USBIG Discussion Paper No. 29, March 2002

Work in progress, do not cite or quote without author's permission

PROMOTING ECONOMIC EQUITY IN A 21st CENTURY ECONOMY: THE BASIC INCOME SOLUTION

Charles M. A. Clark
St. John's University

WHAT IS ECONOMIC EQUITY AND WHY IS IT IMPORTANT

It is no accident or coincidence that just about every human society has had some mechanism to promote economic equity. From the Old Testament's redistribution of wealth through the Jubilee to the modern welfare state, a common feature of human society has been the redistribution of wealth and incomes to account for those who have not been adequately provided for by the given "rules of the game" that determine income allocation. This constant feature of social living shows that there is a need to account for factors besides existing property rights in determining the ability of individual community members to subsist and thrive. The reason that such redistribution schemes are a fundamental feature of human societies is that wealth and incomes are collectively created, but often the rules that determine the initial distribution of incomes, usually based on power and property rights, do not typically provide for the whole community. Many people in the community are not currently economically productive but still need to be provided for to ensure the economic sustainability of the community (children and the elderly). Furthermore, many factors besides what is necessary to promote future production influence what the initial distribution of income will be (such as a lucky hunter), thus it may be harmful to the health of the community to allow such inequalities to persist.

Anthropologists have long known of these features of human society, yet they are often ignored when analyzing modern capitalist economies, yet the need for redistribution is just as necessary today as it was for our ancestors. Our economy produces a distribution of income that has levels of

inequality well beyond any instrumental need to send out the market signals of differential incomes in order to coordinate economic activities. Power and property rights, totally disconnected to issues of effort and productivity, greatly influence the distribution of incomes in modern capitalist economies (Clark 1996). This "market driven" level of inequality causes serious problems for the long run health of the community. First, it creates a situation of insufficient aggregate demand, that is the economy is not able to purchase the amount of goods it has the potential to produce simply because those with needs do not have the adequate resources to satisfy them. Second, many are unable, given the "rules of the game" for distribution to secure sufficient incomes to support themselves and their families. Without some mechanism to redistribute incomes these people will eventually perish or become hostile to the existing political order. Lastly, gross inequalities, especially when they cannot be justified based on economic necessity, weaken the social bond (some might say the social capital) of the society, and thus lead to great strains and costs of the society as a whole, diverting resources towards protecting existing property relations and away from meeting human needs. Thus the economic pie as a whole shrinks. Hence the importance of economic equity.

The most common definition of equity is fairness. However, left like this, the definition is vague; for what constitutes "fairness"? If it merely means that one gets one's due out of market transactions, then an overly narrow (purely procedural) definition of equity is being used, which can lead to very inequitable outcomes in practice. The older and more exact meaning of equity, derived from the field of Jurisprudence, defines equity as referring to provisions to supplement or correct the outcomes of the law. That is, it is long recognized that the outcomes of a strict adherence to the law or rules often produce results that are contrary to either the spirit of the laws or society's intent, thus causing a need for adjustments in the outcome. This adjustment is equity in the classical sense of the word. In terms of the economy, this means that following the laws and rules that guide the economy will often produce outcomes that might be in accordance with the restrictions of justice in that everyone has followed the letter of the law, yet which are socially or morally unacceptable. To give an example: market wages might not be at levels that can support a family at a decent level, and in many cases can be below the subsistence level. Thus it has been common for societies to intervene in such market outcomes to ensure that certain social minimums are met. Strict adherence to the logic of economic theory suggests that all market outcomes, as long as they are the result of free actions, are necessarily fair (equitable) and that it would be unfair (a violation of justice) to interfere with such outcomes. Yet this conception of equity not only ignores the second and older definition of equity, it is a mere tautology, for it assumes that all market outcomes are equitable, and the proof of this is that they are market outcomes. Market outcomes need to be evaluated using criteria other than the market, and all market economies have eventually adopted this approach, for markets

often produce unacceptable outcomes.

An examination of how particular societies solve the central economic problem of how to provide for their material reproduction shows that equity considerations (questions of fairness not only in procedures, but also in terms of outcomes meeting socially desirable standards) are important at every level of economic activity. We can see this by breaking down the economic problem into its three basic component parts, the three economic questions all societies must answer: What to produce? ; How to carry out production? ; and To whom to distribute the benefits of economic production? All three of these questions have both necessary and discretionary aspects -- necessary in that the forces of nature place restrictions on how we address each question and discretionary in that these natural forces do not wholly determine our answers. In fact, as a society develops and becomes more affluent the discretionary aspect grows and the restrictions of nature shrink. We see this clearly in our first question: What to produce? Nature tells us that we must produce sufficient food, clothing and shelter to meet the community's basic physiological needs, and that these are appropriate for the community's natural environment (climate, available resources etc.), yet in an affluent society such as the United States the limits imposed on us by nature are rather small. Thus the role of discretion looms much larger and we must ask ethical questions when deciding what to produce. When the outcomes of the economy violate our sense of decency and fairness we must intervene and adjust these outcomes. In our economy what gets produced is determined mostly by those with the most money (with a large role for advertisers). Thus, the wants of affluent suburbanites for SUVs and very large houses take precedence over the needs of those on low incomes for adequate transportation and shelter (which often go unmet).

Equity issues are central also to the second question -- how to carry out production -- for this question is not solely about what technology to use, but what is more important, about the social division of labor, i.e., who gets what jobs. As income, status and how much one gets to participate in society are often determined by one's job, this is not a trivial matter. Our necessary component to this question is that we must come up with a system of allocating jobs and tasks in a manner that those who get particular jobs have the ability to do them adequately. However, here, as elsewhere, discretion plays the bigger role, for most jobs provide the majority of the skills and training necessary to do them in the form of on-the-job training. As almost all hiring decisions are discretionary, the potential for exclusion of groups without connections to the "good jobs" (friends or family) is great and thus society must intervene to allow access to good jobs for all willing and able to work.

How a society distributes the benefits of its economic production is the classic equity issue, and we can see that it is clearly related to the first two questions. The distribution of wealth and incomes greatly shapes the demand for goods and services (as well as political decisions), and thus what society

will produce, as well as the ability to achieve the right credentials and connections to get the most desirable jobs. Our major constraint on how we distribute incomes and wealth is that it has to be done in a manner that contributes to future production. Too much inequality hampers the ability of society to materially reproduce itself, both on the production side (under fed and ill housed workers will be much less productive than their potential) and on the demand side (the primary cause of the Great Depression was inadequate aggregate demand caused mostly by the high levels of income inequality generated by the economy of the roaring 20's), while perfect equality (everybody gets the same income regardless of job or effort) might produce disincentives to work hard, acquire skills, undertaking difficult jobs and innovate. In the mythology of our economy, incomes are determined by how much one contributes to the marketplace, thus such outcomes are "fair and just" (from each according to their abilities, to each according to their deeds). Yet the reality is that power determines incomes more than anything else, and this power is distributed not according to the necessary requirements of an efficient economy, but according to past income and wealth and how the "rules of the game" are set. Incomes are determined by bargaining, and how well you can bargain is determined by your initial position and the context of the bargaining process (laws, regulations and customs).[1] If you belong to a strong union, or if your industry has considerable market power (few competitors) or if you have the political clout to get the government to set the rules in your favor, and most important, if you can exclude others from competing against you, and encourage them to compete against each other, you will have significant power and can greatly determine your income. The less economic power you have the lower your income will be. Throughout the history of capitalism, the incomes of the most powerless have frequently fallen to below subsistence levels and these groups have been able to share in the economic progress generated by capitalism only through intervening in market outcomes, either through the government (minimum wages, social protection expenditures) or through collective action (unions and collective bargaining). The rules of the market are created by those with power and thus have never benefited the poor and marginalized, and have only benefited the middle class to the extent that they have been able to influence these rules through collective action.

The rules that generate economic outcomes are not natural laws. The market outcomes are not natural phenomena like the weather, something we can complain about but cannot change. Markets are social institutions and the rules are socially determined. Most often the rules are created to benefit those with the power to adjust or set the rules, but they can be adjusted to promote greater equality and inclusion. And if changing the rules is too difficult or costly, then equity dictates that we intervene after the fact to produce outcomes that will ensure that *all* benefit and *all* can contribute.

SOCIAL JUSTICE REQUIRES EQUITY AND EFFICIENCY

In most discussions of the economy, questions of economic equity are peripheral to what economists and policy makers are really interested in -- economic growth. In fact, when equity does enter the discussion it is seen as in opposition to economic efficiency. This is the famous, or infamous, depending on ones' perspective, "Big Trade-off" between equity/equality and efficiency. This idea of a necessary trade-off between equity/equality and economic efficiency is so fundamental to how economists think about these issues that they often merely dismiss any call for greater equity without giving it any serious thought or analysis. Yet, the requirements of social justice call for both equity and efficiency and suggest that they support, rather than oppose, each other.

The idea of a trade-off between equality and efficiency became solidified in economic theory with the famous book by Arthur Okun, *Equality and Efficiency: The Big Trade-Off*. Okun argued that market economies, in order to operate efficiently, must necessarily generate a certain level of income inequality. The reason is simple enough. Markets must pay higher incomes to get people to take more difficult or stressful jobs, or to acquire the necessary education and skills which some jobs require, and for entrepreneurs to undertake higher levels of risk with their investments. In order to generate greater levels of equality, Okun contended, this market mechanism would have to be hampered with, thus weakening the role of price signals and thus lowering the efficiency of markets. Okun stated that public policies that promote equality are like transferring water from one well to another. Inevitably some will spill in the process. This spillage from these leaky buckets (equality promoting policies) is lost economic efficiency, which means that the economy will produce less Gross National Product than it could have. It is ironic that this analysis has since been used to argue against re-distributive economic policies, for the main point of Okun's book was that the United States could well afford considerable spillage in order to achieve the more important goal of greater equality.

The central weakness in Okun's analysis is its contention that market outcomes are necessarily efficient. If one defines efficiency as market outcomes, then it is natural to measure efficiency with Gross National Product (GNP), which measures the total of all market exchanges for final goods and services. It is well known that this is a poor measure of economic and social well-being for it includes many economic transactions that do not promote the well-being of the community (such as crime; illness; pollution) while excluding activities that do promote well-being (household production, caring for children and elderly; volunteer work). In fact, much of the economic growth in the US economy in the past thirty years has been social decay by another name. To give an example: the rise in divorce rates and family break-

ups causes a considerable increase in market transactions (two homes, multiple appliances, paid child-care, divorce lawyers, fast food; psychological counseling etc.). Arthur Pigou, a famous English economist of the early 20th century once quipped that when a man married his housekeeper, the country's national income declined (because now the activities of the housekeeper will not be provided as a market exchange). We have been promoting economic growth by doing the opposite. This is one reason why so many feel they are not experiencing the beneficial effects of the "good" economy. Market outcomes might be the most profitable for those with economic power, but they are rarely the best possible outcome for the entire population, especially the poor and marginalized. As we saw above, the market only considers the demand of those with money. The voices and needs of those without money are not considered. Thus our current economy at its peak in 2000, considered the envy of the world, still produced an outcome with 32 million people living in "official" poverty, with millions more living in actual poverty. Any outcome that excludes 32 million people cannot be considered efficient by any definition based on human needs and decency. Not only are these 32 million individuals being excluded from the benefits of what the economy actually produced, their potential contribution to the economy and society is lost, thus society as a whole is poorer than it could be. Society is operating at its most efficient level when all are contributing to their fullest potential, with non-market contributions being given their due importance.

Economists often equate equity with equality, thus creating a straw man. You would have a hard time finding anyone who advocates perfect equality in incomes (everyone receives the same income). In fact such equality would be a violation of most conceptions of social justice, in that all people do not have equal needs. An adequate income for all is the equity criterion asserted by the UN Declaration on Universal Human Rights as a human right. Yet rights need to be balanced with responsibilities, thus there is a necessary second component to social justice. The right of all to a decent standard of living is coupled with the responsibility of all to contribute to the well-being of the community (though this does not have to be in the form of paid employment. The parent who cares for their children and raises them to respect others and to be good citizens is certainly contributing the economic and social well-being of society). However, many are prevented from fulfilling this responsibility by social structures that erect barriers to their social participation. One such barrier is the extreme poverty that too many Americans experience. An adequate income is a minimum criterion to social participation and to contributing to the well-being of the community. This is the minimum criterion of social justice, the adequate provision to all so that they can lead a decent life and contribute to their fullest potential toward the well-being of the community. *Equity promotes real efficiency*. It is not a trade-off, but two sides of the same coin.

This is not merely a theoretical case we are making here. The experience of the past 50 years confirms that when we promote greater

equality and equity, we are at the same time promoting a more efficient economy. One example of this is the provision of universal access to education regardless of ability to pay. Education helps to break down barriers to the poor and marginalized, generating greater equality and dramatically improving the productivity of workers and the economy. Expenditures on education do more to promote economic growth than spending on anything else. We should remember that the period from WWII to 1973, often called the “golden age of capitalism” experienced both falling levels of income inequality, a breaking down of barriers to the poor and the fastest growing economy ever experienced in the USA. This widening of social participation was a key ingredient to this economic progress. The Reagan experiment can be best seen as an attempt to promote economic growth by increasing income inequality (a rather perverted use of the equality/efficiency trade-off), yet its success was due to good old fashion Keynesian deficit spending. The 1990s boom was built on speculation and historic levels of consumer debt. None of these paths to economic growth are sustainable. Only a growth strategy built on promoting equity and real efficiency is sustainable (economically, politically, socially and environmentally) in the long run.

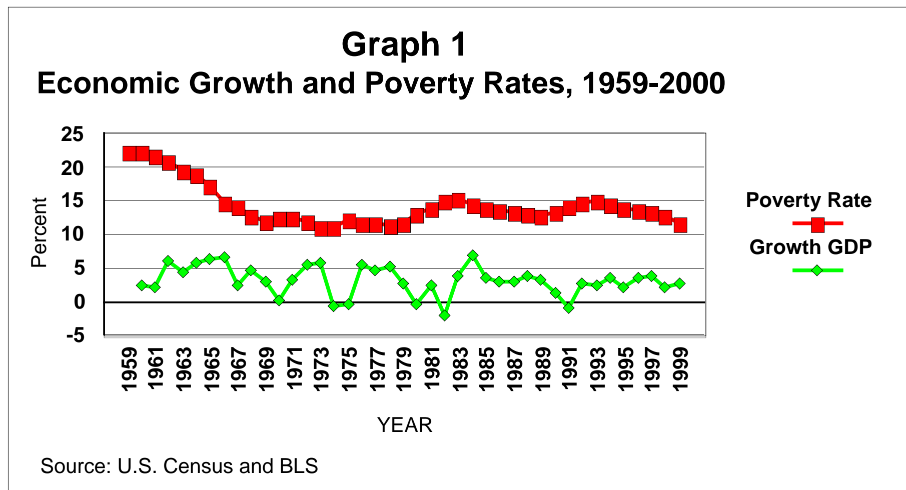
A RISING TIDE WILL NOT LIFT ALL BOATS[2]

When President Kennedy made his famous “a rising tide lifts all boats” statement he was expressing the idea that the best policy for reducing poverty is to promote economic growth. This same belief was behind Ronald Reagan’s experiment with “trickle-down economics.” The political benefits of using economic growth to fight poverty are fairly obvious, for they allow the problem of poverty to be tackled without requiring any sacrifice from the more affluent. Both major presidential candidates in the recent election also highlighted this faith in economic growth eliminating poverty. Both Bush and Gore stated the need to keep the economy growing in their position papers on poverty policy, with Gore taking the position that “fiscal discipline” would provide for a healthy economy.

The welfare reform policies of the 1990's are different from the “Great Society” programs of the 1960's essentially in their belief that economic growth is enough, that government support programs are a hindrance to getting out of poverty. All that is necessary for government to do is provide the right incentives for getting out of poverty. Only if one believes that the economy will provide sufficient jobs and incomes to bring everyone willing to work out of poverty, does it make sense to pursue social policies designed to increase the poor’s willingness to work and expect that to be enough to eliminate poverty. Much of the success or failure of these experiments will depend on whether economic growth will be enough to significantly reduce poverty in America.

Relationship Between Economic Growth and Poverty

The theoretical linkage between economic growth and the number of people below the poverty rate is fairly straight forward. More economic growth leads to potentially more income for all. If any of this increase in income "trickles down" to the poor we will get a rise in their standard of living and a reduction in the poverty rate, *ceteris paribus*. If one looks at the long term relationship between economic growth and the poverty rate (or numbers in poverty), it is clear that there has been a close and inverse relationship between the rate of economic growth and the poverty rate, with increases in GNP coinciding with declines in the poverty rate, and when economic growth slows down, or when the economy experiences negative growth in GNP (recession), the poverty rate rises. We can see this in two ways. In Graph 1 below we see the relationship between economic growth and poverty, as measured by the official poverty rate.



In this Graph we see that the poverty rate fell consistently from 1959 to 1973 when it hit its all time low of 11.1 percent, and since then it has fluctuated around 13 percent (plus or minus 2 percentage points).

The secular trend upward of the poverty rate can be seen in Table 1 below, which gives the average poverty rate for each of the business cycles from 1959 to 1999. Here we see that the poverty rate reached its lowest average level in the 1973-79 cycle and has been rising with each successive business cycle.

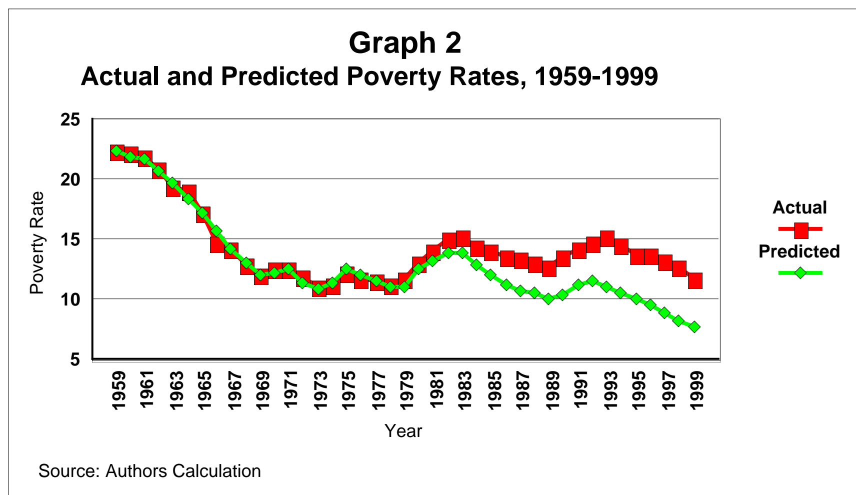
Table 1
Average Percent in Poverty over Business Cycle Peaks, 1959-99

Years	Poverty Rates %

1959-67	19.1
1967-73	12.5
1973-79	11.6
1979-89	13.6
1989-99	13.7

Source: U. S. Bureau of the Census, P60-201.

Economic growth's ability to reduce poverty has been greatly weaken since the early 1980's (see Blank 1993 and Mishel, Bernstein and Schmitt, 1999. pp. 292-4). Using a model based on the work of Rebecca Blank, we have estimated the effects that various macro economic variables have had on poverty rates in the United States from 1959 to 1980 and carried forward these variables up to 1999 to see how these variables influenced the poverty rates in the 1980s and 1990s.



In Graph 2 above we see both the actual and predicted poverty rates. We see that the factors that reduced poverty (all economic growth related) before 1980 failed to have the same impact after 1980. Had the relationships of the 1960s and 1970s held, we would have expected a significant drop in poverty rates to historic lows, reaching 7.8% in 1999. What has changed from the 1960's to the 1990's? The rise in income inequality is the main cause of the inability of economic growth to significantly reduce poverty. Just about all of the income gains of the past 20 years have been concentrated in the hands of the richest 20 percent of the population, thus leaving little to trickle down to the poor. The reason that the rich a have been the main beneficiaries of this economic growth (unlike in the 1950 and 1960s) is because of the change in

the balance of power (economic and political) brought about partly by the rise of the "New Economy." As we will see the changes brought about by the "New Economy" have greatly weaken the ability to spread the benefits of economic growth more equitably.

CHALLENGES OF THE "NEW ECONOMY"

So far we have argued that economic equity is not merely following the letter of the law, but has to include fairness in outcomes based on the criteria that all have a right to a decent standard of living and a right to participate to their fullest capabilities in promoting the well-being of the community. These dual criteria of social justice means that we must promote both efficiency and equity, and that efficiency without equity (ensuring all share in the benefits of economic progress) that is economic growth alone, will not reduce poverty. Here we will look at the complex problem of how to promote equity and a prosperous economy in the context of "globalization" and the "New Economy."

Few would doubt that the economies of the world are going through a period of rapid change and transformation. Whether this is a "New Economy" or merely an acceleration of the evolutionary trends of the past two hundred years is a question for academics to debate. What is beyond debate is that many of our old assumptions and beliefs about the economy and the institutions and structures that determine economic outcomes no longer hold. In many ways we are at a turning point in economic history not unlike the one Karl Polanyi wrote about in his classic *The Great Transformation* (1944). Three points that Polanyi emphasized are worth keeping in mind when considering the current transformation. First, technological change requires institutional change, that is, society must change the "rules and habits" by which the economy and society are organized. Second, institutional changes generated by the economy will shift the costs of the new production methods to those with the least power and influence, the poor and workers. Third, and finally, these changes will generate a social backlash by those adversely affected by the new economic order. Polanyi used the development of the Industrial Revolution to illustrate these points, but we can take our present economies in transition to make the same points.

Why 20th Century Economic Institutions Do Not Fit the 21st Century Economy

One of the reasons that the post WWII period was the "golden age" of capitalism is that its social and political institutions underwent a dramatic change to complement the advances in economics and technology. The creation of the Welfare State played a key role in this economic progress

because it helped to spread the benefits of economic progress to all, or at least to most. These efforts at inclusion were necessary not only for the generation of economic progress, but also because they allowed for stronger democratic institutions and a stronger civil society. The model used for structuring the economy so that all or most of the citizens shared in the benefits of economic progress has been called (at least in the English speaking countries) the Keynes-Beveridge model. This model was set up under the following assumptions:

1. **Full employment as the norm.** The experience of the wartime economies showed that Keynes's policy suggestions worked and that full employment could be achieved. If there were bouts of unemployment, they would be temporary and short-lived. Keynesian fiscal and monetary policy would keep the economy at or near full employment.

2. **Productivity gains were passed on to workers**. Various institutions were set up to ensure that the gains of economic progress would be widely shared. Most of these involved intervention in various labour markets: with labour unions; work place regulations; minimum wages; subsidized benefits such as health care and retirement pensions and a progressive tax system that checked the growth of income inequality.

3. **One worker per household**. Under the Keynes-Beveridge model, each household should be able to have a standard of living within the accepted norms of a decent quality of life provided one of the household's adults participated full time in the labour force. Wage increases that reflected productivity gains allowed for rising standards of living, while also supporting non-market contributions to the economic and social life of the community and household.

In order to pursue such a model, both macro and micro policies must be used.

1. **Necessary Macroeconomic Policies included:** fiscal policies (the ability to raise and lower taxes and spending levels, including deficit spending, in order to regulate aggregate demand); monetary policy (ability to raise or lower interest rates to counter inflation and influence aggregate demand) and trade policy (use of trade barriers to protect home production and the use of trade surpluses to generate aggregate demand and use imports to fight inflation, and after 1971, the ability to manipulate one's currency to influence trade and inflation).

2. **Necessary Microeconomic Policies included**: price regulation;

> investment subsidies; minimum wages and other wage regulations; labour regulations (on all aspects of work and remuneration); intervention in capital, land and resource factor markets, and the use of taxes and subsidies to promote greater levels of income equality, and income supports for those who, for what ever reason, could not compete successfully in the market economy. (In many countries there were strict demarcations between those who had legitimate reasons for their lack of success in the market economy, such as age, illness, unemployment, and those who did not. This is the Elizabethan demarcation between the deserving and non-deserving poor).

It is only with these assumptions and complementary macro and micro economic policies that the Welfare State was able to insure that all or most of society was able to share in the economic progress of the post WWII era. Starting in the beginning of the 1970s however, these conditions started to falter, and the Welfare State economies started to come under increasing strain. The first and second oil shocks dramatically reduced the aggregate demand for the goods and services that these economies produced. The extra revenues that went to pay for the increasingly higher energy cost meant reductions in money being spent on domestically produced goods and services, which translates into higher unemployment rates. Furthermore, the higher energy costs lead to inflation. Thus you had the infamous *stagflation*, rising prices *and* unemployment levels. The rising unemployment levels prevented the use of Keynesian fiscal policies to fight inflation (tax increases), as aggregate demand was already insufficient. Thus a monetary policy of high interest rates was used to fight inflation. This had an even greater dampening effect on aggregate demand, and by the end of the 1970 and early 1980 many countries had double-digit levels of unemployment.

The flexibility and mobility that are the chief characteristics of the "New Economy" run counter to the structure of the Welfare State, which achieved its goal of income security by creating inflexibilities. The goal of economic security is a worthy one; in fact no society can call itself decent and civilized that doesn't provide a decent minimum level of economic security. If the advanced capitalist economies are to remain functioning democracies and are to pursue long-term prosperity and maintain their strong civil societies, then their main challenge will be to ensure that all share in the benefits of the "New Economy." To understand how this can be achieved, we must first look at what are the driving forces of the "New Economy": technological change; trade liberalization; increased capital mobility (capital/financial flows); and labor market flexibility.

Technology

Not a day seems to go by without a new technological marvel being heralded

in the press. No doubt the pace of technological change has been accelerating, much like it did for the first "great transformation." At such a quick pace, it is no wonder that most analysts have not looked at the potential long term economic implications of these advances. The changes in the technology of production have the potential to generate technological unemployment at an unprecedented scale (Rifkin 1995). Unless demand grows just as fast, this increasing productivity will lead to millions of workers without jobs in the paid labor force. The major source of unmet needs that can meet this demand for goods and services are the poor, both in the rich countries and in the Third World, but although they have unmet needs, they lack the money to meet these needs. New methods of distributing income will be needed so that these needs get met.

Trade Liberalisation

Trade liberalisation is a fact of the "New Economy." The only question is whether it will be limited to regional trade agreements or to a global system (as proposed with the WTO). One of the ways that countries have spread the benefits of economic progress down to workers and the poor has been by protecting these workers from foreign competition. Unions do this nationally, but in an international economy, this is achieved through trade policy. There are two basic forms of trade policy: tariffs and trade barriers; and currency policy. Tariffs and trade barriers provide protection for workers and businesses in that they reduce competition from low-cost foreign producers. Currency policy allows the government or central bank to reduce the cost of production domestically by lowering the exchange rate of the currency (this also makes foreign goods more expensive), promoting exports and reducing imports. These two important tools for raising the standards of living of domestic workers and ensuring that the benefits of economic progress are more widely shared have been partially or completely eliminated. A new set of institutions is needed to ensure that the benefits of the "New Economy" will be widely shared.

Capital Mobility

One of the most dramatic aspects of the "New Economy" is the increase in capital mobility, the ability of money to enter and exit economies, leading to rising investment levels, and often to speculation and economic crisis (Asian-crisis, Mexican Crisis, Latin American Crisis etc.). One of the effects of capital mobility is the fall in the share of income going to workers and the rise in the share going to capital. Another effect is the change in the rules of the economy. Due to the increased mobility of capital, real interest rates have increased, the result of higher levels of risk and uncertainty in the post Breton Woods world. This too contributes to more income inequality. More than any other development of the "New Economy," the increased capital mobility

has weakened the relative position of workers, thus promoting greater income inequality. Short of massive international capital controls, some other means needs to be devised for more equitably distributing the benefits of economic progress.

Labor Market Flexibility

As with the other factors mentioned above, a key method of spreading the benefits of economic progress down the economic ladder has been through the regulation of labor markets, either by the government or by unions. Many of these regulations only are successful to the extent that they create rigidities. These rigidities allow wages to rise, with the cost being shifted to another sector (either a fall in profits or in higher prices). Declining unionization rates and falling government support for worker protections have lead to greater labor market flexibility, but at the cost of reducing the ability to distribute the benefits of economic progress more widely, thus furthering the case for the need for new institutions to achieve this.

New Opportunities: The Basic Income Solution

Guy Standing (in Lerner, Clark and Needham, 1999, p. 106) has noted:

> Every era of capitalist triumphalism creates the basis for renewed social struggle to ameliorate inequalities, a struggle to limit the new mechanisms of inequality. Every technological revolution has been accompanied by ruling elites calling for more flexibility (or whatever the word at the time) from workers and for more "discipline" over them. In such times, momentarily, the forward march of social progress seems to be halted, even reversed. Then, once a vision of an alternative, viable system of distributive justice has crystallised, the state has moved in that direction, to re-embed the economy in society. Then–perhaps– in directions that were not previously foreseen– the forward march resumes.

The inability of the old institutions to deal with the problem of promoting economic equity in the context of the "New Economy" requires us to come up with some new ideas. The failure of "Welfare Reform" to help the poor and marginalized shows that going backwards will not work either. What is needed is a new way of looking at the role of work in our economy and society. Following John Paul II (1991), we must take a broader view of work, one that includes all forms of social participation and contributions. As fewer full-time paid employment opportunities will be available, we cannot rely on such employment as the only rewarded way in which someone can contribute to the economic and social well-being of the community. Furthermore, we

must recognize that paid employment and the market will not provide a decent minimum income for all. We must devise systems of support that provide a decent level of income and which do not create barriers to further development. We must help the poor, not regulate them.

One policy that is being debated in many European economies that would promote both greater equity and economic efficiency is the provision of a Basic Income to all citizens as a right of citizenship.[3] Such an income would be tax-free and would not go down when one's income increases, thus avoiding poverty and unemployment traps (creating inefficiencies). It also supports all the necessary and valuable activities in the social economy, activities upon which the social health of our society depends but which currently go unrecognized and unsupported.

In the previous section we have noted that the "New Economy" requires flexibilities that weaken the ability of the Welfare State to promote economic equity. The Welfare State approach of regulating the poor creates many barriers to escaping poverty (poverty traps) and other disincentives, as well as taxing the fiscal and economic health of the overall economy, while the "workfare" approach of reducing benefits and tightening eligibility has at best lead to higher levels of hidden poverty and shifting the responsibility of providing necessary assistance for the poor to private charities and churches which do not have the resources to adequately deal with this problem. The only option being proposed to these admittedly inadequate systems is the Basic Income proposal, which provides, through its universality and security, an effective social safety net and also promotes an efficient and flexible economy. Thus the choice seems to be between income security or economic flexibility or (with a Basic Income System) both income security and economic flexibility. The first two options do not offer attractive alternatives, for they frequently, in essence, pit the social classes against each other, with income security benefiting those at the lower end of the economic ladder, while a reduced welfare state (workfare) benefits those who are already well off (in terms of reduced tax rates). With its ability to offer both income security and labor market flexibility, Basic Income gets beyond this trade-off, providing a means in which all Americans will be able to benefit from the economic progress being created by this new economy.

Basic Income is a generic term that fits many different types of proposals (or at least is applied to many proposals). The main differences are twofold: 1) different levels of benefits, from a full Basic Income, with benefit levels set at the official poverty level, to a partial Basic Income set at a lower level; and 2) how the Basic Income system will be funded. Most Basic Income proposals include a flat income tax as their sole, or primary, source of funding. Such a funding mechanism is not an essential aspect of Basic Income. Alaska has a Basic Income system with their Permanent Fund, which is funded from the revenues generated by their oil and gas reserves. A flat income tax is often used because it is the easiest source of tax revenues for the person developing a Basic Income proposal to estimate and model. As

these proposals have been, for the most part, developed by individuals and groups with very limited resources, this is their only option. Were a system to be developed by either a government agency or a well-endowed research institute alternative modes of taxation could easily be developed, and the tax on income could be dramatically reduced.

For the purpose of furthering the discussion on Basic Income I am presenting a rudimentary Basic Income system for the United States as if it were instituted in 1999. The system is designed to replace the entire social welfare and income assistance system in the United States with the exception of Social Security (a good case can be made for including Social Security in the system, but that was not done here.) In this section we will present this proposal, along with some analysis of its effects on income distribution. We present this Basic Income System for America not as an actual proposal, but as a hypothetical proposal that allows the issues raised by a Basic Income proposal to be discussed. Much further work, requiring resources beyond those at our disposable, would be required to develop a complete American Basic Income proposal.

Hypothetical American Basic Income System

The following Basic Income proposal is based on 1999 figures, with the population levels, income distribution and payment rates as they were in 1999. The proposed Basic Income system is a full Basic Income system, meaning that the levels of payment are set so that everyone is brought above the poverty line (for 1999). The Basic Income system would have payment levels at:

Table 2
Basic Income Payments, 1999

Age	**Payment**
Under 18	$3,500
Adult	$8,667
Over 65	$7,990

This will have the following costs:

Table 3
Costs of Basic Income System, 1999

Age	**Payment**	**Population (Millions)**	**Costs ($ Millions)**

Under 18	$3,500	70.2	245,697
Adult	$8,667	167.95	1,455,640
Over 65	$7,990	34.54	275,975
Total			1,977,311

The total costs of our Basic Income proposal would be just under 2 trillion dollars. Add to this the cost of the other functions of the Federal Government, which in 1999 totaled $1,465,333 ($1,703,040 million minus $237,707 million, income security funds to be cut under a basic income proposal). Thus the total costs of the Federal Government would be $3,442,644 million.

Funding for the Basic Income system, as well as for the Federal Government in general, would be through a flat tax on all incomes at a rate of 35.8%. Federal government expenditures on income security would be cut, with the exceptions of pensions and social security. The flat income tax would replace the current income tax system. All other taxes collected by the Federal Government would remain. There would be no income tax deductions. State and local tax and benefits systems in our example are left untouched, although obviously they would change dramatically (i.e., be reduced or eliminated, leading to reductions in local and state taxes). All funding for health, veteran's programs, education, and housing remain.

Table 4
Federal Government Revenues
(Millions)

Flat Tax	$2,576,970
Corporate Taxes	$184,680
Social Insurance	$611,833
Excise Taxes	$70,414
Total	$3,443,897

Thus, under this proposal the total expenditures of the Federal Government would be $3,442.6 billion, while the total revenue would be $3,443.9 billion, leaving a small surplus of $1.3 billion.

Distributional Impact

Using the 1999 consumer expenditure survey data, I have simulated how such a policy would effect the distribution of income in the United States. Table 5

presents the results of this simulation.

Table 5
Income Distribution Effects of Basic Income System

Income Quintile	Without BI (1999)	With Basic Income (1999)
Bottom	3.5	8.22
2nd	8.65	12.22
3rd	14.86	16.96
4th	23.93	23.39
Top	49.06	39.2

Source: Author's calculations. Totals may not equal 100% due to rounding.

In Table 6 we see the average household income for each household quintile, and their gain or loss due to the Basic Income system.

Table 6
Average Household Income by Quintile, 1999
Without and With BI

Income Quintile	Without BI	With BI	Difference
Bottom	$7,101	$16,714	$9,613
2nd	$17,576	$24,826	$7,250
3rd	$30,186	$34,448	$4,262
4th	$48,607	$47,515	$-1,092
Top	$99,656	$79,622	$-20,034

Source: Author's calculations.

Introducing a Basic Income system in the United States like the one proposed would have the dual effect of lifting everyone above the "official" poverty level, and dramatically reducing the level of income inequality. We will not turn to the arguments for and against such a policy.

ARGUMENTS FOR AND AGAINST BASIC INCOME

One of the most interesting aspects of the Basic Income discussion is the wide ideological range of its supporters (and its critics).[4] The idea of something like a Basic Income system was first fully developed by Thomas Paine in the late 18th Century. Recent supports include liberal economists John Kenneth Galbraith and James Tobin and conservative economists James Meade and Herbert Simon. Both Richard Nixon and George McGovern discussed proposals that were, in some regards, similar to a Basic Income. Such a diverse list of supports causes some confusion in that many of the arguments for a Basic Income contradict other supporting arguments (usually based on what the person feels is wrong with the existing system.)

Views from Conservatives

The conservative case for a basic income centers on two economic prepositions: 1) unemployment is caused by imperfections in the labor market; and 2) standard policies (Keynesian) designed to reduce poverty and promote full employment instead cause inflation. The best example of the first proposition is James Meade's work (especially Meade, 1989). His argument is as follows. Under the current system, wages are downwardly rigid during recessions. This downward rigidity prevents the labor market from reaching the market-clearing price, thus causing mass unemployment. The sources of this rigidity are the rational choices of those who retain their jobs during the economic downturn and the lack of any mechanism for those without jobs to influence the labor market. By partially separating income from work, the incentive of workers to fight against wage reductions is considerably reduced, thus making labor markets more flexible. This allows wages, and hence labor costs, to adjust more readily to changing economic conditions. It is thus argued that this increased efficiency in the labor market, particularly the responsiveness of wages to conditions of excess labor supply, would lead to full employment and greater economic growth.

The second reason conservatives support Basic Income policies stems from Milton Friedman's advocacy of a negative income tax. Friedman proposed a negative income tax as an alternative to Keynesian Demand management policies, which he felt were inflationary, and created large government bureaucracies. Negative income taxes (and a Basic Income) would give the money directly to the poor without causing inflation or big government.[5]

Some conservatives argue against Basic Income proposals on two grounds. First, it is argued that such policies require high tax rates to fund them and conservatives are almost always against high taxes. Second, they feel that giving a non-means tested payment will damage the incentive to

work. These incentives are also lessened by the high tax rates just mentioned. Thus they feel that these types of policies will lessen the labor supply and reduce economic growth and efficiency.

Both the conservative case for and against Basic Income policies came up short when evaluated from the perspective of what we know about labor markets and incentives. The case for requires unemployment to be caused solely by market imperfections, yet the primary cause of unemployment is inadequate aggregate demand. Improving wage flexibilities will do little to improve this inherent problem of advanced capitalist economies; in fact it might make it worse (unless there is a basic income system in place, then it will not necessarily make things worse). The case against basic income rests on the notion that high taxes or benefits will reduce the labor supply, but the preponderance of the evidence shows that such factors are not important for the labor supply of adult males and single females. It is only married women whose labor supply is greatly influenced by tax and benefit levels. Thus the impact on economic growth and efficiency will not be great.

Views from Liberals

The liberal case for a Basic Income policy stems from the fact that it allows those in poverty more opportunities to raise themselves out of poverty, in large part because of the elimination of the poverty and employment traps. Furthermore, liberals see the universality of Basic Income systems as a means of preventing individuals from falling through the social safety net, as well as taking away the stigma of being poor and on public assistance. Some liberal economists feel that a Basic Income system will strengthen the position of workers in their bargaining with employers. They also note that a Basic Income, paid to each individual, greatly empowers women and promotes communitarian values, citizenship and equality.

The liberal argument against Basic Income policies is a reaction to the labor market flexibility argument put forward by conservatives. Some liberal economists have argued that a Basic Income system will lead to wage substitution and weaken societies commitment to promoting full employment in the traditional Keynesian sense. Yet for this to happen you would have to repeal the minimum wage laws and eliminate unions and labor legislation.

The great Insititutionalist economist, C.E. Ayres wrote that the institution of a universal guaranteed income “would ... restore the reality of free private enterprise” (Ayres 1965, p. 161). His argument is based partly on the positive aggregate demand effects such a system would have and partly on the great liberating effect economic security has on individuals. All societies attempt to provide some form of economic security. This is due to the simple fact that as individuals we are poor and that we only achieve affluence through the cooperation of others, i.e. life in society. On the level of societies, this economic security allows for experimentation and knowledge creation.

Communities that are living hand to mouth do not have the time or the resources to break from their poverty through technological or institutional change. The risk of failure is too great (starvation) for them to undertake such a gamble. The same is true for poor individuals in an affluent society. Economic security provides the support for experimentation and risk taking, what would be called in business circles as entrepreneurship, allowing the poor to find their way out of poverty.

CONCLUSION

The dual problems of persistent poverty and rising income inequalities are a real threat to the health and well being of the United States. Under the hey day of the Welfare State the government was able to affect the "rules of the game" for distributing income by creating inflexibilities that shifted power down the economic ladder and thus allowing them to demand a larger share of the economic pie. Globalization and the "New Economy" are increasingly making it difficult or impossible for governments to achieve these same results without significant costs to the competitiveness of the economy. New policies are needed to promote economic equity in a way that does not create these inflexibilities. A Basic Income system allows for the promotion of greater economic equity (in our proposal it reduces the official poverty rate in the United States to zero) while also getting the government out of the business of regulating the poor and creating stigmas and barriers to getting out of poverty. Furthermore, a Basic Income system helps to support atypical forms of employment, as well as those who contribute to society in the social economy and not through paid employment. Lastly, a Basic Income system is a recognition of the fact that wealth and income are socially created, with our technological and intellectual heritage being the most important factor of production. All of us are inheritors of these gifts from our forbearers, yet currently most of the benefits of this inheritance do not reach all of our citizens. A Basic Income system ensures that all share in the benefits of economic progress, while maintaining the flexibilities that ensure future economic progress.

References:

Ayres, Clarence E., "Guaranteed Income: An Institutionalist View." In *The Guaranteed Income: Next Step in Economic Evolution?* Edited by R. Theobald, Garden City, New York: Doubleday & Company, 1966.

Blank, Rebecca M. "Why were Poverty Rates so High in the 1980s?" in Poverty and Prosperity in the USA in the Late Twentieth Century, edited by Dimitri B. Papadimitriou and Edward N. Wolff. New York: St. Martin's Press, 1993.

Clark, Charles M. A., "Inequality in the 1980's: An Institutionalist Perspective." In *Inequality: Radical Institutionalist Perspective on Race, Gender, Class and Nation,* William Dugger, ed.,

Westport, CT.: Greenwood Press,1996.

Clark, Charles M. A. "Does a Rising Tide Lift All Boats? How Poverty has Become Immune to Economic Growth" *Vincentian Chair of Social Justice*, 1999, Vol. 5, pp. 43-53.

Clark, Charles M. A, *Basic Income Guarantee: Promoting Equity and Efficiency in the Irish Economy* . Dublin: Liffey Press, forthcoming.

Clark, Charles M. A and Kavanagh, Catherine, 1996, "Basic Income, Inequality, and Unemployment: Rethinking the Linkages Between Work and Welfare. *Journal of Economic Issues*, June, 1996; 30:399-406.

John Paul II, *Laborum Exercens*, Vatican, 1991.

Lerner, Sally, Clark, Charles M. A. and Needham, Robert, *Basic Income: Economic Security for All Canadians*. Toronto: Between the Lines, 1999.

Meade, James E., *Agathotopia: The Economics of Partnership*. Aberdeen: Aberdeen University Press, 1989.

Mishel, Lawrence, Bernstein, Jared and Schmitt, John, *The State of Working America, 1998-99*. Ithaca: Cornell University Press, 1999.

Okun, Arthur, *Equality and Efficiency: The Big Trade-Off*, Washington: Brookings Institute, 1975.

Polanyi, Karl, The Great Transformation, Boston: Beacon Press, 1944.

Rifkin, Jeremy, *The End of Work.* New York: G.P. Putnam's Sons, 1995.

Standing, Guy. *Global Labour Flexibility* (London: Macmillan Press Ltd., 1999.

Widerquist, Karl. Perspectives on the Guaranteed Income, Part I. *Journal of Economic* Issues September 2001a; 35:749-757.

Widerquist, Karl. Perspectives on the Guaranteed Income, Part II. *Journal of Economic Issues* December 2001b; 35:

Endnotes:

[1] See Clark 1996 for an Institutionalist approach to explaining income inequality.

[2] This section is based on Clark 1999.

[3] For an excellent overview of recent Basic Income proposals see Widerquirst 2001a and 2001b. Also see http://www.usbig.net/ for more information on Basic Income.

[4] This section is based on Clark and Kavanagh 1996.

[5] There are many significant differences between Friedman's negative income tax and the Basic

Income outline here. The two most glaring of these are 1) the level of payment (at the official poverty line) is much higher than Friedman argued for, and 2) all Basic Income payments in this proposal are tax free and thus free of poverty traps. Friedman's proposal had a high withdrawal rate, thus high poverty traps.