The Past and Future of America's Social Contract

theatlantic.com/business/archive/2013/12/the-past-and-future-of-americas-social-contract/282511

December 19, 2013

Business

In the 20th century, the United States moved from an economy based on high wages and reliable benefits to a system of low wages and cheap consumer prices, to the detriment of workers. What's next?

By Josh Freedman and Michael Lind

December 19, 2013

Reuters

The problem of low pay has dominated headlines this year thanks to striking fast food workers, tone-deaf employers, and a spate of successful campaigns to raise state and local minimum wages.

Behind the news cycle, however, there's a deeper issue than what Walmart or McDonald's pay their workers today. Americans are once again wrestling with what they fundamentally want from the social contract—the basic bargain most of us can expect from the economy throughout our lives.

A generation ago, the country's social contract was premised on higher wages and reliable benefits, provided chiefly by employers. In recent decades, we've moved to a system where low wages are supposed to be made bearable by low consumer prices and a hodgepodge of government assistance programs. But as dissatisfaction with this arrangement has grown, it is time to look back at how we got here and imagine what the next stage of the social contract might be.

The story of the modern social contract can be divided into two parts, with the first beginning in the aftermath of the Great Depression. The New Deal era of the 1930s through the 1970s was largely defined by high and rising wages, which were pushed up by strong unions, limited global competition, low energy and commodity prices, and more stringent regulations on businesses. At the same time, the ability to automate and innovate in the dominant manufacturing sector made it possible to offer workers high pay while keeping prices on consumer goods low.

But the social contract didn't just encompass paychecks. During the mid-century boom, many employers—led by industrial giants like General Motors and General Electric—acted as "welfare capitalists" that were also primarily responsible for providing benefits like a pension to workers and their families. Part of the motivation was cultural: Before the notion of shareholder capitalism took root in the 1980s, companies viewed it as part of their mission to act in the interests of all of their stakeholders, including workers and their communities, rather than in the interests of investors alone. However, companies also favored the arrangement because providing benefits to workers directly gave them some leverage against labor unions. Ultimately, the welfare-capitalist social contract became the norm.

Starting in the 1980s, however, the social contract underwent a profound change. Deregulation of industry, increasing global competition, and the increasing cost and volatility of raw materials all led companies to move away from the New Deal era consensus. In its place grew what we term the "low-wage social contract" that has dominated through the current day.

After the New Deal, a Worse Deal

The low-wage social contract seeks to balance poor private sector pay with cheap consumer goods, low taxes, and government subsidies that boost after-tax incomes. What does this mean in practice? Cheap imports from countries like China are one big part of it, as are policies like the Earned Income Tax Credit and Child Tax Credit that allow Washington to supplement low-income workers' pay through the tax code.

Proponents of the low-wage social contract on both the left and the right have argued that the combination of inexpensive goods and low taxes should give consumers more spending power than they would have in a high-wage, high-price economy. In a famous paper entitled "Wal-Mart: A Progressive Success Story," Jason Furman, now Chairman of the President's Council of Economic Advisors, argued that the low-wage model actually made low-income consumers better off overall.

For many, though, the bargain has clearly failed. It is true that tax credits and cheap goods have boosted the standard of living for otherwise impoverished workers. Yet, according to the Census Bureau's Supplemental Poverty Measure, which takes into account wage subsidies and additional costs like taxes and medical costs, almost 10 percent of the total *working* population still lives in poverty. This includes roughly 5 million Americans who work full-time, year-round.

A key reason for this is that the low-wage social contract does not do much to help families in the areas they need most. Clothing, food, and other items found at Wal-Mart might be cheap for low-wage workers. But other necessary services—health care, daycare, eldercare, and college—have simultaneously become less affordable and more important as most mothers work outside of the home and the wage premium for college remains high. In 1960, the average family spent about $12,000 in inflation-adjusted dollars on childcare, education, and healthcare over the course of 17 years raising a child. Four decades later, the average family spends almost $63,000 per child. Medical out-of-pocket expenses now push more people below the poverty line than tax credits can lift above it.

The low-wage social contract has also contributed to a lack of aggregate demand. Because workers are also consumers, and because low-income households spend more of their money than do wealthier households, the low wage system limits the power of workers to help the economy grow by purchasing goods and services.

The Next Social Contract

That's how we got here—but what might lie ahead?

While the "low wage" social contract may not be much of a bargain for many workers, there's no pretending we can go back to the New Deal-era system of old. The combination of conditions that allowed for high wages, high profits, and low prices no longer exists in a service-based economy with more unstable employment and in which the declining number of manufacturing jobs are more subject to global competition. And while the welfare capitalist model did benefit many in the middle class, it often excluded African-American workers and was reliant on a family model based on a sole male breadwinner. The next social contract needs to adapt to these new economic conditions and further the huge strides we have made toward equality for women and minorities in the workforce.

What, then, would a better social contract look like?

First, we could accept the basic shape of the low-wage economy while softening its edges by asking government to do even more. With higher taxes on the wealthy, Washington could use the tax code to provide poor and middle-class families more generous means-tested subsidies to pay for childcare, education, and healthcare. Since the Clinton era, much of the Democratic Party has embraced this version of the social contract. It is essentially the model behind Obamacare.

The downside, besides the challenge of raising taxes, is that subsidies don't guarantee affordability. They can even encourage industries to raise their prices; see, for example, the proliferation of cheap student loans, which have not made college much more affordable. What's more, means-tested programs for the poor often lack the political support needed to keep them strong.

Another possibility, which would please many progressives, would be to nudge the economy toward a social democratic model such as that of Scandinavia. This social contract would entail high wages, a high cost of living, and a universal welfare state paid for with high, relatively flat taxes.

But transplanting the Nordic model as a whole to the U.S. would be difficult in the face of fierce resistance to higher levels of spending. It would also be hard to import a system of benefits paid for by broad and flat taxes, like payroll taxes and consumption taxes, on a country like the U.S. with much greater inequality.

In our own work at the New America Foundation, we have outlined a third idea we call the "middle-income social contract." It assumes that many service industries won't be able to offer their workers middle-income salaries, which means that, in addition to raising wages somewhat, the government will have to take a more active role in making essential services like education, child care and health care more affordable. The best way to do this is to provide these programs directly, such as through universal Pre-K, single-payer health insurance, or subsidies to the states for taking care of the elderly. Policymakers can begin to build a middle-income social contract by raising the federal minimum wage closer to a true living wage and expanding public early education, both of which are widely popular proposals.

The current low-wage social contract between American workers, employers, and the government has been a raw deal for most Americans. Just as the New Deal contract shifted to the low wage model, we need to shift once again to a system more suited to the current economy and needs of workers and citizens. The options for the next social contract are many—we just have to choose the right one.