88	$3.46	$4.33	$5.43	$6.73	$8.17	$9.62	$12.72
1969	$1.60	$1.83	$2.36	$2.88	$3.46	$4.37	$5.39	$6.73	$8.17	$9.88	$13.46
1970	$1.60	$1.83	$2.31	$2.88	$3.50	$4.36	$5.39	$6.73	$8.20	$10.10	$13.03
1971	$1.60	$1.83	$2.31	$2.88	$3.51	$4.38	$5.38	$6.73	$8.22	$10.10	$13.22
1972	$1.60	$1.83	$2.31	$2.88	$3.50	$4.41	$5.38	$6.73	$8.37	$10.10	$13.46
1973	$1.60	$1.83	$2.31	$2.88	$3.49	$4.42	$5.48	$6.73	$8.37	$10.10	$13.46
1974	$2.00	$2.31	$2.88	$3.51	$4.42	$5.48	$6.73	$8.32	$10.10	$12.69	$16.83
1975	$2.10	$2.40	$2.88	$3.72	$4.64	$5.77	$7.21	$8.75	$11.06	$14.28	$17.07
1976	$2.30	$2.50	$3.17	$3.96	$4.92	$6.25	$7.69	$9.62	$12.02	$14.90	$18.61

(Continues)

Table 1 (*Continued*)

	MW	1st	2d	3d	4th	5th	6th	7th	8th	9th	10th
1977	$2.30	$2.50	$3.16	$4.00	$4.94	$6.25	$7.69	$9.62	$12.02	$14.90	$19.00
1978	$2.65	$2.88	$3.75	$4.71	$5.77	$7.21	$8.99	$11.30	$14.07	$17.26	$24.04
1979	$2.90	$3.37	$4.04	$5.00	$6.25	$7.79	$9.62	$12.02	$14.90	$19.23	$24.04
1980	$3.10	$3.51	$4.42	$5.50	$6.73	$8.41	$10.34	$12.93	$16.35	$19.71	$24.04
1981	$3.35	$3.76	$4.81	$5.77	$7.21	$9.15	$11.54	$14.30	$17.55	$24.04	
1982	$3.35	$3.76	$4.81	$5.77	$7.21	$9.25	$11.54	$14.38	$17.40	$22.12	$27.40
1983	$3.35	$3.77	$4.81	$5.77	$7.21	$9.21	$11.54	$14.42	$17.50	$22.12	$26.92
1984	$3.35	$3.75	$4.81	$5.77	$7.21	$9.14	$11.54	$14.42	$17.60	$22.12	$27.40
1985	$3.35	$3.76	$4.81	$5.77	$7.21	$9.23	$11.54	$14.42	$17.60	$22.12	$27.40
1986	$3.35	$3.75	$4.81	$5.77	$7.21	$9.33	$11.54	$14.42	$17.55	$21.92	$27.16
1987	$3.35	$3.75	$4.81	$5.77	$7.26	$9.31	$11.54	$14.42	$17.79	$22.12	$27.31
1988	$3.35	$3.80	$4.81	$5.77	$7.21	$9.25	$11.54	$14.42	$17.79	$22.12	$27.40
1989	$3.35	$3.81	$4.81	$5.77	$7.21	$9.23	$11.54	$14.42	$17.72	$21.95	$26.92
1990	$3.85	$4.50	$5.64	$6.73	$8.50	$10.56	$12.98	$16.59	$20.19	$24.39	$31.25
1991	$4.25	$4.81	$5.91	$7.21	$9.43	$11.54	$14.42	$17.79	$22.60	$28.06	$35.58
1992	$4.25	$4.81	$5.86	$7.27	$9.45	$11.54	$14.42	$17.98	$22.74	$28.37	$35.60
1993	$4.25	$4.81	$5.84	$7.21	$9.38	$11.54	$14.42	$18.27	$22.66	$28.37	$34.67
1994	$4.25	$4.81	$5.85	$7.29	$9.61	$11.54	$14.42	$18.27	$22.75	$28.37	$35.58
1995	$4.25	$4.81	$5.92	$7.39	$9.49	$11.54	$14.42	$18.27	$22.98	$28.37	$35.58

1996	$4.70	$5.29	$6.73	$8.17	$10.10	$12.50	$15.87	$19.71	$24.04	$30.77	$38.46
1997	$5.15	$5.77	$7.21	$9.13	$11.54	$14.42	$17.31	$22.10	$27.40	$33.65	$40.87
1998	$5.15	$5.77	$7.21	$9.13	$11.54	$14.42	$17.40	$21.83	$27.40	$33.65	$40.87
1999	$5.15	$5.77	$7.21	$9.13	$11.54	$14.42	$17.31	$22.03	$27.40	$33.65	$41.26
2000	$5.15	$5.77	$7.21	$9.13	$11.54	$14.42	$17.40	$22.12	$27.40	$33.65	$40.87
2001	$5.15	$5.77	$7.21	$9.13	$11.54	$14.42	$17.43	$22.12	$27.40	$33.65	$40.87
2002	$5.15	$5.77	$7.21	$9.13	$11.54	$14.42	$17.31	$22.12	$27.41	$33.65	$40.87
2003	$5.15	$5.77	$7.21	$9.13	$11.54	$14.42	$17.61	$22.12	$27.40	$33.65	$40.87
2004	$5.15	$5.77	$7.21	$9.13	$11.54	$14.42	$17.79	$22.12	$27.40	$33.65	$40.87
2005	$5.15	$5.77	$7.21	$9.13	$11.54	$14.42	$17.60	$22.12	$27.40	$33.65	$41.35
2006	$5.15	$5.77	$7.21	$9.13	$11.54	$14.42	$17.60	$22.12	$27.64	$33.65	$40.87
2007	$5.85	$6.92	$8.41	$10.00	$12.39	$15.87	$19.71	$24.04	$31.25	$38.46	$48.08
2008	$6.55	$7.21	$9.62	$11.90	$14.42	$17.79	$22.50	$27.88	$34.62	$44.23	$55.29

Source: Author's calculations based on Miriam King, Steven Ruggles, Trent Alexander, Donna Leicach, and Matthew Sobek, Integrated Public Use Microdata Series, Current Population Survey: Version 2.0 (machine-readable database) (Minneapolis: Minnesota Population Center, 2004), http://cps.ipums.org/cps/. Table reprinted with permission from Oren Levin-Waldman, *Wage Policy, Income Distribution, and Democratic Theory* (London and New York: Routledge, 2011), 147.

jumpstart the economy to provide relief to the long-term unemployed, but one hopes that in conjunction with other policies it can be used to prevent long-term unemployment in the future.

A wage policy might result in job creation by allowing individuals to effectively demand more goods and services. The neoclassical model, it will be recalled, assumes a full employment in the absence of government interventions and wage rigidity that prevents workers from dropping their wages until their labor services are consumed. This should lead to a drop in prices for goods and services because, at the pre-recession prices, demand will be lower due to workers' reduced ability to obtain goods and services. And yet, because there are other costs, mainly fixed costs, associated with the production process, there really is a limit to how low prices overall can drop. The only way to get around this problem is through a wage policy that would enable workers to, at a minimum, continue demanding goods and services in the aggregate, and perhaps more. As workers are able to purchase more goods and services because of their greater purchasing power, other firms might then be able to expand, thereby creating new jobs. This can be seen in Figure 1.

The neoclassical model, or what might be called the "orthodox view," effectively holds that lower wages will reduce labor costs, which should lead the aggregate supply curve to shift downward. This view assumes labor costs to be a significant element in the typical firm's cost structure, and it also implicitly assumes that the aggregate demand curve will more or less remain constant. It will remain constant because it is then assumed that aggregate prices will also drop. If prices, however, do not drop, the reduced wages should result in a shifting of the aggregate demand curve to the left of AD_1, thereby resulting in unemployment because of a contraction in aggregate demand. Lower wages mean that individuals will have less ability to consume. Because prices cannot be relied upon to drop, there is most likely a limit to how much wages can be reduced. Therefore, a wage policy should have the effect of shifting the aggregate demand curve to AD_2, as depicted in the diagram. Lower-wage workers have a relatively high marginal

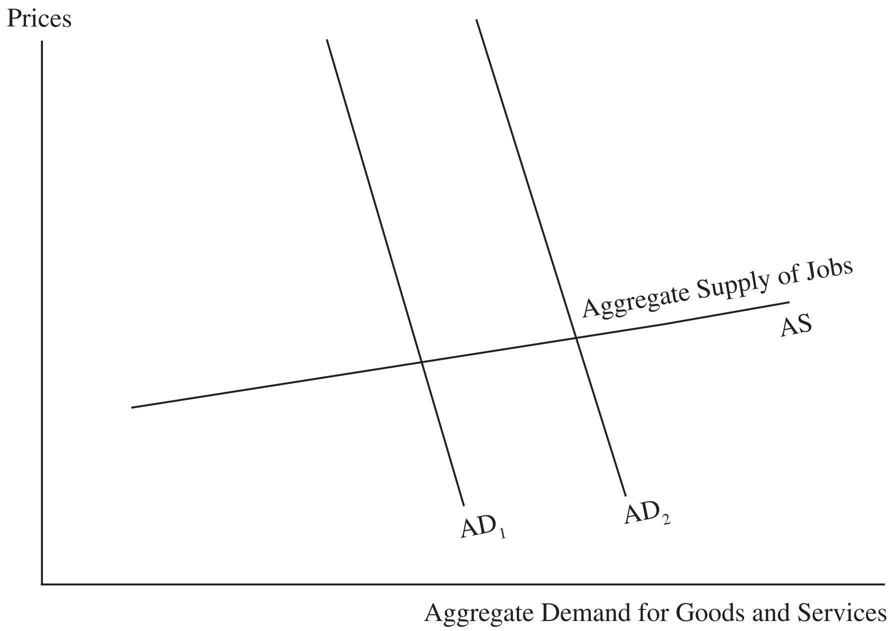

Figure 1. Wage Policy Model of Job Creation

Note: In a flexible labor market workers would reduce their wage demands during a recession with the consequence being reduced demand for goods and services in AD_1, because in most likelihood aggregate prices will not drop. A wage policy should enable workers to maintain their purchasing power, if not increase it, thereby resulting in a shift in the aggregate demand curve from AD_1 to AD_2. The macro benefits of this can be seen in aggregate supply (AS) curve.

propensity to consume. Whatever higher wages they receive will be spent almost immediately. The orthodox view, however, holds that if wages were to rise and consequently profits were to decline on each unit produced, we should expect to see a shifting of the aggregate demand curve to the left of AD_1, thereby resulting in unemployment. But as the wage contour analysis suggests, the increases in median wages throughout the ten contours did increase in all years when there were increases in the minimum wage, thereby resulting in welfare benefits for the middle class. The effect of a wage policy, then, coupled with wage contour effects, is to shift the aggregate demand curve out from AD_1 to AD_2, thereby creating a need for more jobs, as reflected in the direction of the aggregate supply curve.

Conclusion

I have been arguing for a wage policy as a necessary ingredient in the policy arsenal for the creation of jobs. Although this will strike some as counterintuitive because of the neoclassical assumption that a wage policy that artificially raises wages will have adverse employment consequences, it is really illogical to assume that merely lowering interest rates that provide incentives for firms to expand and hire new workers can really result in the long-term creation of jobs if workers, because of their stagnant wages, cannot afford to demand goods and services. It stands to reason that a policy that enables individuals to demand goods and services is more likely to be successful at job creation, in large measure because it is grassroots and bottom-up rather than top-down. These were many of the underlying assumptions behind the Wagner Labor Relations Act and the Fair Labor Standards Act, both passed during the 1930s. The goal was to give workers purchasing power. Wage policy was conceived of as a macroeconomic plan to stimulate aggregate demand for goods and services, thereby leading to the creation of new jobs. This fact has unfortunately been lost in the current debate over the minimum wage that relegates it to an anti-poverty measure, which has only resulted in stigmatizing its recipients. It was originally conceived as a labor management or human resources issue.[23] But there is another implication here that needs to be addressed, especially in a complex economy. That is, no single policy approach will suffice to create jobs. Rather, a multitude of approaches needs to be pursued, but these approaches need to be coordinated. One of the challenges is that because different institutions are responsible for different functions, we are often lacking a coordinated response. And yet, it is too easy to rely on the Fed because it is immune to political pressures. Both fiscal and wage policy are difficult because they would require acts of Congress, meaning they enjoy no such immunity. At the end of the day, creating jobs may require bold thinking and courage. At a minimum, it requires readjusting our assumptions.

Notes

1. Oren M. Levin-Waldman, "The Broad Reach of the Minimum Wage," *Challenge* 52, no. 5 (September–October 2009): 100–116; Oren M. Levin-Waldman and Charles Whalen, "The Minimum Wage Is a Middle Class Issue," *Challenge* 50, no. 3 (May–June 2007): 59–71; see also Oren M. Levin-Waldman, *Wage Policy, Income Distribution, and Democratic Theory* (New York: Routledge, 2011).

2. Sidney Weintraub, "Incomes Policy: Completing the Stabilization Triangle," *Journal of Economic Issues* 6, no. 4 (December 1972): 105–22.

3. Assar Lindbeck and Dennis Snower, "Long-Term Unemployment and Macroeconomic Policy," *AEA Papers and Proceedings* 78 (May 1988): 38.

4. John Maynard Keynes, *The General Theory of Employment, Interest, and Money* (New York: Harcourt, 1964).

5. Hyman Minsky, *Stabilizing an Unstable Economy* (New Haven: Yale University Press, 1986), 123–24.

6. Richard A. Lester, "Shortcomings of Marginal Analysis for Wage-Employment Problems," *American Economic Review* 36, no. 1 (March 1946): 63–82.

7. N.J. Simler, "Long-Term Unemployment, the Structural Hypothesis, and Public Policy," *American Economic Review* 54, no. 6 (December 1964): 985–1001.

8. Laurence Ball, "Aggregate Demand and Long-Run Unemployment," *Brookings Papers on Economic Activity* 2 (1999): 189–251.

9. Stefan Collignon, "Unemployment, Wage Developments and the Economic Policy Mix in Europe," *Empirica* 26 (1999): 259–69.

10. Susan B. Hansen, *Globalization and the Politics of Pay: Policy Choices in the American States* (Washington, DC: Georgetown University Press, 2006).

11. See L. Randall Wray, "The Employer of Last Resort Programme: Could It Work for Developing Countries?" Economic and Labour Market Papers, International Labour Office, Geneva, Employment Analysis and Research Unit, Economic and Labour Market Analysis Department, International Labour Organization (August 2007).

12. Arthur F. Brimmer, "Monetary Policy and Economic Activity: Benefits and Costs of Monetarism," *American Economic Review* 73, no. 2 (May 1983): 1–12.

13. Employment Act of 1946, *Statutes at Large* 60 (1946): 23.

14. Michael D. Reagan, "The Political Structure of the Federal Reserve System," *American Political Science Review* 55 (1961): 64–76.

15. Franco Modigliani, "The Keynesian Gospel According to Modigliani," *American Economist* 47, no. 1 (Spring 2003): 3–24.

16. Bruce E. Kaufman, "John R. Commons and the Wisconsin School of Industrial Relations Strategy and Policy," *Industrial and Labor Relations Review* 57, no. 1 (2003): 3–30.

17. Phillip Van Parijs, "Basic Income Capitalism," *Ethics* 102 (April 1992); Stuart White, *The Civic Minimum: On the Rights and Obligations of Economic Citizenship* (Oxford: Oxford University Press, 2003).

18. Weintraub, "Incomes Policy," 117–18.

19. See James K. Galbraith, *Created Unequal: The Crisis in American Pay* (New York: Free Press, 1998).

20. John T. Dunlop, "The Task of Contemporary Wage Theory," in *New Concepts in Wage Determination,* ed. George W. Taylor and Frank C. Pierson (New York: McGraw-Hill, 1957).

21. Levin-Waldman, *Wage Policy, Income Distribution, and Democratic Theory.*

22. Ibid., 157–66.

23. See Oren M. Levin-Waldman, "The Minimum Wage and Competing Ethical Conceptions," *Advances in Industrial and Labor Relations (AILR)* 16 (2009): 181–210.