Maine Law Review

Volume 50 | Number 1 Article 2

January 1998

What Happened to the American Social Compact?

Robert B. Reich

Recommended Citation

Robert B. Reich, *What Happened to the American Social Compact?*, 50 Me. L. Rev. 1 (1998).
Available at: https://digitalcommons.mainelaw.maine.edu/mlr/vol50/iss1/2

WHAT HAPPENED TO THE AMERICAN SOCIAL COMPACT?

Robert B. Reich[*]

As I write this speech, there is much to celebrate about America. The economy is surging. More than thirteen million jobs have been added since the start of the Clinton Administration (for which I, as Labor Secretary during most of this time, take full credit). The rate of unemployment is lower than it has been in more than two decades, and there is no sign that inflation is accelerating. Corporate profits are up, and the stock market is soaring to record heights. America is also enjoying a time of relative peace. Ethnic tensions are running high in certain regions of the globe, but no large foreign power threatens America's preeminence. For the first time in the history of this nation, we have no rival on the globe—economically, politically, or ideologically. We are finally, indisputably, Number One.

The sobering news is that six years of economic recovery have failed to reverse the trends that began in the late 1970s toward declining wages and shrinking health and pension benefits for the bottom half of the American workforce, and toward widening inequality in earnings and wealth. The real weekly earnings of the median full-time worker are still below its level in 1989. Even in the robust twelve months from the middle of 1996 to the middle of 1997, the real median weekly earnings of full-time workers increased just three-tenths of one percent. But employer-provided health and pension benefits continue to drop, so at least half the workforce is getting nowhere. Meanwhile, all the rungs on the economic ladder are now further apart than they were a generation ago, and the space between them continues to spread.

Many families have made up for the steady decline by working longer hours, which the current tight labor market has facilitated. But for most mortals who do not relish what they do for pay, more hours at work does not translate into a higher standard of living. At the same time, the upper reaches of America—mostly college educated, mostly professional or managerial—have never had it so good. Their pay and benefits have continued to rise, and their shares of stock have exploded in value. Nearly 40% of the nation's financial wealth is held by the richest 1% of the population. Even taking into account pension wealth held on behalf of workers, the top 1% still owns 22% of all financial assets.

This tenacious trend toward a two-tiered society is deeply troubling. Yet, America is strangely immobilized. Rather than giving us the confidence we need to move forward, the good economic news on growth and jobs, combined with a rare period of world peace and global preeminence, seems rather to have anaesthetized us. Future generations

---

* Robert Reich was formerly the Secretary of Labor under the Clinton Administration. He is currently a University Professor and the Maurice B. Hexter Professor of Social and Economic Policy at Brandeis University and its Heller Graduate School. He is also editorial Chairman of *The American Prospect* magazine which he co-founded in 1990.

looking back on this era will ask why—when today's Americans had no hot or cold war to fight, no depression or recession to cope with, no great drain on our resources or our spirits—we did so little. Little, that is, relative to what the situation demanded. Little, relative to what we could have done. Did we simply assume that the economic expansion would last forever, and that the disparities would automatically shrink? Did we deny the problem to begin with? Or had we simply resigned ourselves to the inevitability of a sharply two-tiered society?

The budget deficit, which has so obsessed the nation, began to vanish this year even before the White House and Congress reached agreement, with much fanfare, to make it do so officially. The economic expansion boosted earnings so much, particularly for those at the upper rungs of the economic ladder, that tax revenues poured into the Treasury to a far greater extent than had been foreseen. But rather than dedicate this unexpected largesse to what has been most neglected and is most needed—universal health care, child care, better schools, jobs for the poor who will lose welfare, public transportation, and other means of helping the bottom half of our population move upward—most of this windfall is going to the wealthiest members of our society in the form of the largest federal tax cut on upper incomes since 1981. According to an analysis by the widely-respected Citizens for Tax Justice,[1] almost half of the tax cut will go to the richest 5% of Americans, and the richest fifth will receive over 75% of its benefits. Middle-income families and individuals will pay, on average, $200 less per year, while the richest 1% will pay over $16,000 less. Most of these cuts will explode in later years: The Joint Committee on Taxation estimates that the legislation will cost $95 billion from 1997 through 2002, but the cost will expand to $180 billion in the subsequent five years.[2] Because of the phasing-in of the estate-tax cuts and part of the capital-gains cut, and the use of back-loaded Individual Retirement Accounts, the annual cost by 2007 will be $39 billion—double the average annual cost in the first five years.

New funds (some $24 billion) will be allocated to provide health coverage to a portion of the nation's uninsured children, surely a worthy accomplishment. But this progressive step will be tempered by cuts in Medicaid to the poor (about $13 billion, to be achieved mainly by lowering payments to hospitals that treat the poor). Medicare will also be cut, partly by increasing the premiums on elderly beneficiaries. (A proposal to reduce Medicare benefits to wealthy retirees was scrapped.) With almost no public discussion or awareness, annual defense spending is slated to rise steadily from $269 billion in 1998 to almost $290 billion

1. *See* Citizens for Tax Justice, *Tax Plan Violates the President's "Principles"* (last revised July 31, 1997) <http://www.ctj.org/html/final.htm>.

2. *See* Iris J. Lav, Center on Budget and Policy Priorities, *The Final Tax Bill: Assessing the Long-Term Costs and the Distributional Tax Benefits* (August 1, 1997) <http://www.cbpp.org/801tax.htm>.

in 2002, faster than inflation. But all other discretionary spending will be held to $256 billion per year, which means steadily fewer dollars when adjusted for inflation. Fewer resources will be available to people who are poor or of modest means for education, job training, low-income housing, mass transit, food stamps, or even inspections of factories to ensure safety and adequate wages.

If "balancing the federal budget by 2002" were the most important thing the United States could achieve now, such a regressive tilt would still be cause for alarm. But it is not the most important thing. The entire federal budget is an accounting device, and a curious one at that—calculated very differently from the way private businesses do their books. A company would never show a deficit in its income statement, for example, when investing in new machinery or a new factory; these entries would be considered capital expenditures rather than charges against income. The only debits would be on the depreciation of the existing capital stock. But in the federal budget, all outlays are considered spending, regardless of what the spending is for.

The most important thing the United States could achieve now is to get back on the track we were on during the first three decades after World War II, toward a more inclusive, more equitable society. We got off that track in the late 1970s and have veered even further off it since. A large part of the reason why earnings began diverging then, as we all know, was the combined effects of two revolutions—one in computer technology, the other in global economic integration—the combined effect of which has been to shift demand in favor of workers with the appropriate education and skills to take advantage of these changes, and against workers without them. Two minor forces are also at work—the shrinkage of the unionized segment of the workforce (also related, in part, to technological advances and to globalization), and the decline in the real value of the minimum wage; the first force has disproportionately affected lower-wage men, while the second has largely affected lower-wage women. But even all of this combined together would not reveal the whole story.

The real paradox is why, at this juncture in history, the social compact that America fashioned during most of this century—to help ensure that prosperity was widely shared and that no one should disproportionately suffer the risks and burdens of economic change—should now be coming undone. In the world's preeminent democratic-capitalist society, one might have expected just the reverse: As the economy grew through technological progress and global integration, the "winners" from this process would compensate the "losers" and still come out far ahead. Rather than being weakened, the social compact would be strengthened.

Nations are not passive victims of economic forces. Citizens can, if they so choose, assert that their mutual obligations extend beyond their economic usefulness to one another, and act accordingly. Throughout our history, the United States has periodically asserted the public's interest when market outcomes threatened social peace—curbing the power of the great trusts, establishing pure food and drug laws, implementing a progressive federal tax, imposing a forty-hour workweek, barring child labor, creating a system of social security, expanding public schooling and access to higher education, extending health care to the elderly, and so forth. We effected part of this reform explicitly through laws, regulations, and court rulings, and part through social norms and expectations about how we wanted our people to live and work productively together. In short, this nation developed and refined a strong social compact which gave force to the simple proposition that prosperity could include almost everyone. The puzzle is why we seem to have stopped.

Every society and culture possesses a social compact—sometimes implicit, sometimes spelled out in detail, but usually a mix of both. The compact sets out the obligations of members of that society toward one another. Indeed, a society or culture is *defined* by its social compact. It is found within the pronouns "we," "our," and "us." *We* hold these truths to be self-evident; *our* peace and freedom are at stake; the problem affects all of *us*. A quarter century ago, when the essential provisions of the American social compact were taken for granted by American society, there was hardly any reason to state them. Today, as these provisions wither, they deserve closer scrutiny.

The first provision pertained to the private sector. As companies did better, their workers should have as well. Wages should have risen, as should have employer-provided health and pension benefits, and jobs should have been reasonably secure. This provision of the compact was reinforced by labor unions, to which, by the mid-1950s, about thirty-five percent of the private-sector workforce belonged. But it was enforced in the first instance by public expectations. We were all in it together, and as a result grew together. It would be unseemly for a company, whose profits were increasing, to fail to share its prosperity with its employees and the communities in which they lived. The job of management, proclaimed Frank Abrams, chairman of Standard Oil of New Jersey in a 1951 address that was typical of the era, is to maintain

> an *equitable and working balance* among the claims of the various directly interested groups . . . stockholders, employees, customers, and the public at large. . . . Business managers are gaining in professional status partly because they see in their work the basic responsibilities [to the public] that other professional men have long recognized in theirs.[3]

The second provision of the social compact was social insurance through which Americans pooled their resources against the risk that any one of us—through illness or bad luck—might become impoverished. Hence, unemployment insurance, Social Security for the elderly and disabled, aid to widows which became Aid to Families with Dependent

3. Gilbert Burck, *The Jersey Company*, FORTUNE, Oct. 1951, at 99.

Children, and Medicare and Medicaid. "Cradle to grave," Franklin D. Roosevelt told my predecessor, Frances Perkins, "from the cradle to the grave they ought to be in a social insurance system."[4] And, for the next half century or so, most Americans agreed.

The third provision was the promise of a good education. The national role began in the nineteenth century with the Morrill Act, establishing land grant colleges. In the early decades of this century, a national movement to create free high school educations through the twelfth grade for every young person swept across America. After the Second World War, the GI Bill made college a reality for millions of returning veterans. Other young people gained access to advanced education through a vast expansion of state-subsidized public universities and community colleges. In the 1950s, our collective conscience, embodied in the Supreme Court, finally led us to resolve that all children, regardless of race, must have the same—not separate—educational opportunities.

It is important to understand what this social compact was and what it was not. It defined our sense of fair play, but it was not primarily about redistributing wealth. There would still be the rich and the poor in America. The compact merely proclaimed that at some fundamental level we were all in it together, and that as a society we depended on one another. The economy could not prosper unless vast numbers of employees had more money in their pockets. None of us could be economically secure unless we shared the risks of economic life. A better educated workforce was in all our interests.

The unraveling of the first provision, pertaining to the private sector, began in the late 1970s and early 1980s, and it continues today. Profitable companies now routinely downsize their workforces, or they resort to what might be called "down-waging" and "down-benefitting." Layoffs in the current expansion are occurring at an even higher rate than in the expansion of the 1980s. Companies are replacing full-time workers with independent contractors, temporary workers, and part-timers; they are bringing in new full-time workers at lower wage scales than current workers; or, they are sub-contracting the work to smaller firms offering lower wages and benefits. Employer-provided health benefits are declining across the board, and health costs are being shifted to employees in the form of higher co-payments, deductibles, and premiums. Defined-benefit pension plans are giving way either to 401(k) plans without employer contributions or to no pensions at all. Meanwhile, beginning in the early 1980s, American companies battled against unionization with more ferocity than at any other time in the last half century. The incidence of companies illegally firing their employees for trying to organize unions (adjusted for the number of certification elections and union voters) increased from 8% in the early 1970s to 14% in the late 1970s, and then leaped to 32% in the early

4. FRANCIS PERKINS, THE ROOSEVELT I KNEW 283 (1946).

1980s, where it has more or less remained.[5] The unionized portion of the private-sector workforce, which had been 35% in 1955, continues to shrink. It is now 10%.

The relentless drive among American companies to reduce their labor costs is perhaps understandable given that payrolls typically constitute 70% of the costs of doing business, and that pressures on companies to cut costs and show profits have intensified. Competition is more treacherous in this new economy, where large size and low unit costs no longer guarantee competitive advantage, and where institutional investors demand instant performance. Yet, it is also the case that the compensation of senior management, professional, and highly-skilled technical workers has escalated in recent years. In large companies, top executive compensation has been increasing for over a decade at the rate of over ten percent per year, after inflation. Top executives and their families receive ever more generous health benefits, and their pension benefits are soaring in the form of compensation deferred until retirement. Although they have no greater job security than others, when they lose their jobs it is not uncommon for them to receive "golden parachutes" studded with diamonds.

The second provision—that of social insurance—is also breaking down. We see evidence of this in who has been asked to bear the largest burden in balancing the budget—disproportionately the poor and near poor, whose programs have borne the largest cuts. Unemployment insurance now covers a smaller proportion of workers than it did twenty years ago—now, only thirty-five percent of the unemployed.[6] Even before welfare "reform," welfare payments were shrinking in many states.[7] In fact, the entire idea of a common risk pool is now under assault. Proposals are being floated for the wealthier and healthier to opt out. Whether in the form of private "medical savings accounts" to replace Medicare, or "personal security accounts" to replace Social Security, the effect would be much the same; the wealthier and healthier would no longer share the risk with those who have a much higher probability of being sicker or poorer.

The third part of the social compact, access to a good education, is also under severe strain. The Clinton Administration has expanded opportunities at the federal level—more Pell grants and low-interest direct loans for college, school-to-work apprenticeships, and tax breaks for education and training. But the federal government accounts for only eight cents of every public dollar spent on primary and secondary school education in the United States; states and localities divide the rest.

As Americans increasingly segregate by level of income into different

---

5. *See* U.S. DEP'T OF LABOR & U.S. DEP'T OF COMMERCE, COMMISSION ON THE FUTURE OF WORKER-MANAGEMENT RELATIONS 84 (May 1994).

6. *See* LAURIE J. BASSIEE ET AL., THE EVOLUTION OF UNEMPLOYMENT INSURANCE, STAFF PAPER, 24 (August 1995).

7. *See* DAVID T. ELLWOOD, POOR SUPPORT 39-43 (1991).

townships, local tax bases in poorer areas cannot support the quality of schooling available to the wealthier. Public expenditures per pupil are significantly lower in school districts in which the median household income is less than $20,000 than they are in districts where the median household income is $35,000 or more—even though the challenge of educating poorer children, many of whom are immigrants with poor English language skills or who have other social or behavioral problems, is surely greater than the challenge of educating children from relatively more affluent households.[8] De facto racial segregation has become the norm in several large metropolitan areas.

Across the United States, state-subsidized higher education is waning under severe budget constraints, and its cost has risen three times faster than median family income. Elite colleges and universities are abandoning "need-blind" admissions policies, by which they guaranteed that any qualified student could afford to attend. Young people from families with incomes in the top 25% are three times more likely to go to college than are young people from the bottom quarter, and the percentage is rising.

Why is the social compact coming undone—especially at a time when it is most needed? The reasons relate to the same basic forces that have divided the workforce. Technological advances—primarily in information and communication—and global trade and investment have rendered a substantial portion of the tax base footloose. Capital can move at the speed of an electronic impulse. Well-educated professionals are also relatively mobile. As a result, governments are forced to impose taxes disproportionately on labor—typically lower-wage labor, which is the most rooted. As technology continues to advance and global markets continue to integrate, this "mobility gap" will continue to widen, resulting in wider disparities in tax burdens.

For example, corporate income taxes (which, given the incidence of shareholding in the United States, are relatively progressive) have steadily declined as a percentage of federal tax revenues, from 23.2% in 1960 to 17% in 1970, and now 11.8% (as of 1996). Meanwhile, federal payroll taxes (which are regressive, given that income above a ceiling of approximately $60,000 is not taxed) have steadily increased as a percent of federal revenues, from 15.9% in 1960 to 23% in 1970, and now 35.8% (as of 1996).[9] State and local tax burdens also have become more

8. Public school expenditures per pupil (in 1996 constant dollars) in school year 1992-1993 (the most recent date for which such data are available) for districts in which median household income was less than $20,000 was $5,237; in districts where median household income was $35,000 or more, it was $6,661. *See* U.S. Department of Education, National Center for Education Statistics, "National Public Education Financial Survey," (various years). *See also* U.S. Department of Education, National Center for Education Statistics, *The Condition of Education* (1997).

9. THE BUDGET FOR FISCAL YEAR 1988, HISTORIC TABLES 29-30 tbl. 2.2 (1988). For an assessment of the relative progressivity or regressivity of these two sources of government revenue, see JOSEPH A. PECHMAN, THE BROOKINGS INST., WHO PAID THE TAXES 1966-85 (1986). In fact, the same pattern is apparent in most advanced nations. On average, the standard rate of corporate

regressive, as states and localities shift from taxing incomes to taxing sales and property.[10] Stated another way, capital markets quickly and ferociously penalize any chief executive who pays more than is necessary to get a job done, and they penalize with equal severity any governor, president, or prime minister who is inclined to impose high taxes in order to pay for social insurance or education.

The market for highly-skilled people is not nearly as instantaneous or cutthroat as the market for capital, but its effects run in the same direction. Professionals move out of cities into remote suburbs where their property taxes do not have to pay for the costs of educating those in the inner city. They work from home offices or office complexes in the country. In the extreme instance, highly-skilled people can simply emigrate from relatively poorer nations, where they are relatively more taxed, to richer ones, where their tax burden is lower. As a result of the mobility of capital and the highly skilled, average and poorer working people find themselves bearing an increasingly large portion of the cost of social programs. Still, the incomes of most working people have not risen along with the growth of the economy; indeed, many of them are concerned with simply keeping their jobs. Such an environment is not conducive to a strong social compact.

Yet, even this analysis does not entirely explain the paradox. Today's wealthy investors and skilled professionals are not merely winners in a growing economy; they are also citizens in a splitting society. Wealthier and more fortunate members of society have long engaged in efforts to improve their community or nation—spearheading not just charitable activities but also progressive reforms. Why would they now allow the social compact to unravel? Are other forces weakening the bonds of affiliation and empathy on which a social compact is premised?

I do not have a clear answer, but I do have several hypotheses. The first is that Americans no longer face the common perils of Depression, hot war, or cold war that were defining experiences for the generations that reached adulthood between the 1930s and the 1960s. Each of these events posed a threat to American society and culture. Each was experienced directly or indirectly by virtually all Americans. Under those circumstances, it was not difficult to sense mutual dependence and to conceive of a set of responsibilities shared by all members, which exacted certain sacrifices for the common good. Today, fewer Americans remember these events or the "social bonding" that

---

income tax in member countries of the Organization for Economic Cooperation and Development (OECD), which comprises all advanced nations, fell from 43% in 1986 to 33% in 1995. The highest marginal rates of personal income tax among OECD nations dropped as well—from 59% in 1975 to 42% in 1995. Simultaneously, rates for lower-wage workers have risen. The marginal tax rates for workers receiving two-thirds of average earnings rose from 32.6% in 1978 to 38.4% in 1995.

10. *See* Citizens for Tax Justice, *State and Local Taxes Hit Poor and Middle Class Far Harder than the Wealthy*, press release, June 26, 1996 <http://www.ctj.org/html/whopays.html> (visited Nov. 17, 1997) (reporting regressiveness of various states' taxes).

accompanied them. Peace and prosperity are delightful, but they do not necessarily pull citizens together.

Second, in the new global economy, those who are more skilled, more talented, or simply wealthier are not as economically dependent on the local or regional economy surrounding them as they once were, and thus have less selfish interest in ensuring that their fellow inhabitants are as productive as possible. Alexis de Tocqueville noted that the better-off Americans he met in his travels of the 1830s invested in their communities because they knew they would reap some of the gains from the resulting economic growth—in contrast to Europe's traditions of honor, duty, and *noblesse oblige*:

> The Americans . . . are fond of explaining almost all the actions of their lives by the principle of interest rightly understood; they show with complacency how an enlightened regard for themselves constantly prompts them to assist each other and inclines them willingly to sacrifice a portion of their time and property to the welfare of the State.[11]

Today, increasingly, the geographic community within which an individual may live is of less consequence to his or her economic well being. It is now possible to be linked directly, by modem and fax, to the great financial or commercial centers of the world.

Third, any social compact is premised on "it could happen to me"-type thinking. Social insurance assumes that certain risks are commonly shared. Today's wealthy and poor, however, are likely to have markedly different life experiences. Disparities have grown so large that even though some of the rich (or their children) may become poor and some of the poor (or their children) will become rich, the chances of either occurring are less than they were several decades ago. The wealthy are no longer under a "veil of ignorance" about their futures, to borrow philosopher John Rawls's felicitous phrase, and they know that any social compact is likely to be one-sided—they will be required to subsidize the poor.

Perhaps all of these hypotheses are at work to some degree. But there should be no doubt that, unchecked, the disintegration of the social compact threatens the stability and moral authority of this nation. It also threatens continued economic growth. Those who believe that they bear a disproportionate share of the burdens and risks of growth but enjoy few, if any, of the benefits will not passively accept their fates. Unless they feel some stake in economic growth, they are likely to withdraw their tacit support for free trade, capital mobility, relatively open immigration, deregulation, and similar aspects of open economies that generate growth, but which simultaneously impose losses and insecurities on them. Some aspects of this backlash can already be

11. ALEXIS DE TOCQUEVILLE, DEMOCRACY IN AMERICA 146-47 (Henry Reeve, trans., Longman, Green, Longman, and Roberts, new ed. 1862).

observed in the resistance shown by the public to renewal of "fast track" authority enabling the President to move trade treaties quickly through Congress.[12] Public opinion polls over the past decade have shown a distinct decline in support of immigration as well, as evidenced in the anti-immigrant aspects of recent welfare legislation. Note, too, the "communitarian" movement's increasing resistance to capital mobility. Social conservatives have recently decried the openings of K-Marts and Wal-Marts in various communities, charging that they undermine "community values."

The current situation—widening inequality coupled, paradoxically, with a weakening social compact—is not sustainable. Those who are losing ground will not allow it to continue unabated. One of two things will occur. Either a new, more virulent form of statism will emerge, which achieves stability at the cost of economic growth. Or, the better-off members of society will participate in the creation of a new social compact that permits economic dynamism and growth, but also compensates economic "losers" and gives them a full opportunity to become "winners." At this moment in time, when the economy is expanding briskly and even those in the bottom half have high hopes of doing better for themselves in the future, such warnings may seem far-fetched. But history counsels wariness. The social compact is a promise we made with one another, and we are not keeping that promise when we can most afford to do so.

12. It is remarkable that not even the current economic expansion has reassured Americans about the North American Free Trade Agreement. According to a *Business Week*/Harris poll conducted September 3-7, 1997, 42% were in favor of NAFTA, down from 48% in April of 1995. *See Harris Poll: Freer Trade Gets an Unfriendly Reception*, BUS. WK., Sept. 22, 1997, at 34. Fifty-four percent of the respondents said they opposed extending NAFTA to other Latin American countries, and 54% also were opposed to renewal of "fast-track" authority. *See id.*