Ethical Economic Policy and Poverty in America

By

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Abstract: This paper argues that there is a strong connection between ethical economic policy and poverty in a nation, especially in the United States. Economic policy is ethical when a nation's real wage grows as fast as its productivity, foreign trade is in balance, and the tax system is progressive. From these criteria, the US economic system was unambiguously ethical from 1950 to the 1970s, when nearly 30 percent of the labor force was employed in manufacturing, and the rate of poverty fell at the fastest pace.

The paper will show that a rise in the wage productivity gap is the main cause of rising unemployment, poverty and even unbalanced trade. Hence proper economic policy is to make sure that this gap remains low and stable; such indeed was the case in the United States prior to the 1980s, when strict enforcement of anti-trust laws kept companies' monopoly power in check, so that US firms remained competitive enough to generate balanced trade. Hence high competition is better than economic policies that create debt, the kind that have been followed ever since 1981.

Introduction:

The Great Recession that started in December 2008 was declared over in June 2009, some 18 months later. Since then millions of people have been added to payrolls, but American poverty is the worst in over 50 years. This has happened in the backdrop of trillions added to federal debt, which approached $19 trillion at the end of 2016. This paper contends that unethical policies or political corruption are the root cause of grinding poverty in one of the richest economies in the world.

The common sense notion of ethics is that people should be treated equally without discrimination. For instance, most would agree that no one is above the law. This idea is ethical and fair. In the same way, ethical economic policy is one that conforms to high standards of fairness. We may call an economic system unethical if

1. The tax system is regressive (or not progressive), so that low income groups pay a larger share of their income in taxes than high-income groups;
2. People are not rewarded for their skills so that the real wage does not rise in proportion to their productivity or even falls, which in turn raises the gap between labor productivity and the real wage.
3. Markets are not competitive and oligopolies dominate the industrial structure, resulting in lower wages and higher prices. Such measures also raise the wage gap defined as:

$$\text{Wage Gap} = \text{Productivity}/\text{Real Wage}$$

This type of system has prevailed almost all over the world since 1980, and initially the world prospered but only at the expense of the United States. While the US adopted freer trade, many other nations resorted to currency manipulation and simply decimated America's manufacturing, which in turn led to lower wages in spite of rising productivity.

Higher productivity increases supply of goods but stagnant wages keep demand in check, resulting in overproduction of goods and services, layoffs and poverty. The US suffered from this affliction after 1980 when the so-called supply-side economics took hold of economic policy. But since 2007, the whole world has been suffering from it.

The only way to escape from the chokehold of the Great Recession that started in 2007 is to adopt ethical measures that prevailed in the United States, Japan and Europe from the 1950s to the 1970s. During these years US poverty fell sharply, but has been rising ever since the early 1980s.

America during the 1950s

Following WWII the United States was the overwhelming economic and military power in the world. It imposed major reforms in Germany and Japan by breaking large conglomerates and monopolies into smaller competitive firms. Consequently, in spite of their near destruction from the war, both Germany and Japan grew apace, and enjoyed a quick jump in their living standards. Within two decades poverty virtually vanished from these nations. In Germany the unemployment rate fell to 1 percent of the labor force and became the envy of the world.

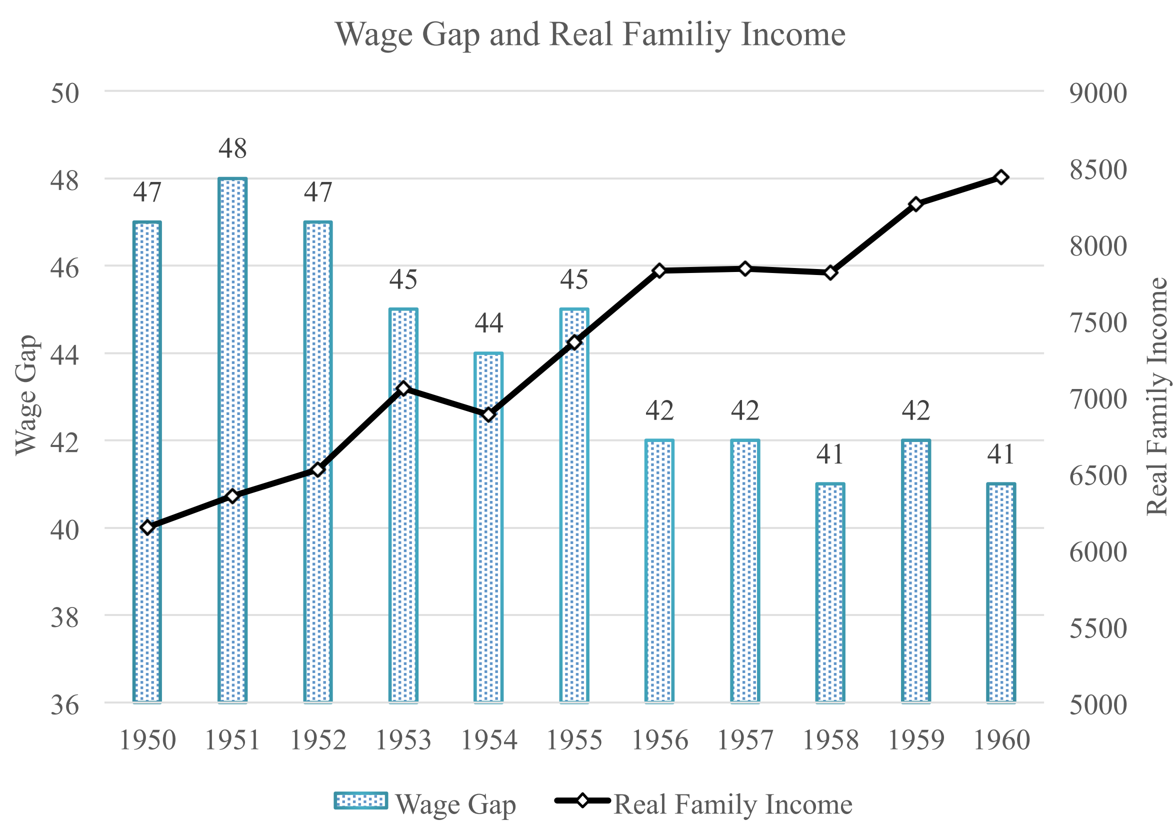
While the U.S. government was busy promoting free-market policies in Germany and Japan, it failed to do so at home. As the economy shifted from a war-time outfit to peace-time production, the military technology discovered in the 1940s was utilized in the industry. However, this development only increased the growth and dominance of big business. Most industries-- automobile, chemicals, electronics, tobacco, oil, telephone, computers—became oligopolies, so much so that just 0.5 percent of corporations came to control 50 percent of corporate assets.

The labor union movement responded to this consolidation with consolidation of its own. In 1955, American Federation of Labor (AFL) merged with Congress of Industrial Organizations (CIO) to form one union, AFL-CIO. Thus, corporate monopoly power was counterbalanced by union monopoly power. This way, while corporations were able to set prices, they were unable to dictate wages, which were determined through tough negotiations between equally powerful parties. As a result, real wages kept pace with productivity gains arising from advances in technology. In fact, as in Germany during the 1960s, the wage gap declined in America in the 1950s. Such a rare development could not but generate widespread prosperity.

First, the unemployment rate fell to as low as 2.9 percent in 1953, a feat never duplicated in U.S. peacetime annals; this happened even though the debt ratio fell, because a lot of war-time debt was being retired every year. However, by 1960 the jobless rate had jumped to 5.5 percent due to a recession induced by rising interest rates. Second, as displayed in Figure 1, real family income soared 37 percent during the 1950s, as the wage gap index fell from 47 in 1950 to 41 in 1960. Interestingly, even though joblessness went up towards the end of the decade, family income continued to climb.

Needless to say, poverty fell sharply as the number of families with annual income below $3,000 plunged 25 percent. This is displayed in Figure 2. Except in 1954, poverty declined slowly but steadily during the 1950s.

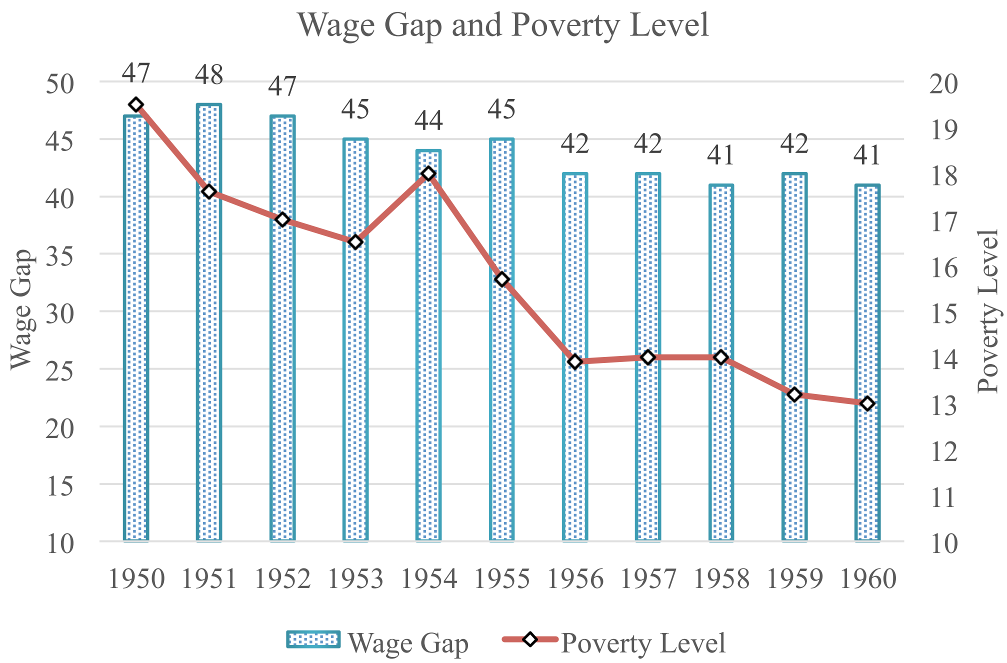
Figure 1: The Wage Gap and Median Income in the United States: 1950-1960



Source: *The Economic Report of President, 1975*, p. 274

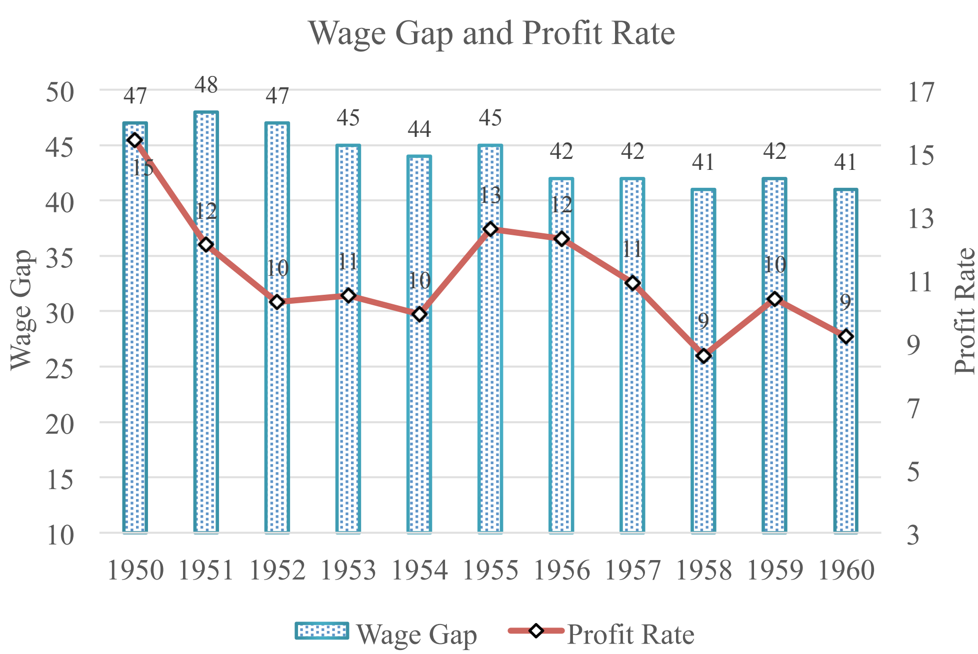
In Figure 2, the wage gap is on the left axis and the percentage of families below the poverty threshold of $3,000 on the right hand side. This measure of poverty fell from over 19 percent in 1950 to 13 percent by the end of the decade.

Figure 2: The Wage Gap and Poverty Rate in the United States: 1950-1960



Source*: The Economic Report of President, 1975*, p. 274

Figure 3: The Wage Gap and the Rate of Profit in the United States: 1950-1960



Source*: The Economic Report of President, 1975*, p. 337

Not surprisingly, the rate of profit fell over the decade, which refutes the hypothesis of trickle-down economics that prosperity seeps down from the wealthy to the poor. During the 1950s, monopoly capitalists suffered a profit decline, while poverty fell and prosperity spread to the masses. Figure 3 reveals that except for two years, the profit rate dropped steadily. And remember all this happened in the backdrop of a tax rate as high as 91 percent on top incomes. Thus, the 1950s offer a stinging rebuke to the supply-side dogma and "tricklism". They reveal that prosperity actually trickles up, not down.

We have limited our discussion mainly to the 1950s, because American economy has seldom faced a decline in the wage gap, where productivity rises slower than the real wage. This phenomenon lasted longer in Germany, but in the United States the wage gap first stabilized in the 1960s and then began a steady rise after 1975. Its advance accelerated following 1981, when supply-side economics dominated government policy, and has not retreated yet.

Everyone can now see the results. More than 60 percent of Americans have about $500 in savings; over half of retirees have a pension fund of just $50,000; almost 50 million people go partially hungry every day. This is what explains the stunning election of Mr. Trump as president, which occurred in spite of, rather because of, the media's shrill denunciation of his anti-establishment rhetoric during the electoral campaign. The electorate simply wanted change that hopefully would end their poverty.

Conclusion:

It is clear from this short paper that economic policy needs a drastic overhaul. The United States, indeed the world, needs to adopt free-market measures rather than pile up enormous debt at the consumer and the government level to fight poverty and still lingering unemployment. The following measures should be adopted.

1. As in Germany and Japan, large conglomerates and oligopolies should be broken into smaller competing units.
2. Tax rates should be raised for the wealthy and trimmed for the poor.
3. Trade deficits and surpluses should be minimized.

This is old-fashioned macroeconomics and trade theory, but it did a tremendous job. Such is the testimony of history.

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