

**Dualism and Economic Stagnation:
Can a Policy of Guaranteed Basic Income
Return Mature Market Economies to *les Trente
Glorieuses*?**

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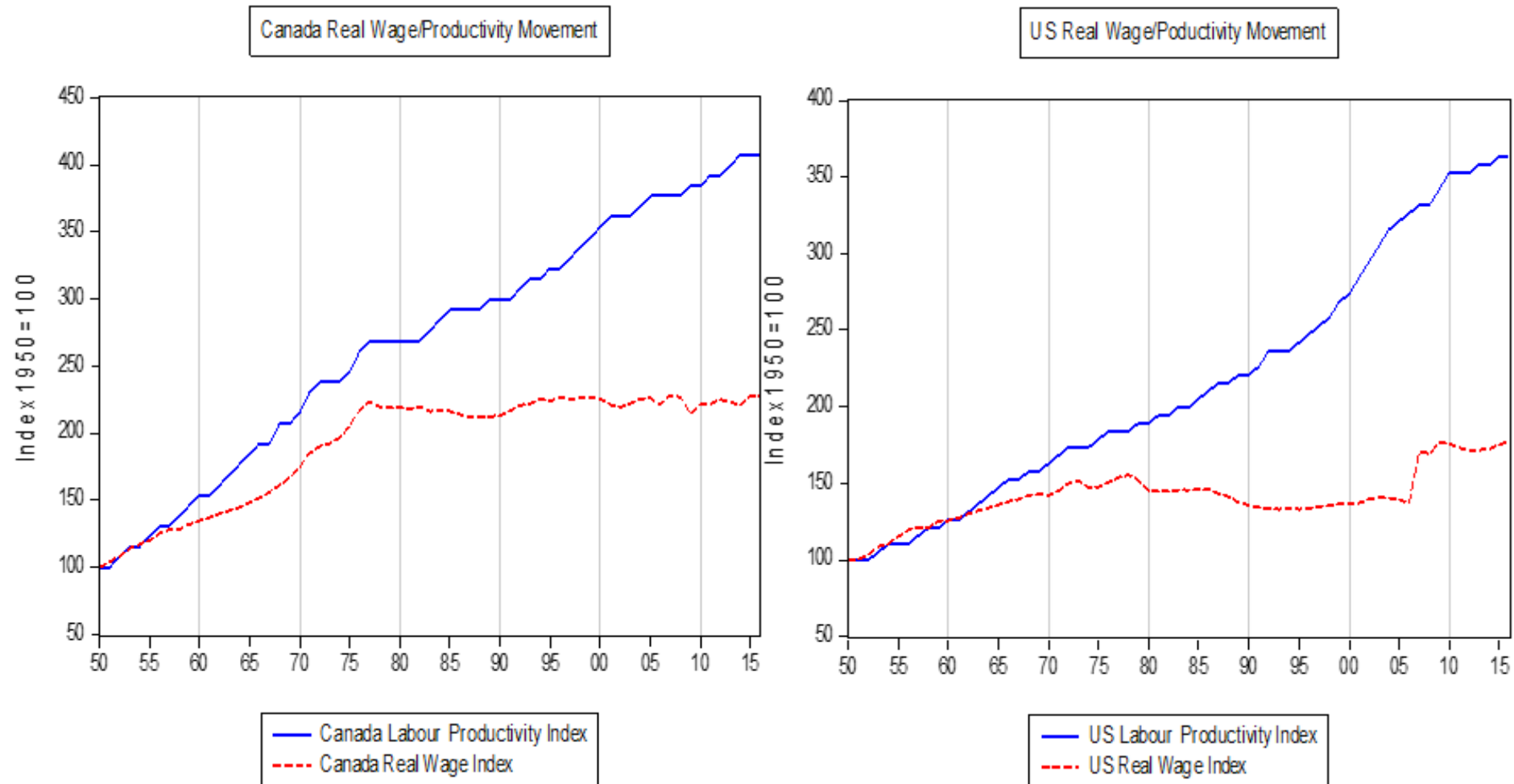
Introductory Remarks

- There has been much discussion in recent years, arising from the work of celebrated economists such as Piketty (2014), regarding the growing polarisation of incomes and wealth, together with the work Temin (2016, 2017) on the long-term evolution and transformation of mature market economies into dual economies.
- As these fragmented economies have succumbed to forces of globalisation and policies of austerity in recent decades, these fractured societies have also tended towards dualistic structures that used to be the distinctive feature of industrialising economies during their early stages of economic development.
- We see this distinct dualistic phenomenon in Great Britain during the First Industrial Revolution where these enclaves of industrial growth spurred on rising productivity because of major innovations and because of economies of large-scale production characteristic of the new industrial era of expansion, but with real wages remaining relatively stagnant for a very long time.

Decoupling of real wages and productivity

- This early decoupling of the patterns of growth of productivity and real wages were typical of an era of embryonic industrial development or what some traditional economic historians would have once characterised as a Rostovian “take-off” into industrialisation.
- A phenomenon of decoupling of real wages and productivity growth and the polarisation of incomes characteristic of these early industrial economies has reappeared, particularly since the 1980s, and has now become a feature of mature industrial economies.
- Yet there was an exceptional period in Western economies sometimes referred to as a Golden Age or in French as the “glorious” thirty years: an historically specific era during which policies had been put in place to achieve full employment and strong social transfer mechanisms that institutionally came to be associated with the post-war Keynesian welfare state.

Figure 1: Evolution of Output per Person-Hour and Real Average Hourly Earnings in North American Manufacturing, 1950-2016



Goal of this paper

- The purpose of this paper is to offer some insights as to what may have happened to lead to a reversal towards dualistic patterns characteristic of an era that had long passed (namely of the late 18th and early 19th centuries) but have returned with a vengeance; and to discuss what policies can seek to prevent this tendency from destroying the very fabric of these mature industrial societies.
- In particular, we shall look at a policy of guaranteed income (GI) that is being promoted as a means to address these growing income disparities accompanying disappearing industrial employment and other dualistic polarising patterns that have taken hold in mature industrial economies.

The Classical Dual Economy and the Lewis Model of Dualistic Growth

- Shaped by the experience of the British Industrial Revolution, the notion of a dualistic structure is deeply rooted in British classical economic thought.
- Throughout the late 18th and early 19th centuries, there was a general belief in some “Iron Law of Wages”, whereby real wages tended towards a “natural” or “normal” level compatible with the subsistence needs of the workforce.
- This, however, was not some sort of physiological subsistence, which was sometimes supported by Malthusian population theory at the time, but, in fact, some type of social subsistence that was determined both by societal norms and by the bargaining power of these labourers themselves vis-à-vis their employers, as Adam Smith had made very clear already in his *Wealth of Nations*.

The Classical Dual Economy and the Lewis Model of Dualistic Growth

- Classical economists beginning with Adam Smith in the 18th Century and all the way to Karl Marx by the middle of the 19th Century, conceived of the real wage in the long run as a given that was not subject to the conditions of supply and demand in the neoclassical sense, but was determined by legal/societal norms in vogue that constrain workers' bargaining power and by the broad economic conditions that prevailed in the vast non-capitalist agricultural sector upon which depended the industrial sector for its domestic source of labour.
- The latter traditional sector was the backdrop and the natural fall-back for industrial workers and it could even be the source of informal individual/community transfers that would be siphoned towards this enclave industrial sector to support workers if market wages fell temporarily below subsistence needs.

The Classical Dual Economy and the Lewis Model of Dualistic Growth

- In the classical vision of the economy, there was no natural tendency for real wages to rise concomitantly with productivity unless: (1) growth was sufficiently strong that would be depleting labour reserves in the traditional sector; and (2) if there was increased societal recognition/validation of what level of social subsistence needs ought to be met over time.
- While the first would depend on the rate of growth of employment in the industrial sector that can lead to the eventual elimination of labour reserves from the traditional sector, the second would depend on the strength of institutional changes that, according to Karl Polanyi (1944), resulted from the “double movement”, with societal pressures arising through collective action, such as trade union pressure or through political/institutional change resulting from government policy decision.

The Classical Dual Economy and the Lewis Model of Dualistic Growth

- The original Lewis model had a hybrid classical design with a “capitalist” and a “subsistence” sector as the fundamental division, as well as certain neoclassical features (about zero marginal product of labour), but its core analysis was non-neoclassical.
- When it came to the subsistence wage, Lewis’s analysis of what determined the long-run subsistence wage was non-neoclassical and was very much compatible with the features of the classical model that one discovers in the works of Adam Smith to Karl Marx based on bargaining power and social norms.
- Instead of marginal products, Lewis allowed that the real wage in the large traditional sector to be set to what he termed a “conventional level of subsistence” (Lewis 1954: 149), which opened the door to societal/conventional norms as to what determines wages that is outside of the usual demand/supply mechanism.

The Classical Dual Economy and the Lewis Model of Dualistic Growth

- In the early postwar period, when Arthur Lewis was writing about dual economies in the context of the developing world, it appeared as if the more highly industrialised countries of North America and Western Europe had successfully achieved a pattern of sustained and integrated growth, whereby real wages seemed broadly to be moving with advances in productivity.
- In the context of the early post-WWII era, the problem of dualism had disappeared, at least superficially, in the advanced industrial countries and was a challenge that needed only to be surmounted by the “underdeveloped” world by embracing the classical model of capitalistic development with each country eventually “taking off” and achieving industrial maturity.
- However, this turned out to be so only for the historically specific period of the “Glorious Thirty” --- *les Trente glorieuses*.

What precisely were the key transformation that made it possible for the advent of *les Trente glorieuses* that was not sustained after the 1970s?

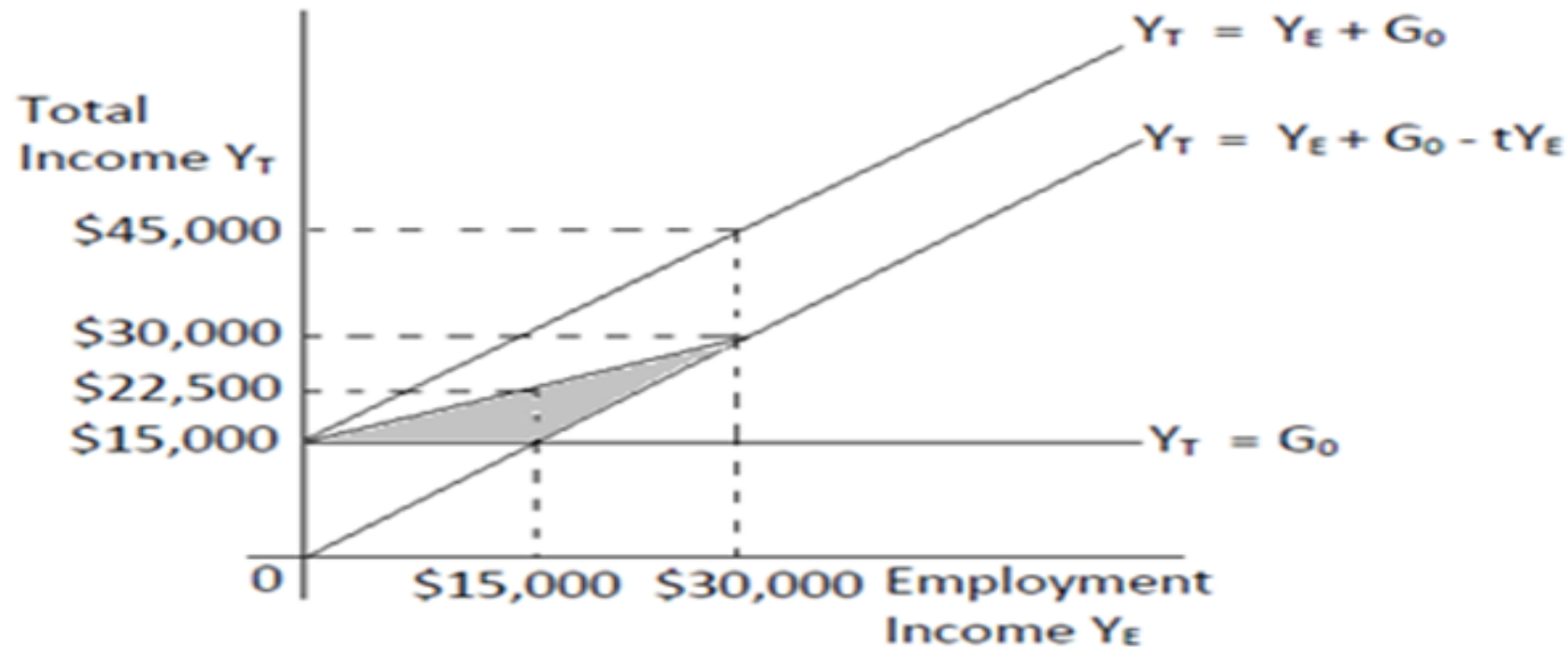
- The developments would hardly have surprised Smith or Marx.
- The early post-war period was an era in which Western governments had come out of the Great Depression and WWII with a strong commitment to full employment. They had done so by pursuing macroeconomic goals that depleted labour reserves, with those economies having reached very close to full capacity output.
- At the same time, one had already in place, since the interwar era, key institutions of the so-called “Keynesian” welfare state that did not become fully operative until the early post-WWII years with the provision and extension of social security benefits on a universal basis along the lines, for instance, of the Beveridge plan in Britain that led to legislated reforms during the 1944-48 period.
- All these developments, together with the widening of trade union rights to large-scale mass-production industrial workers and the public sector, led to a strengthening of the bargaining power of workers that, as even Adam Smith would have predicted, pushed long-term real wage growth.

The Retreat

- The retreat from the Keynesian welfare state starting in the 1970s is well known, but this occurred at the same time as Western countries embraced globalisation and export-led growth which tended to reinforce deflationary pressures and dualistic structures among each of the trading countries.
- With the attack on the welfare state through cuts in public spending, consumer expenditures needed propping up, which came through increased availability of consumer credit as Western economies slowly financialized and have been plagued with greater systemic fragility ever since.
- Given our understanding of the recurrence of dualism and income polarisation, can the current movement in support of Guaranteed Income (GI) bring us back to *les Trentes glorieuses*?

Can a GI Policy Bring Economies to a New Golden Age?

- There are two broad types of proposals: The UBI and the GAI-NIT.



Can a GI Policy Bring Economies to a New Golden Age?

- The difference between the GAI-NIT scheme and UBI programmes is that the latter, which is normally favoured on the political Left, would provide a total income level to low-income workers perhaps considerably higher than the GAI-NIT. However, for both schemes, the basic income would be an “aid-in-wages” or add-on to any employment income that individuals or households can earn.
- One by-product of this could be that, like welfare programmes in general, the GI would also be establishing a floor for what the 19th-Century classical economists referred to as the subsistence income. But there is much debate about that as we shall see.
- This is because, while neoclassical economists worry about the disincentive effects of the GI schemes, heterodox writers are more concerned about the behaviour of employers on the demand side, with some of these writers being largely influenced by the views of Karl Polanyi on GI.

Basic Income and Karl Polanyi: Why GI Programmes Can Potentially Create Greater Market Income Polarisation and Wage Deflation

- Karl Polanyi would have been, undoubtedly, a strong supporter of a modern universal basic income, as argued strongly by Kari Polanyi-Levitt (2013: 115). This is because of the possible social “re-embedding” of the labour market in a way that establishes a decent minimum social subsistence income for everyone in a community regardless of labour market status.
- However, a careful reading of his writings would suggest that this would not have been a fully unqualified support.
- His historical approach completely rejected the mainstream concern about the work disincentive effects of GI programmes. The principal reason for this concern has to do with the so-called Speenhamland effect on market wages.

The Speenhamland Effect

- There has been much written historically on the behaviour of these working poor at the time of the Industrial Revolution in England going back to such writers as the French historian, Paul Mantoux (1928), and, of course, Karl Polanyi (1944), and there was much controversy even during the time of the actual adoption of the Speenhamland system over the consequences that eventually led to the repeal of that specific income supplementation system.
- As was highlighted by Polanyi (1944: 128), this form of income supplementation was *de facto* a wage subsidy to employers to encourage downward wage adjustment in times of high job scarcity.
- Within a chronically demand-constrained labour market reflective of a Lewis-type dual “labour-surplus” economy, it was hypothesised that the Speenhamland mechanism could facilitate the acceptance of wages even below subsistence, as long as their overall household income was being supplemented by a non-market wage subsidy under the Poor Laws.

The Speenhamland Effect

- In contrast to the concerns of most mainstream neoclassical economists about the work disincentive effects, the objective of a GI programme for its neoclassical advocates like Milton Friedman was actually to create incentives for individuals to enter the labour force by taking up a job and, at least, partially to get off welfare through income supplementation.
- It was believed that a GI system would not much “distort the market or impede its functioning” (Friedman 1962: 191). It could thus have the effect of increasing wage flexibility in response to changes in labour demand, much as were the presumed Speenhamland effects previously alluded to by Polanyi (1944).
- As it had been argued elsewhere, the “compensation effect” of the GI system could serve to reduce workers’ resistance to a cut in their market wage (see Iacobacci and Seccareccia 1989).

The Speenhamland “Compensation” Effect

- It could be shown that this “compensation effect” would be negatively related to the tax-back rate, t .
- In current traditional welfare systems where one *cannot* receive welfare transfers while holding a job (that is where $t = 1$), *de facto* the compensation effect is zero. On the other hand, the Friedman GAI-NIT is an intermediate case where $0 < t < 1$ and the compensation effect is positive and significant. Finally, in the case of a UBI (that is where $t = 0$), the individual recipient will be able to retain the full G_0 transfer. This would suggest that, for a given G_0 , the wage subsidy effect would always be present, with the potential of a market wage deflating effect at the bottom end of the wage ladder regardless of the type of GI system in place.

The Speenhamland Effect

- In terms of this undesirable Speenhamland effect, it can be argued that is not so much the level of the tack-back rate but the size of the minimum subsistence income guarantee, G_0 , that would matter.
- Indeed, the greater the G_0 , the lower the pressure on individuals to take up any jobs to supplement their basic income, and the lower would be these downward wage adjustment effects.
- Conversely, the lower the G_0 , the greater the incentive to take up a job to supplement the low basic income guarantee. We can thus see that the critical debate is over the level of G_0 .
- With a guaranteed minimum income, G_0 , that is very low, there would be significant pressure on individual recipients to take up employment and actually increase the labour force participation rate as Friedmanite supporters would envisage.

Market Wage Polarisation of the Speenhamland Effect

- In a high unemployment or “labour surplus” environment, this could create downward pressure on market wages, as employers seek to take advantage of the wage subsidy. The importance of this effect would depend crucially on the existence of a floor to market wages at the bottom end of the wage scale, established by, say, some statutory minimum for market wages or other support programmes in place.
- If, instead, say, the minimum wage is removed, then, as Friedman (1962) had envisaged, this would become a more flexible wage system whereby, as unemployment rises, market wages at the bottom would become more flexible downward. The consequence would be greater market wage polarisation, even if counterbalanced via the existence of GI floor that would be reducing simultaneously after-transfer income disparities.
- One can further infer that the greater is the incidence of unemployment in such an economy, the greater would be the market wage polarising effect of a low G_0 -type GI system.

The Need for a Commitment to Full Employment as a Complement to a GI System

- For this reason, it would be imperative that a GI plan is coupled with a commitment to some explicit full employment policy that would create sufficiently tight labour markets to prevent the negative Speenhamland effect on market wages from occurring. As Keynes (1936: 372) had emphasised, a policy on income distribution should be coupled with a full employment commitment.
- In the absence of a full-employment commitment and in the absence also of other floors to market wage deflation (such as a comprehensive minimum wage system and unemployment insurance), an income supplementation scheme adopted in the context of a chronic “labour surplus” economy could merely become an institutional mechanism to spread low-wage employment even while guaranteeing a basic income, as suggested by Polanyi (1944).

GI Programme as an Automatic Stabiliser

- All those predictions about the macroeconomic expansionary effect of a GI programme, such as the recent research by Nikiforos, Steinbaum, and Zezza (2017) of the Roosevelt Institute or by Brown (2017) of the Public Banking Institute in the US, start with the assumption that a GI policy would be associated with substantive Keynesian-style deficit spending.
- While such would undoubtedly have the desired macroeconomic outcome of preventing the full working of the Speenhamland effect, and that the GI programme would serve institutionally as strong automatic stabiliser, the problem is that when one studies the usual proposals that have come out and are supported especially by the political Right, they all start from the premise of an explicit or implicit assumption of government budget “deficit neutrality” of the GI programmes.
- If this is the usual institutional macroeconomic box within which such policies are framed, GI proposals would succumb definitely to the Polanyian critique previously discussed.