BLAMING THE WORKER

BY KARL WIDERQUIST

Inflation is your fault; that's what the Federal Reserve Board thinks. The Fed, the government agency in charge of economic stability, thinks it can stop inflation by keeping unemployment high enough so that you're afraid to ask for a raise. This is no conspiracy: You can read about it in the newspaper and see it on TV. They don't use the same words; they say the economy is "overheating," which might "spark" inflation. But, the spark they are talking about is rising wages and the cure is more unemployment.

The theory that rising wages cause inflation is relatively new, it goes back only to about 1960. But, the idea that low wages are good for the economy is very old. There is a long history of economic theories saying wages cannot or should not rise. There is always a different problem to blame on wage increase, but every time one theory is discredited a new theory pops up blaming workers for something else.

Mercantilists, economists of the 1600s and 1700s, believed that the working class was naturally lazy, and worked as little as they could to make bare subsistence. If wages rose, workers would work less—meaning that if wages go up, production goes down. Therefore, they supposed wages should be so low that workers have to work 60 or even 80 hours a week to make enough money to survive. In other words, workers must be poor for the nation to be rich.

In the late 1700s, Adam Smith, who is now mistakenly considered a champion of the business class, became one of the first to challenge this idea. He claimed that workers are paid less than they are worth because of their bargaining position: Workers are desperate for a job because they need one to survive, but employers, who can live off of their capital, are not desperate for workers. This observation is usually associated with Karl Marx, but actually he got it from Adam Smith. Real wages, according to Smith, could rise only if workers' productivity or bargaining position improved. He contended that it was not necessarily a rich economy that had high wages, but a growing economy with a tight labor market—just the thing that the Fed believes causes inflation.

It didn't take long for someone to think of some other problem to blame on high wages. Around 1800 Thomas Robert Malthus said that high wages cause starvation. If workers are paid more than subsistence, they will have more children, and the population will explode faster than food production can keep up. High wages for this generation means starvation for the next generation. Malthus thought birth control was immoral, but he thought it was moral to keep wages just barely above starvation. This idea was popular through the first half of the 1800s, losing favor only when the industrial revolution made it obvious that food production could increase faster than population.

The theory of low wages was kept alive after Malthusian population theory died by three different theories blaming wage increases for unemployment. The first was the "Wages Fund Doctrine" which stated that businesses spend a fixed amount of money on wages no matter what. If an employer has a $1000 fund he can hire ten workers at $100, twenty workers at $50, one hundred workers at $10 and so on—so that you can get a raise, only if you throw your next door neighbor out of work. There is no plausible reason to believe the wages fund should be fixed, but nevertheless this theory was widely accepted for most of the 1800s.

In the 1890s John Bates Clark essentially took Adam Smith's theory and ignored the problem with workers' bargaining position. He claimed that flexible wages will always adjust so that workers are paid exactly what they are worth and exactly enough so that all workers who want a job can find one. In other words, wages will fall until working isn't any better than unemployment. He said wages could rise, but only if productivity rises. Since the market pays workers what they're worth, any effort to improve their bargaining position—such as unions or a minimum wage law—forces firms to cut back, causing unemployment.

Profit is never too high, just wages.

For forty years following Clark, minimum wage proposals were defeated, as were proposals to make collective bargaining a legal right, and the Great Depression happened anyway with 20 percent unemployment. In 1936 John Maynard Keynes blamed unemployment on insufficient demand. It wasn't his intention to blame workers, but Keynes had to answer Clark's claim that low wages would cure unemployment. He said workers resist wage cuts and, even if they accepted cuts, they'd buy less goods, causing demand to drop even more and so it wouldn't cure unemployment. But, no one paid much attention to the second half of that statement. By the 1950s, Keynes's and Clark's ideas were synthesized into a theory that said workers are generally paid what they're worth, but they might be paid too much during a recession. It became common for economics textbooks to say that a little inflation was good because it caused real wages to fall, reducing unemployment.

Left-leaning economists never accepted the theory that high wages caused unemployment and in the 1960s the reasoning was abruptly reversed to something that both sides could agree on: the now standard belief that rising wages cause inflation. Clark's idea that workers tend to be paid what they're worth was kept but the rationale of what goes wrong when wages get too high has been changed from unemployment to inflation. Ironically, this new theory is much more damaging to labor than the previous theory. Using the old theory people would only say wages were "too high" if there was high unemployment, but now anytime wages begin to rise or even anytime that unemployment gets low the Fed begins to think about slowing the economy down before inflation starts.

The Fed has unofficially used this theory of inflation since about 1979, but, in fairness to the Fed, they're not really trying to keep people unemployed, they're just following a theory that says its natural for about six percent of us to be out of work. They're not really trying to keep you from getting a raise either. They just think it's impossible for you to get a real raise. If your wages go up, but prices go up by the same amount, you're not really any better off than you were before, and so an economist would say your "real" wage hasn't changed. According to the theory, low unemployment doesn't last because when it happens the labor market gets tight, wages go up, which in turn causes prices to go up until people start to buy less and unemployment returns to its natural six percent level. Most economists believe the Fed can save time and trouble by raising interest rates, which will keep unemployment at its naturally high level. The Fed is so sure of this theory that they think the current 4.6 percent unemployment is "too low." It's a reasonable theory but it is just a theory. This theory is so widely believed that even liberal economists tend to say things like unemployment could go a little lower before wages start to rise and inflation picks up, but very rarely does anyone challenge the basic notion that once wages rise, inflation is the necessary result. Seeing how so many economic theories of the past have been proven wrong, isn't it possible that some day the current theory will be discarded?

Isn't it possible that wages could go up while the prices stay the same? The Fed thinks that's possible, but only if your wage goes up no more than the average increase in productivity: two or three percent in a good year. That's a holdover from Clark's theory that workers are paid what they're worth. The Fed plays it safe. If you're secure enough at your job to ask for a raise, you might ask for "too much" and we'll get inflation. It's possible that the Fed could do this job too well. In the last ten years productivity has increased 30 percent, but real wages have gone up only 10 percent. That means we've missed most of the pay raises that even the Fed thinks are possible. That could mean we can all get a 20 percent pay raise without sparking inflation, but the Fed thinks that's too risky, the safe bet is to keep wages stagnant and unemployment high. It is possible that prices can go up while wages stay the same. This is exactly what has happened to the lower income bracket of workers in the last 25 years, but most economists don't even consider that possibility.

I think we have established a pattern. Today we think high wages are bad because they cause inflation and unemployment is good because it reduces wages. Before that we thought high wages were bad because they cause unemployment and inflation was good because it reduces real wages. Before that we thought high wages were bad because they caused overpopulation. Before that we thought high wages were bad because they might allow workers to take a day off. Six theories over 300 years each with a different justification for the same conclusion: in short, economists aren't sure why wages should not rise, but we sure are sure wages should not rise.

Notice that not one of these theories blames profits; profit is never "too high," just wages. The pattern is so strong you'd be tempted to think its a global capitalist conspiracy, but its not: economists are very sincere about their beliefs. But, the pattern is too strong to be pure coincidence either. Perhaps it is a bit of class bias. Any innovative economist with a new economic theory sees himself as a lot more like an industrial entrepreneur than an average autoworker. But, I think its even simpler than that. Economists tend to look at the economy as a whole as a big machine and the most important thing is to keep it running smoothly. We forget that when we talk about keeping wages low and unemployment high we're talking about people. Most economists never seem ask themselves what good is a smoothly running economy if it doesn't produce a decent living wage for the average person. The function of an economy to serve people, not the other way around. It is as if we've forgotten that a low unemployment of 4.6 percent means that more than six million real people can't find a job. What's worse is that more than ten million people are working full time and still living below the poverty line, while we won't let them ask for a raise because we're afraid it will cause inflation.

What if Adam Smith was right: what if the only way that the most disadvantaged workers can get an increase in their real wages is if there is a tight labor market? The Fed is actively trying to prevent a tight labor market, thinking that this will hold down inflation without affecting real wages. If there is any truth at all to Smith's idea that workers are at a disadvantage in the labor market, real wages will be the civilian casualty in the fight against inflation.

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