The Disconnect Between Political Promises and Performance

BY DWIGHT R. LEE

What can politicians do to create more higher paying jobs? Politicians must think that most of us believe the answer is: a lot. One of the most persistent campaign promises is the creation of good jobs at good wages. I shall argue that politicians can do quite a number of things to increase high-wage employment. But this does not mean that I favor politicians trying to keep their high-wage promises, because the things politicians *can* do to improve jobs are not the things they *will* do.

Politicians can enact policies from two general categories to achieve desirable outcomes, including the creation of high-paid jobs: 1) policies that work, but in ways that do not benefit politicians, and 2) policies that don't work (and typically make matters worse), but which create the mirage of working in ways that do benefit politicians.

Under prevailing democratic arrangements, electoral survival demands that politicians appear to promote desirable social objectives with direct and decisive action that caters to organized interest groups. Even when such special-interest policies are socially harmful, as they invariably are, they still do more to promote the interests of politicians than policies that would promote broad social benefits indirectly by creating a setting in which people can pursue their various interests through productive interaction. The political problem with the indirect approach is twofold: 1) the benefits are created so gradually and spread so widely that few will notice them, and 2) even if the benefits are noticed, it will be difficult, if not impossible, for politicians to claim credit for them. As F.A. Hayek pointed out in volume three of *Law, Legislation and Liberty*, politicians "who hope to be reelected on the basis of what their party during the preceding three or four years has conferred in *conspicuous* special benefits on their voters are not in the sort of position which will make them pass the kind of general laws which would really be most in the public interest" (emphasis added).

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When we look at policies aimed at creating high-paying jobs, we easily find examples where politicians preferred conspicuous "benefits" that actually harmed the public to inconspicuous benefits that really were good for the public.

Many policies would increase the number of high-paying jobs indirectly, and many would appear to increase the number directly but actually reduce those jobs and lower wages. The former policies all do the one thing necessary for higher wages and salaries —increase labor productivity—while the latter policies all reduce, or retard, labor productivity, and so reduce wages below what they would be otherwise. The political bias against effective policies is readily apparent from

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the following list and brief discussion. Consider first some policies that would increase wages.

Eliminate restrictions on imports: One of the most effective things the federal government could do to increase labor productivity and wages is eliminate tariffs and other restrictions on imports. Reducing import restrictions increases real wages in two ways. First, it reduces the price workers have to pay for those goods and services that can be produced at less cost in other countries than they can be domestically. Second, it increases the competition domestic producers face from foreign producers, which directs workers into those employments in which they are most productive—in which they have a comparative advantage.

Increased productivity is both necessary and sufficient to increase wages, at least in general. No serious person can deny that there are costs associated with workers moving to more productive jobs, or that a few people will be unable to find new jobs that pay as much as the ones they lost. But no economy can prosper without open competition, which keeps all resources, including labor, moving from less-valued to more-valued employments (in the eyes of consumers) in response to constantly changing conditions. And even those who end up with lower wages because of the particular adjustments they are required to make still earn far higher wages than they would in an economy where they, and everyone else, are protected against having to make such adjustments.

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End corporate welfare: Import restrictions are a form of corporate welfare, but unfortunately not the only form. Businesses have successfully lobbied government for a large number of subsidies and regulations that transfer wealth to them by hampering the competition they face. Eliminating all forms of corporate welfare would increase high-wage jobs by reducing taxes and their distorting influence (see below), and allowing both domestic and foreign competition to direct labor and capital into their most productive uses, as determined by consumers, not by politicians catering to their special-interest clients.

Lower marginal tax rates: No matter how efficient a government is, it has to raise revenue to finance its activities, and that means imposing taxes. Unfortunately, all taxes reduce economic productivity by 1) putting a wedge between the price suppliers receive and demanders pay, thus preventing mutually beneficial exchanges from occurring, and 2) motivating people to make decisions to avoid taxes rather than create wealth. These distortions are commonly called dead-weight losses and are an inevitable cost of taxes over and above the opportunity cost of the money raised. Reducing the dead-weight loss from taxation increases the effectiveness of exchanges between employers and employees at directing workers to where consumers would value them most, and increases the general level of productivity, both of which increase the real wages of workers. So an effective way of increasing the number of high-paying jobs is by lowering the marginal tax rate and expanding the tax base by eliminating tax loopholes, reducing the dead-weight loss of taxes for a given amount of revenue raised. The lower the marginal tax rate the smaller is the wedge between what sellers receive and buyers pay, and the fewer the tax loopholes (along with a low marginal tax rate), the less the tax benefit from diverting resources from high-valued production to low-valued tax avoidance.

Avoid inflation: The federal government can do a lot to increase high-paying jobs by avoiding inflation. Inflation erodes labor productivity and lowers real wages, just as surely as it erodes the value of the dollar. The most destructive thing about inflation is that it distorts the information communicated by market prices, reducing the ability of market exchange to direct resources, including labor, into their most productive uses. Just as a yardstick ceases to be useful for measuring and comparing distances if its length is subject to sporadic change, so market prices are less useful for expressing and comparing values when the value of money is subject to sporadic changes. Also, inflationary distortions make it almost impossible to know what interest rate is appropriate when people borrow and lend money to finance long-term investments. So in an inflationary environment, many efficient capital investments that would increase the future productivity of labor—and increase future wages—never get made.

Avoid the Pork

Reduce pork-barrel spending: There can be no doubt that reducing pork-barrel spending would increase real wages by increasing the productivity of the economy. A major portion of federal spending is motivated by the ability of particular congressional districts or organized interest groups to capture benefits by spreading the costs over the entire taxpaying public. With those receiving most of the benefits paying only a small portion of the cost, the pressure is to expand spending well beyond the socially efficient level. Resources are transferred from higher-valued uses to lower-valued uses (for consumers), reducing the value of the goods and services available, and thereby reducing the real value of salaries and wages. Excess government spending is a negative externality, just like excess pollution, and the former is no less destructive of productivity, and does no less to erode real wages, than the latter. If politicians worried about the negative externalities of pork-barrel spending as much as they claim to worry about those of excess pollution, the result would be less wasteful government spending and more high-paying jobs.

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Eliminate the minimum wage: This would increase wages by increasing the human capital that, for many young people, is best acquired through on-the-job training. Minimum-wage legislation clearly creates unemployment among young people who, for a variety of reasons, including being trapped in dysfunctional public schools, don't have skills worth the legally imposed minimum wage. The result is not just unemployment, which may be a short-term problem, but a reduction in the opportunities for many young people to acquire the skills and attitudes that will make them more productive over the long run. Even those who do get a job at the minimum wage are less likely to get one in which the employer invests in them by providing training opportunities at the cost of some immediate output. The minimum wage prevents many young people with little opportunity to continue their formal education to develop the skills necessary to earn a good income in the future by working at a low wage when they have few financial responsibilities. Eliminating the law would make it legal for our less-advantaged youth to have much the same opportunity for higher-paying future jobs as more fortunate youth get through college subsidies.

Reduce the power of labor unions: Eliminating some of the legislative privileges that empower labor unions would be an effective way to increase wages. Labor unions can, and do, increase the wages of some workers. But they do so by reducing the wages of others by enough to reduce wages in general. Because of legal privileges that unions receive, it is difficult (and sometimes impossible) for workers to qualify for some jobs without being members of a union. Thus unions can increase some wages by restricting entry into some occupations and rendering those workers less efficient with rigid work rules.

All these practices reduce the productivity of the general labor force. Restricting entry into some occupations increases the wages of union members who work in those occupations, but it increases the number of workers in other occupations where their skills are less valuable. This not only lowers their wages, but reduces the productivity and wages of workers in general by preventing them from moving into their highest-valued employments. By reducing the flexibility of employers to shift workers from one task to another in response to changing conditions, rigid work rules also reduce the productivity, and wages, of workers.

Industry-wide labor unions have also lowered general economic productivity through cartelization of workers. If the firms in an industry explicitly agreed to reduce their output to increase their prices, they would be in clear violation of antitrust law (from which unions are exempt) and subject to harsh penalties—including prison time for senior managers. On the other hand, the firms in an industry have little to worry about if output is reduced because of a strike by its union. So both industry profits and union wages can be increased by the inefficiencies of a cartel "agreement" that remains within the law only because it is brokered by a labor union. (I am not arguing for antitrust laws. Even if antitrust laws could be rendered immune to political considerations, which they have never been and never will be, they would still reduce the competitiveness of the economy because of the static textbook notion of perfect competition on which they are based.)

All these union-induced inefficiencies reduce output below competitive levels and therefore reduce real wages. These inefficiencies would be reduced and the real wages of workers would be increased by reducing the power of labor unions.

As I have noted, all the policies discussed have one thing in common—they would increase wages by increasing economic productivity. They also have another thing in common—they would increase wages broadly, indirectly, and gradually by establishing an environment in which people productively cooperate with one another through markets in ways that best serve their collective interest. This means that the better jobs and higher wages will not be readily noticed, and even when they are, they will not be seen as the result of can-do government actions for which politicians can easily take credit. So the effectiveness of these policies at creating the type of jobs that politicians are constantly promising to provide does not translate into much political support for them. Politicians would rather receive credit for appearing to create better jobs with counterproductive policies than not get credit for policies that actually allow better jobs to be created. We now consider some policies that are politically popular because they give the appearance of increasing high-wage jobs while actually reducing them.

Policies That Reduce Wages

Restrict imports: When politicians argue for increasing an import restriction or against reducing a restriction, they invariably claim that they want to protect high-paying jobs. An import restriction does protect some high-paying jobs, but at the cost of reducing the emergence of other, even higher paying, jobs, because of the general reduction in productivity that lowers average real wages. But the protected jobs are currently held by relatively few identifiable workers who are typically well represented politically and are fully aware of the benefits they receive from politicians who vote for a trade restriction protecting them from foreign competition. The resulting loss of even more productive jobs can be safely ignored by politicians since it is widely dispersed and not easily noticed—it is hard to miss what we never had. And even if the loss is noticed, the cause—the import restriction—is not easily seen.

Put corporations on the dole: Politicians oscillate between attacking business and praising it, depending on the political issue and climate. But they are constant in dispensing large quantities of corporate welfare that the general public pays for through higher taxes and lower economic productivity. The most common justification for this welfare is that it creates jobs. And indeed it does, but only by destroying the chance for more productive jobs that would have emerged if competition had not be restricted and consumers had been allowed to spend the money paid in taxes to buy what they valued most instead of paying for corporate welfare. Unfortunately, the jobs that are created are visible and easily seen to be the result of government policy, while the higher paying jobs that don't emerge are invisible—it is difficult to miss what never was created.

Raise taxes: Politicians often call for higher taxes as the best way to promote economic growth and create more and better jobs. Supposedly higher taxes will reduce the budget deficit, which will reduce interest rates by reducing government borrowing. The popularity of raising taxes to increase good jobs seems to contradict the thesis of this article. It suggests that politicians are willing to take an unpopular action—raising taxes—to provide a general benefit—widespread economic growth and job creation. But raising taxes is not an effective way to increase economic growth and create jobs. Even if raising taxes did reduce the federal budget deficit, it is not likely to have much effect on interest rates. Interest rates are determined in a worldwide capital market, with rates often falling when the federal budget deficit is increasing and rising when it is decreasing. Second, increasing taxes seldom reduces the budget deficit, at least not for long. Even when higher taxes raise more tax revenue, the additional money is invariably used to expand government spending and pork-barrel programs, with spending growth typically outpacing revenue growth. The effect is to substitute public spending guided by political influences for private spending guided by economic considerations—a sure prescription for reducing productivity and lowering real wages. Also, with higher tax rates, special interests are willing to pay politicians more for tax loopholes, which introduce more productivity-reducing distortions in the allocation of spending and investments. The political cost of increasing taxes is more than offset by the political benefits from the plausible pretense that good jobs are being created while securing more of the national income to buy more electoral support.

Increase government spending: The list of benefits from more spending on highway construction, recycling, education, agricultural subsidies, parks, airport expansion, water-diversion products, and so on always includes additional jobs. But the jobs created are a major cost of these spending projects, not a benefit. The jobs necessary to build a road or recycle aluminum cans are filled by workers who are not producing value in other activities. Unless this cost is considered, the jobs created will be destroying wealth at the margin, since the value created by workers on government-funded projects will be less than the value (in terms of consumer preferences) they could be creating elsewhere. Political incentives make this misallocation of labor inevitable.

Regulate labor markets: Politicians can take credit for protecting and creating jobs by imposing a number of productivity-reducing restrictions on labor markets. To list two: affirmative-action enforcement pressures employers to hire workers on the basis of the racial mix of the communities in which they operate and increases the difficulty of dismissing unproductive workers; politically mandated employee benefits reduce the flexibility of employers to adjust compensation in ways that attract the best mix of workers to their firms at the least cost. (We've already discussed the minimum wage.)

The advantage of the policies that would create more high-paying jobs indirectly is that they do so by creating a positive-sum setting in which people interact in increasingly productive ways. The same increase in productivity that raises real incomes also increases the general level of wealth, enhancing our lives in a host of ways. For example, as wealth increases, infant mortality decreases, life expectancies (and the quality of life) increase at all age levels, poverty declines, the environment becomes cleaner, access to the arts increases, more leisure time becomes available, and jobs become safer, more pleasant and higher paying.

The problem with policies that try to create more high-paying jobs directly is that they do so with government transfers and protections that are negative-sum. Yet this negative-sum approach is politically compelling because politicians receive much of the credit for the benefits, while receiving little of the blame for the larger losses.