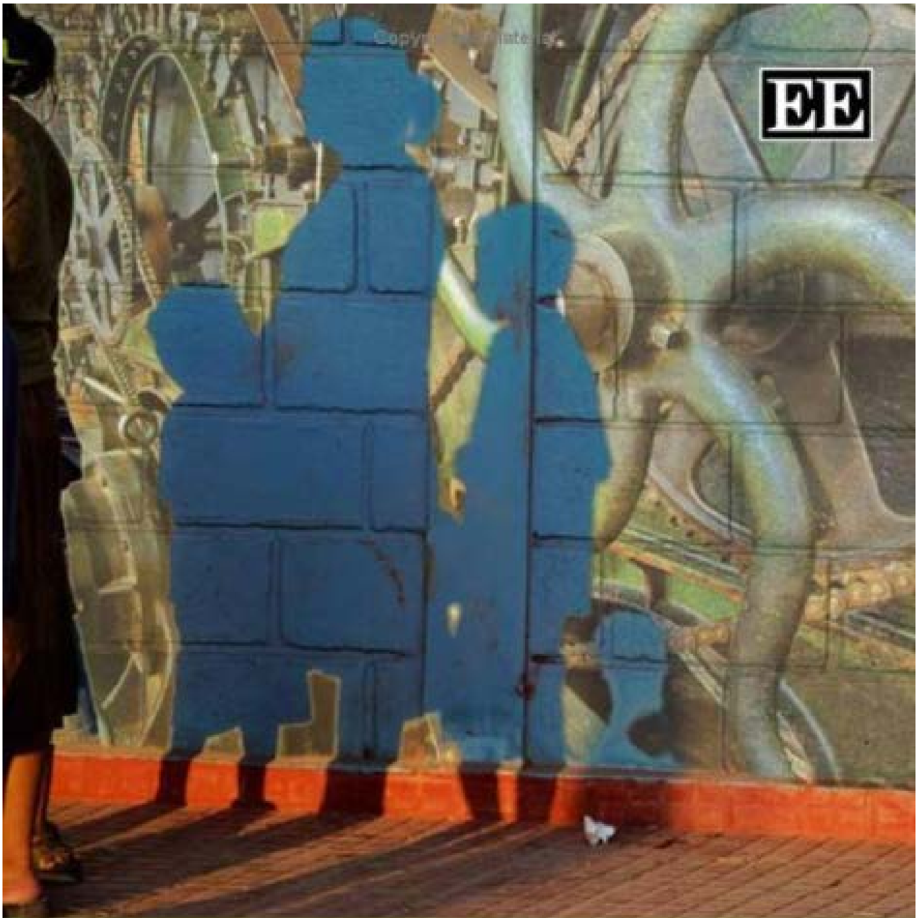

The Living Wage: Lessons from the History of Economic Thought

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Contents

Preface

In Fall 2006 a small group of students at St Mary's College of Maryland where I teach took over the office of the college's president and refused to leave until the college's administration agreed to consider giving its lowest paid workers a living wage. After several days of negotiating the administration gave in to the demands of the students and the college held a series of community forums to discuss the issue of the living wage. Having written several books and articles on what economists thought should be done to help workers get better wages (Stabile, 1984, 1993, 1996, 1997, 2000) my sympathies should have been with the students and their efforts. Instead, I found myself to be of two minds, that is, wanting to see the workers gain a better life but objecting to the approach being used to get it for them.

On reflection I recognized that my objections had three sources. First, the students supporting the living wage insisted that a living wage should be given to workers because of 'social justice'. In their discussion at the community forums the college held they did not offer a definition of what they meant by 'social justice' and since those forums were poorly attended it was hard to determine whether all students believed in 'social justice' however defined. The definition of 'social justice' was crucial because, my second objection, the approach the protesting students were using to get a hearing was coercive and I wondered what theory of 'social justice' could be consistent with coercion. One could argue, I suppose, with apologies to Barry Goldwater, that coercion in defence of 'social justice' is no vice. But I remained unconvinced. The third cause for my objection was that the workers at the college were organized into and represented by a union. Having always held a favourable view towards unions, I wondered why the union had not negotiated a wage scale that included a living wage for the lowest paid workers and a suitable structure of pay for all other workers based on seniority and skill level. Why were students interfering in matters that were more appropriately a part of collective bargaining?

This book is a result of my reflections on these objections and why I felt in two minds about the living wage and the movement around it. In it I have documented what leading economists said both for and against the idea of a living wage for workers as a way to move the debate over the living wage away from a debate over the definition of 'social justice' towards a consideration of the economic issues involved in that debate. In writing it I have tried to present fairly both sides in the debate because there are lessons to be learned from both sides of the debate. The concept of a living wage is more complicated than its advocates represent it to be, and if nothing else this book reflects those complications. Economists have been thinking about work and wages for a long time, including the idea of a community-based subsistence wage, and there are lessons to be learned from them.

In drawing out those lessons I want to avoid any suggestions that we should follow those lessons in the spirit of asking, 'What would Jesus do?' The economists whose ideas form the basis for this book were intellectually oriented men who wrote in the context of their time. While the concern of many of them for a community-based subsistence wage transcends that context, the ways they thought that wage would be achieved reflect what was feasible in their day. Several weeks after our campus's flurry of activity over the living wage, I gave a talk to our Economics Club on Adam Smith and the Living Wage. It was well attended for that sort of talk. One student asked me whether Smith would have supported the efforts of community organizations to secure a living wage for low-wage workers. I confessed that I did not know nor did I know whether Smith would have supported labour unions. I did know that he wanted a better life for workers because he was in favour of the sustainability of the workforce. Because sustainability has become such a powerful slogan among students they readily understood what I meant. The terms I use to categorize the arguments of the debate this book details – sustainability, capability and externality – developed out of that talk to the Economics Club at St Mary's College of Maryland.

Thus when it comes to giving thanks to the persons who helped in the production of this book my first gratitude is to two sets of students. The students who took over the president's office motivated me to think about the living wage in a new way and to do what I always do, ask what the history of economic thought had to tell us about the issue. The students who attended my talk asked questions that led me to explain Adam Smith's subsistence wage in terms of sustainability, capability and externality and thereby helped me to organize the debates over low wages in the history of economic thought. In addition Andy Kozak an old friend and colleague at St Mary's College of Maryland read the manuscript and offered his usual encouragement and enthusiasm for the project. Jerry Friedman, a new friend at the University of Massachusetts/Amherst where I have many old friends, also read the manuscript and helped me tremendously with textual criticisms as well as with an improved organization of the chapters. Finally, I thank the staff at Edward Elgar Publishing – especially Tara Gorvine, Bob Pickens and Alan Sturmer – for their congenial support in the publication of this and previous books. The task of transforming a manuscript into a book is much easier when it is done graciously and effectively.

1. Introduction: the living wage

INTRODUCTION

For the past decade a social movement with a goal of providing workers with a living wage has been growing in the US. Comprised of labour unions, religious groups and community organizations, the movement has focused on helping low-wage workers in local areas get higher wages through the use of political action and moral persuasion (Pollin and Luce, 2000: 1; Freeman, 2005: 14–15). The movement has made small gains in attaining its goal of a living wage, with success in about 100 municipal governments by 2003 and victories at some major universities (Luce, 2004: 33–5). In 2007, the state of Maryland implemented a living wage law that required contractors doing business with it to pay their workers a living wage of $11.30 an hour in high-cost areas and $8.50 an hour in rural areas.

Advocates for a living wage typically support it by arguing that it is necessary for 'economic justice' and a 'fair economy' (Pollin and Luce, 2000: title page and 1). This appeal for justness and fairness has long been a standard argument in favour of the living wage. The living wage movement began in the US in the 1870s and in 1906 one of its early advocates, Monsignor John Augustine Ryan, published an influential book, *A Living Wage: Its Ethical and Economic Aspects*. Ryan set forth his thesis as, 'The laborer's claim to a living wage is of the nature of a *right*' (Ryan, 1920: 3). He did not rely on economic arguments, feeling that moral value took precedence over economic value (Ryan, 1920: 68). More recently, Jerold L. Waltman has presented an expanded update of Ryan's work, *The Case for the Living Wage*, which he dedicates to Ryan. Waltman focuses on the political aspects of the living wage and justifies it on moral grounds rooted in religion (Waltman, 2004: 29–53).

ECONOMISTS AND THE LIVING WAGE

The typical economist today, however, would argue that justice, fairness, rights and dignity are not economic concepts and the movement for a living wage begs important questions of what and why. What is a living wage and why should we provide workers with one? In a free market economy, such an economist would say, wages represent a market estimation of what a worker adds to the production of goods and services that society wants. Under this value-added approach, workers paid low wages have low productivity. Paying them a living wage greater than their value-added involves a transfer of income from someone to low-paid workers. Who that someone should be and what implications the transfer of income will have on economic performance are issues that the typical economist would want answered before joining the movement for a living wage. Until those issues are resolved to their satisfaction, most economists today are not going to be members of the living wage movement.

In addition, these economists would argue, the market system rests on a structure of incentive. People in an economy should decide for themselves what productive activities to pursue to earn the best living possible. The quest for income draws those people into the most lucrative activity available to them in terms of the value they add to the economy. That income will enable them to purchase a range of goods and services from others in the economy. The standard of living itself then becomes an incentive for productive activity. A living wage would tamper with this incentive structure and upset the efficiency of a value-added economy. Given the importance economists place on efficiency, they would not support a living wage that undermines the incentive structure.

This lack of support for a living wage from economists, however, is a recent occurrence. We can see the how recent this opposition is through a glimpse at the history of the movement for a living wage. The movement began in the US in the 1870s and followed one that started a bit earlier in the UK (Pollin and Luce, 2000: 27). We can find evidence of its existence in the UK when, in 1894, *The Economic Journal* reported on 'A remarkable series of articles on "A Living Wage". . . in the *Leeds Mercury*' (*Economic Journal*, 1894: 365). By 1912, Philip Snowden, a Member of Parliament who would later become Chancellor of the Exchequer in the first Labour Party Government, had published a book, *The Living* Wage, an account of legislative efforts in the UK to secure a decent standard of living for workers. In Snowden's book as well as in Ryan's *A Living Wage*, the authors grappled with all the issues present-day advocates for a living wage face, such as how to define a living wage and what justification can be found to support it.

More important from the perspective of this book, a surprising part of this early living wage movement is that its members counted economists as supporters of the living wage. Ryan used the writings of John Stuart Mill and Alfred Marshall in support of his definition of a living wage (Ryan, 1920: 95–6). Similarly, in a chapter in his book titled 'The economy of high wages,' Snowden offered the following statement, 'From Adam Smith downwards economists have pointed out that higher wages made labour more efficient, and led to an increased output of work; larger in quantity and better in quality' (Snowden, 1912: 145). And in a book titled *The Living Wage and the Law of Supply and Demand*, published in 1895, Robert Blanchard pointed out that when opponents of a living wage said it was against a law of economics, they should be asked, 'In what book on political economy can that law be found?' Those opponents, he went on, 'will be unable to tell you' (quoted in Pollin and Luce, 2000: xxi). In his more recent book on the living wage, Waltman quotes Adam Smith several times as part of his case for a living wage (Waltman, 2004: 20 and 89).

This book is about the economists from Adam Smith downwards and what views they held regarding the living wage. Its objective is to make an important point. While the current movement for a living wage has gained a great deal of attention, economic thinkers have been concerned with the issue of a living wage for a long time, for as long as economics has been a topic of interest to social thinkers. We will see that even if we date the beginning of economics with the ideas of Adam Smith, earlier thinkers such as Plato, Aristotle and St Thomas Aquinas pondered the what, why and how of a living wage. Following Adam Smith, great thinkers in the history of economic thought continuously considered the negative consequences to society of paying workers low wages. The lack of concern for a living wage that can be found among economists today is a recent episode in the history of economic thought that started in the early twentieth century. This book will highlight how the ideas of the early economists contrast with the ideas of more recent economists, with the expectation that the lessons we can learn from the contrasting ideas of both the early and recent economists will help us to think more clearly about the issues surrounding whether workers should be paid a living wage. Its premise is that the great thinkers in the history of economic thought are still worth reading for the lessons we can gain from their keen general knowledge about the relationship between markets and the society that surrounds them.

In calling forth these lessons my intention is not to resolve the economic issues surrounding the current movement for a living wage. Robert Pollin and Stephanie Luce have covered this ground very well (Pollin and Luce, 2000), as has Waltman (Waltman, 2004: 127–47). Rather, I will review the ideas of many economic thinkers from Adam Smith downwards and focus on what lessons we can still learn from them. In anticipation of those lessons, in this introduction I will highlight three distinct arguments in favour of a living wage that the early economists developed in support of according workers a decent standard of living. Using the terminology of modern economics, I will contend in this book that the economists from Adam Smith downwards to the twentieth century supported the idea of a living wage based on the sustainability and capability of the labour force and the externality effect of not ensuring that sustainability and capability.

SUSTAINABILITY

The key approach to sustainability in modern economics dates from the publication of Garret Hardin's classic article, 'The tragedy of the commons' (Hardin, 1968). The tragedy of the commons takes into account the problem that arises when no one has an incentive to take care of common property. For example, to encourage students to reduce their driving on campus, my college once experimented with a 'free bike' system; bicycles were made available at various spots on campus and students could take one, ride to class, and leave it for another student to use. Within a week, all of the bikes were broken or gone. A more telling example is fishing in the ocean. Since no one owns the ocean or the fish in it making them 'free,' commercial fisherman may catch as many fish as they can as fast as they can, leading to over fishing and a depletion of the 'free' resource. The term used to describe the opposite of such depletion is sustainability, that is, how to ensure that the supply of a renewable resource is sustained.

At first glance it is hard to see how this approach could apply to labour. After all labour is not a free good and workers 'own' their labour. Fish in the ocean may not be able to negotiate a catch level that sustains their population, but workers can negotiate a wage that keeps them alive. At least so many economists would have us believe. In the course of this book we will find a number of economic thinkers who did not share this belief. Instead they found it more reasonable to argue that the bargaining power between business and labour was heavily in favour of business. As a result workers might not get the wage a free market should have given them and they might have to work long hours to earn it. This result would add to the number of low-wage workers who did not earn a living wage. Without a living wage these workers might not be able to sustain themselves or their families and there might be a depletion of this resource. To the extent that working long hours to earn a wage diminished the strength and longevity of workers it also hindered the sustainability of the resource.

The usual solution to the tragedy of the commons is to establish private ownership of the resource, giving an owner the incentive to charge a high enough price for using the resource and thus giving users of the resource a further incentive to limit their use. The problem with applying this approach to labour is that we cannot give private ownership of it to anyone. To see this point let us consider slavery. Slave owners have every incentive to take care of their property to ensure that it is sustained. If a business offered to hire the slave owners labour force at a rate that would not enable the owners to feed and sustain their slaves, they would be less likely to do so unless they were in a vulnerable condition. Of more importance, they would be negotiating for the entire labour force and in a good condition to know its value. While this may be a case in favour of slavery it is not a persuasive one. For example, slave owners in the South of the US often argued that they treated their slaves better than the manufacturers of the North treated their 'wage slaves'. Whether or not their argument was true, it was not accepted as valid.

Regardless of whether this argument had any merit, in the modern economy we rely on labour markets to set wages. Individual workers in a labour market may be in a better bargaining position than fish in the sea, but we will find economists in this book who did not see their position as strong enough to enable individual workers to secure the wage the market entitled them to. In that case, several of them suggested unions as a way to help workers attain a living wage as being the closest workers could come to privatizing their resource.

CAPABILITY

There is a second difference between humans and fish. The primary use of a fish is to supply humans with nutrients when we eat them. The capability of a fish to accomplish this objective is largely set by nature, although that capability might be improved by breeding on fish farms. Society has a number of objectives in mind for its human workers. It wants them to be effective workers and effective members of society. In the language of modern economics, this requires that workers develop their human capital and their social capital if they are to participate in life in a meaningful way. In terms of a living wage, this capability approach means workers should be given something more than sufficient nutrition to survive. Sustainability is not an adequate objective for labour in the modern industrialized world. The primary proponent of the capability approach among present-day economists, Amartya Sen, describes it as follows:

> The need to take part in the life of a community may induce demand for modern equipment (televisions, videocassette recorders, automobiles and so on) in a country where such facilities are more or less universal (unlike what would be needed in less affluent countries), and this will impose a strain on the relatively poor person in a rich country even when that person is at a much higher level of income compared with people in less opulent countries. Indeed, the paradoxical phenomenon of hunger in rich countries – even the United States – has something to do with the competing demands of these expenses. (Sen, 1999: 89–90)

Sen's argument implies that a living wage has a capability element to it and we will see that economists in this book found this element to be of importance.

The capability approach means that in looking at wages we also need to take into account whether those wages enable workers to improve their abilities as workers and members of society and to enhance those abilities in their children. At a basic level it includes such capabilities as reading and writing, good health, the right to vote along with the ability to vote wisely, and a capacity for happiness. In the world of the advanced economies, it may include computer literacy and access to the internet, high-priced running shoes for exercise and organic tomatoes for safe nutrition. The capability approach also carries with it the idea that working conditions matter; workers who earn a decent wage under conditions that diminish their capability as workers or as meaningful members of society may not have a living wage. Moreover, it means that the living wage is not a set amount defined by the need to purchase a fixed bundle of goods and services, and this is an idea the economists in this book addressed as well.

In addition, the economists covered in this book had an interest in the impact wages had on the pure economic capability of workers to produce goods and services. Over the last three decades economists have set forth an efficient wage theory which makes a case for the idea that wages have a positive correlation with worker productivity. This theory implies that higher wages will pay for themselves through higher productivity. The higher productivity results from a variety of factors related to higher pay, such as better motivation from workers due to a feeling that they have been treated fairly (Akerloff and Yellin, 1988: 44–9). We will see that this concept has a lineage in the history of economic thought and many of the writers surveyed in this book made it a key element in their discussions of the capability approach.

EXTERNALITY

An externality is a situation where a person or a business in the pursuit of their individual self-interest creates a side effect that harms or helps someone else. In strictly economic activities, a typical externality would be when a firm produces a product to sell to consumers and in the process imposes a cost or benefit on a person who is not interested in buying the product. The usual example of a negative externality is pollution, where a firm producing tennis balls lets green dye enter into a river making it impossible for persons downstream to swim and thus imposing a cost on them. As long as these costs are not included in the price of tennis balls, the price of the tennis balls will not reflect the total resources (cost) of producing tennis balls and will be inefficient.

The idea of externality is not usually applied to work and wages, but we will see that many of the economic thinkers in this book did so in spirit if not in name. Today's free market economists typically think of the wage bargain as being a voluntary exchange that is of mutual benefit to both parties or else it would not take place. In addition, they would think of the wage bargain as being what is called a 'pecuniary externality' (Friedman, 2000: 28). In a labour market, if a worker accepts a job at a lower wage, that person puts pressure on other workers who want the job to reduce their wage demands as well. There is a sense then in which the worker taking the job at a lower wage imposes a cost on other workers. The person hiring the worker has gained from the lower wage, however, so the net costs to society would be zero. A real externality must impose negative costs on society. For this reason, today's economists would be sceptical of finding an externality resulting from low wages.

Thinkers featured in this book, however, found cases where low wages below some standard (they often used the term subsistence wage) imposed costs on others, ranging from the worker's family to society at large. Those cases usually involved consideration of how reduced levels of labour force sustainability or capability due to low wages imposed a cost on society. While those cases will be described in detail in the book, a modern example will show what they meant. Low-wage workers in the US today frequently have no medical insurance, an important feature of a living wage. When they become ill and remain untreated, they suffer directly from the difficulty of the illness, which may reduce their capability; to the extent their lack of medical care prolongs an illness it may spread to others imposing a cost on them. If instead they find treatment in the healthcare system but do not pay for it, someone else must pick up the tab. This is a real cost to society which arguably qualifies as an externality. If low wages lead to workers being malnourished, which adds to their incidence of illness, that too imposes costs on others that can be construed as an externality. From this perspective, one could argue as economists do in cases of an externality that firms that do not pay a living wage are not paying the full cost of the resource they are using. As a result, their incentives are skewed and they produce too much of their product due to their lower costs. This means that resources are being used inefficiently.

Modern economic thinkers have discovered an array of approaches for handling the problem of a negative externality. The basic idea is to give businesses incentives to internalize the externality by making them part of their cost structure. Once the full costs of all the resources used in production become part of a business' operations the business will attain economic efficiency. Policies to achieve this internalization include voluntarism where firms recognize the damage they are doing and take care of it themselves, regulation from some government agency that tells businesses what to do, use of taxation to give business the incentive to avoid the tax by taking care of the externality, allowing the persons damaged by the externality to sue the business, following the Coase theorem by having both parties negotiate the allocation of the cost of the externality, and doing nothing in hopes that the market will find a way to solve the problem. These policies have different consequences for economic production, however, and choosing the most efficacious one is important.

The economists surveyed in this book advocated for all of these policies to address the needs of low-wage workers. To be sure, they recognized that wages were a function of workers' skills, the state of technology, the amount of capital, and market conditions of supply and demand and understood that tampering with labour market outcomes had the potential to harm the economy. But they also realized cases where interfering in the market to take care of externalities from work and wages was needed. In the process of analysing those cases they developed early versions of the policies outlined above.

In developing those policies, I will also argue, these economists were partly motivated by an ideal of a moral economy. As will be described in Chapter 2, thinkers such as Plato, Aristotle and Aquinas had argued for a moral economy where decisions were made under a spirit of virtue and mutual assistance. A segment of the economists in this book recognized the value of this moral economy but with the exception of Karl Marx did not believe that it was realizable. Their use of the concepts of sustainability, capability and externality represented their effort to attain the benefits of the moral economy's mutual assistance while harnessing the productive potential of the free market and self-interest. In terms of labour market, they saw that from a social perspective workers had a harder time organizing than did employers, which placed them at a severe disadvantage in negotiations over wages.

In opposition to this moral economy, market economists are motivated by a different ideal, the market economy as represented by the model of perfect competition. To them, this model does a better job of capturing the essential workings of the modern economy than does any version of a moral economy. It is also, they would argue, a more scientific method for investigating economic behaviour. Versions of the moral economy must always reflect the personal preferences of the person writing about them, while an economic model can be investigated and criticized on logical, scientific grounds. Any notion of a living wage must be consistent with the economic model of competition and justified on a scientific basis. We will see that this is a tall order.

OVERVIEW OF THE BOOK

Do efforts to improve the standard of living for workers through a living wage result in an improved workforce and a more efficient economy? And if they do, how high should that living wage be? These questions have been a concern of many of the great thinkers in the history of economic thought. This book is a study of how they answered it. Its goal is to bring together the views of these individual thinkers to recount an exchange of ideas regarding the living wage that took place for over two centuries. It will concentrate on a few thinkers, but all of them were influential.

Following this introductory Chapter 1, Chapter 2 will look at the development of the sustainability argument. It will start by describing how Adam Smith built on the ideas of Greek philosophers and Christian moralists to argue that workers should be paid a subsistence wage as equated to a living wage and that the free market could be counted on to produce this outcome in most cases. It will then examine how successive economists built on his ideas and pay special attention to the theory of the role of unions in securing fair wages as elaborated by John Stuart Mill, Alfred Marshall and John Bates Clark, among others. It will then discuss how in the twentieth century market economists eliminated the subsistence wage and the positive features of unions from their thinking. In Chapter 3, the capability approach will be highlighted, starting with Aristotle and Plato on the relationship between income and virtue. It will then analyse the arguments of Adam Smith and John Stuart Mill who argued that a subsistence wage was necessary to enable humans to develop their moral character. Then it will investigate how other economists such as Richard T. Ely and John R. Commons defined capability and made it key to economic study. It will also consider how market economists defined capability in terms of economic production as captured in Gary Becker's theory of human capital. The subject of Chapter 4 will be the theory of externality as applied to labour and wages. The chapter will describe how Adam Smith and Jeremy Bentham saw side effects from self-interested economic decisions but will focus on the ideas of the main advocates of the theory, A.C. Pigou and J.M. Clark, with regard to whether they thought low wages caused a negative externality. This is an idea that market economists found difficult to accept especially after R.H. Coase devised a market approach to handle the externality problem. Throughout these chapters I will offer lessons from the debates among these past thinkers that will inform the current arguments over the need for a living wage and these lessons will be summarized in Chapter 5.

To elaborate on that older debate slightly, what I will argue in this book is that there were a group of economists, let us call them moral economists, who supported the idea that low-wage workers should earn a living wage as defined by the standards of the community in which they lived and worked. They often referred to the living wage as a subsistence wage but they never meant that workers should earn a wage that merely enabled them to survive. The subsistence wage to them stood for an amount that was the least workers could make and still feel they were valuable members of the community. The ideal of a community that they held was based on a moral economy rooted in Greek philosophy (Aristotle's household management) and Christian theology (Aquinas's just wage in a moral community).

In opposition to them, there were the market economists. These economists had as their ideal the economic model of perfect competition. This ideal economy gives workers the wages the value-added of their work has earned them, no more and no less. Moreover, these market economists could claim that their interest in this ideal model was purely scientific, as it served the same function for economics as an idealized model of the structure of an atom did for physics. The concept of a subsistence wage (or living wage) did not fit into this idealized model of the market economy, and the market economists did not find it to be a useful analytical concept. Thus in this book we will have a figurative debate between the moral economists and the market economists over the role of a living wage in two versions of an ideal world, the moral economy and the free market economy. Because the market economists have had the last word in the debate I will give more words to the moral economists and will organize the debate around the concepts of sustainability, capability and externality.

By organizing the debate around these concepts I am well aware of the importance of social and historical context in the formation of any economic idea. The worlds that the great economic thinkers highlighted in this book lived in differed from each other's world as well as our own. We cannot compare Adam Smith's views on labour unions with Milton Friedman's because Smith did not know of unions and Friedman at least could read about them. Given that the economists featured in this book lived in a variety of times and places, situating their ideas in a context other than what their predecessors had written would have been a daunting task, although in a few places I have indicated cases of direct social influences. This does not mean that I accept the notion that ideas have a life of their own or that certain economic ideas such as the living wage are universal.

Rather, I hope to show that, at least among economists, ideas such as the living wage change over time and may cause those economists to discard them. The idea of a living wage, for example, has roots in medieval theology regarding the just wage, a concept that fit in with the small community of medieval times. In that community social justice, like criminal justice, could be determined on a case-by-case basis. Whether the ideas of social justice and the living wage can be determined on the mass basis of an urbanized, industrial society is an issue the great economists grappled with as that society unfolded during their lives. That issue is the latent focus of this book.

2. Sustainability: subsistence, necessities and unions

INTRODUCTION

The living wage raises a number of issues that would be of interest to any person who studies economics. Perhaps the largest of those issues is how to define it. The starting point in that definition is to define it not as a fixed monetary amount but in terms of what goods and services that monetary amount will allow the wage earner to purchase. This starting point, however, leads to a more vexing issue of what the wage earner needs to purchase in order to survive, that is, to sustain himself. Moreover, the idea of wages must also be addressed, as wages and labour markets are a relatively new phenomenon in human history. Along with this idea of the labour market comes the general idea of a market economy where incomes and expenditures are embedded in an exchange process. One must work for wages to earn an income to buy the goods and services needed to sustain life.

This is such a basic concept, that a person must work in order to survive, that one must wonder why it has not been a burning question for every person who ever wrote a book on economics. From the beginning of their existence humans have had to work to survive. What is more recent is the mediation of wages into the work/survival equation. We now take that mediation for granted but it was not always so. Consequently we will start our investigation of sustainability with philosophers in ancient Greece, where wages were not at all common.

PLATO AND ARISTOTLE DISCOVER THE LIVING WAGE

Historians of economic thought have traditionally questioned whether the ancient Greek philosophers comprehended the workings of the market (Blaug, 1991; Petrochilos, 2002: 600; Lowry, 1969: 65). What they have overlooked, however, is that Plato's and Aristotle's ideas regarding economics were part of a debate over the efficacy of the market that took place between Plato and Aristotle on one side and the sophists, Protagoras, Hippias, and Isocrates, on the other. At the time the debate took place the use of market exchanges based monetary gain was new to Athens. The sophists, however, had knowledge of markets and competition because they engaged directly in market activities by teaching for fees (Stabile, 2007: 15–30).

The sophists were immigrants who came to Athens and became professional teachers of higher education for fees. They justified their fees by arguing that their teaching was worth the fees they charged (Plato, 1976: 20; Isocrates, 1982: 309). To them, the value of their teaching was determined in the market by what students were willing to pay. They were also aware that competition among the sophists of their time had reduced their fees (Marrou, 1982: 82). As long as competition existed, any high fees that the sophists earned were not lasting. But a principle was established: income was based on the value one added to the marketplace.

On the other side of the debate, Plato disliked the competition of the marketplace and the persons who used it to make a living. Rather, he was concerned that the pursuit of wealth was inimical to creating an effective society based on virtuous behaviour. Calculations of self-interest, to the extent they influenced human behaviour, had to be controlled in the interest of the community. Plato recognized that society required a division of labour but believed that it would take place through a non-economic process where each person found the occupation that was compatible with his 'natural' abilities (Plato, 1888: 50–4 and 109–10). This system of basing the division of labour on 'natural' abilities also applied to the guardians and rulers of the state. To keep them from being distracted by the lure of money, in his *Republic* Plato proposed that they live a communal life with only the minimal livelihood they needed. They would, in effect, be provided with a living wage that ensured them the basic necessities of life. Plato defined necessities as follows:

> Are not necessary pleasures those of which we cannot get rid, and of which the satisfaction is a benefit to us? And they are rightly called so, because we are framed by nature to desire both what is beneficial and what is necessary, and cannot help it . . . We are not wrong therefore in calling them necessary? . . . And the desires of which a man may get rid, if he takes pains from his youth upward – of which the presence, moreover, does no good, and in some cases the reverse of good – shall we not be right in saying that all these are unnecessary? (Plato, 1888: 266)

Here we have a very early definition of a living wage, based on the indispensable elements of life, and one did not need a market to define it.

Compared to Plato, Aristotle had a more moderate view of the market and defended private property on the same basis as the 'tragedy of the commons', that is, humans needed incentives to care for property. He wrote: 'That which is common to the greatest number of men is given the least care' (Aristotle, 1986: 40). To explain how property could be beneficial to human existence, he divided his study of economics into household management and the art of finance. Household management involved the acquisition of the resources needed by a household, with the head of the household allocating resources among the members of the household. The art of finance was the use of market transactions to get the resources a household needed when it was not self-sufficient (Aristotle, 1986: 19–28).

According to Aristotle, the best way to satisfy basic needs was to be self-sufficient and earn a living by productive labour that did not depend on exchanges for a food supply. In that case a household could accumulate property to store up the necessities of life but in limited amounts. This form of property was natural (Aristotle, 1986: 28). Trade took place when two persons bartered surplus items, but since the objective of such exchanges was to supply 'what is needed for natural self-sufficiency' that type of trade remained natural (Aristotle, 1986: 28). Exchanges with money did not change the sustainability objective per se. Trade for the purpose of making money, however, resulted in an unnatural form of property accumulation, monetary wealth. Aristotle thus argued that buying or selling to meet natural needs was acceptable, while buying or selling to make a profit to satisfy the unnatural needs for luxury was not.

This argument takes Plato's concept of a living wage for guardians, rulers and philosophers and makes it more general. It is based on the sustainability approach as the amount a person needed to live. Aristotle recognized, however, that poverty was a problem to the extent that the poor did not have enough income to provide themselves with a sustainable livelihood. In writing about what a democratic government should do with any surplus revenue it might have, he warned against giving that surplus to the poor because they would just keep asking for more money. Still, something should be done for the poor. He wrote:

> What a true friend of the common people should do is see to it that the multitude is not kept excessively impoverished, because this causes a people's rule to be vicious. Measures should be adopted, then, to make possible a lasting prosperity. And since this is beneficial to the prosperous also, the proceeds of the special revenue should be accumulated and distributed to the needy in sums, as far as possible, to enable them to save enough to buy a piece of land, or else, to start a trade or become a farmer. (Aristotle, 1986: 182)

The state should help the poor gain the capacity to sustain themselves, but only to the point where they had a natural level of wealth, that is, a living wage. Moreover, it was in the interest of the wealthy to contribute taxes to pay for eliminating poverty. While Aristotle was not thinking of low-wage workers and what it would take for them to gain a living wage, he did see a proper level of earned income as essential to establishing self-reliance among all free members of Greek society.

In terms of the theme of this book, the debates among these Greeks were over the market, value-added approach and the sustainability approach. Plato's and Aristotle's side of the debate, with a living wage defined as what was needed to provide the necessities of life, remained more influential however. This influence can be seen by jumping ahead 15 centuries to the ideas of St Thomas Aquinas.

ST THOMAS AQUINAS AND THE JUST WAGE

Writing in the thirteenth century, at a time when commerce was becoming important in the medieval world, Aquinas developed a system of economic thinking that combined Holy Scripture with the ideas of the Greeks, especially Aristotle. He started from the proposition that it was morally proper for humans to seek after material possessions to provide for their sustenance. In a money-based society to be sure that all members of society had access to necessities, Aquinas argued that prices charged for them had to be just. He found it acceptable to use the market price as the just price as long as there was not too much market power on either side of the exchange and no one used coercion. The market (just) price also had to cover the costs of producing the product, so that producers would be ensured a livelihood. To assure that transactions were just, Aquinas argued, both buyers and sellers in the marketplace should follow the Gospel in doing unto others as you would have them do unto you. Both buyer and seller had to be informed about each other's needs. A wage rate that pushed workers below a subsistence level eroded their chances for being virtuous and was therefore unjust (Aquinas, 1968: 124–5 and Aquinas, 1953: 145). Still, Aquinas found that the market wage would normally be just.

In writing about medieval economic thought R.H. Tawney argued that thinkers such as Aquinas would have considered it illogical 'to found a science of society upon the assumption that the appetite for economic gain is a constant and measurable force, to be accepted, like other natural forces, as an inevitable and self-evident datum' (Tawney, 1954: 35). This is exactly the science of society that Adam Smith attempted to found, but he did so with the inclusion of the moral element that Aquinas found essential by showing how the market wage resulted in a just wage.

ADAM SMITH: MORALS, MARKETS AND SUBSISTENCE

Adam Smith (1723–1790) is regarded as the quintessential champion of the market system and his renowned book, *The Wealth of Nations*, was the first systematic study of market economics. But Smith actually stands at a transition point in economic thinking. In his day, the market was just emerging as a dominant social institution and economic thinkers were only dimly aware of its potential force. We can see this transitional point of view in Smith's description of two options available to a society in sustaining its members. He wrote:

> All the members of human society stand in need of each others assistance, and are likewise exposed to mutual injuries. Where the necessary assistance is reciprocally afforded from love, from gratitude, from friendship, and esteem, the society flourishes and is happy. All the different members of it are bound together by the agreeable bands of love and affection, and are, as it were, drawn to one common centre of mutual good offices. But though the necessary assistance should not be afforded from such generous and disinterested motives, though among the different members of the society there should be no mutual love and affection, the society, though less happy and agreeable, will not necessarily be dissolved. Society may subsist among different men, as among different merchants, from a sense of its utility, without any mutual love or affection; and though no man in it should owe any obligation, or be bound in gratitude to any other, it may still be upheld by a mercenary exchange of good offices according to an agreed valuation. (Smith, 1976a: 85–6)

Here in one small quotation we find the distinction between the moral economy and the market economy. More interesting, perhaps, Smith apparently found the market economy to be, in the terminology of modern economics, a 'second-best' solution albeit a viable one.

A small village that built economic relations around love and trust, one in which persons followed Aquinas's advice to use the golden rule in assuring each member sustainability would be consistent with Smith's happy and flourishing society and Smith was influenced by religious thinking about the just price (Stabile, 1997: 296–8). The rules that governed it would surely be close to the communism of the leaders of Plato's ideal republic and Aristotle's concept of household management and Smith had a sophisticated knowledge of Greek philosophy (Lowry, 1987: 5–6). Smith's moral economy was not consistent with the emerging metropolis of London or other industrial cities. That world followed the economics of the sophists and used mercenary exchanges of buying and selling in the marketplace to exist and it was the world that preoccupied Smith in *The Wealth of Nations*. That less agreeable world of the market economy would still work in the absence of moral virtue.

Before looking at Smith's case for letting self-interest and the market handle the problem of giving 'the members of human society' the 'necessary assistance' they stood in need of, we should note that to Smith, one of the main purposes of political economy was to find policies 'to provide a plentiful revenue or subsistence for the people, or more properly to enable them to provide such a revenue or subsistence for themselves' (Smith, 1976b, vol. I: 449). Like Aristotle, Smith believed that it was important for the common people to be able to have the resources to provide for themselves. Following the sophists, however, Smith argued that in the absence of a moral economy market-based incentives were the best way to give them those resources. Also, he felt that by encouraging economic self-interest, society would redirect the passion of greed away from violence and domination.

Consequently, the central part of Smith's case for the market system was that the market let individuals act on clear monetary incentives to follow their self-interest and produce items that would do the most good for society (Smith, 1976b, vol. I: 18). In the marketplace competition would bring prices to their 'natural rate', at which point business owners would earn a natural profit that was moderate and workers would be earning a natural wage. Smith defined the natural wage as the subsistence wage. That definition also included the idea of sustainability of the workforce. He wrote: 'A man must always live by his work, and his wages must at least be sufficient to maintain him. They must even upon most occasions be somewhat more, otherwise it would be impossible for him to bring up a family, and the race of such workmen would not last beyond the first generation' (Smith, 1976b, vol. I: 76). If workers did not earn a subsistence wage, the workforce would be overused and the economy would cease to function.

Smith defined the subsistence wage in terms of what it would allow workers to purchase in order to maintain themselves, which meant that he had to outline the necessities that made up subsistence. He wrote: 'By necessaries I understand not only the commodities which are indispensably necessary for the support of life, but whatever the custom of the country renders it indecent for creditable people, even of the lowest order, to be without' (Smith, 1976b, vol. II: 399–400). The subsistence wage had a decency component to it. This decency component, however, varied from place to place. In the England of Smith's day, it included linen shirts and leather shoes, while in Scotland it was proper for women to be barefoot and in France coarse material was sufficient for shirts.

Smith's definition of a subsistence wage has parallels with the modern concept of the living wage as well as the problems. In both cases the basic wage must depend on a basket of commodities that enable workers to live but also to have a decent life. The problem is that the cost of those necessities as well as the items that fill the basket will vary from place to place as well as over time. The real question, one that Smith addressed, was what it would take for the market wage to at least equal a subsistence wage.

Smith did not intend to explain wages on the basis of subsistence. For him the level of wages had a variety of influences, such as the disagreeableness of the job, the skill required in the job and the cost of attaining it, the amount of trust required on the job, and the risk that one might not succeed in the job. Supply and demand conditions could affect wages in the short term, as an expanding industry would have an increased demand for labour that brought about higher wages until more workers entered the industry and brought wages back to their natural level. In the long run, the economy would grow and there would be a general increase in the demand for labour that would lead to rising wages (Smith, 1976b, vol. I.: 74–6 and 112–19; vol. II, 400). Here we have Smith's optimistic account of market outcomes. Through trade fuelled by self-interest, the division of labour expands, the economy grows, and wages increase. As a result, workers would see a rising subsistence and market forces would have the positive consequence of at least a subsistence wage for all.

While Smith did see that workers in England in his day earned a wage at or above subsistence, he also saw that there were cases where they might not. In labour market negotiations over wages, he believed that masters (employers) had advantages that gave them the upper hand. First, their fewer numbers meant that masters did not compete with each other to the extent that the larger number of workers who wanted jobs did. Second, their greater wealth gave masters the ability to outwait workers who needed a job to survive. Third, the laws of England in Smith's day were on the side of the masters in those negations. This was no accident, for Smith noted that, 'Whenever the legislature attempts to regulate the differences between masters and their workmen, its counsellors are always the masters'. Given these advantages, 'masters are always and every where in a sort of tacit, but constant and uniform combination, not to raise the wages of labour'. Workers in response would 'act with the folly and extravagance of desperate men' and try to force the masters to raise their wages. In those cases, the masters would bring in the government to cause 'the punishment or ruin of the ringleaders' (Smith, 1976b, vol. I.: 74–6 and 158–9). At the time Smith wrote, England's economic system was influenced by a policy of mercantilism, which regulated the economy in an effort the help merchants prosper and enhance the revenues of the crown. Smith was against this mercantilist policy and countered it with his case for the free market. If employers were able to use government regulations to keep wages low, a free market system might give workers a better chance for higher wages. Workers added a great deal of value to society and an unregulated market was the best way for them to attain a subsistence wage.

ROBERT MALTHUS AND THE USES OF HIGH WAGES

Adam Smith's *Wealth of Nations* remained a source of ideas for economic thinkers for two generations after it was written. The next two generations of economists, however, recognized that its optimistic tone about a rising wage level did not coincide with the way economic events developed in the UK after he wrote. During that period, economic growth did increase, but it did so in a cyclical pattern of recession and recovery. In periods of recession labour experienced wages below subsistence level and a number of economists began to believe that a rising subsistence presented special problems that Smith had not anticipated.

This gloomy outlook regarding wages formed a background for the writings of Robert Malthus (1766–1834). Despite his being a minister, Malthus did not follow Smith's moral economy. Instead he aimed at debunking the ideas of optimistic thinkers who believed in social progress. He countered that optimism with his *Essay on Population*, first published in 1798, with its prediction that efforts to improve society would merely set off a process whereby population growth would outstrip food production. The book made him an instant celebrity for his argument 'that population must always be kept down to the level of the means of subsistence' (Malthus, 1959: xiii). The issue Malthus raised was that human fertility might outstrip the fertility of the soil by creating too many mouths to feed. If it did, that would counter Smith's optimistic forecast of a rising subsistence wage.

Smith had set forth a theory of population in his discussion of the subsistence wage, arguing that higher wages could increase the population, but he also observed that as they became more affluent workers might limit the size of their families much as the affluent upper classes on England did (Smith, 1976b, vol. I: 89). Malthus agreed that economic growth could increase wages, but identified several countering affects. First, the additional money earned by businessmen through economic growth might not be used to hire workers, being spent instead on other things such as luxuries. Second, if the additional funds were spent on hiring workers, nominal wages would increase but unless those workers produced additional items of subsistence, the price of necessities – especially food – would rise and the real wage of workers might not increase. Third, if real wages did rise workers would have larger families and the population growth that followed would erode those increased wages (Malthus, 1959: 3–5). Population growth would threaten the sustainability of the workforce.

As a basis for his gloomy outlook regarding labour and wages, Malthus had an analytical tool called the fund for the maintenance of labour. He defined the fund as the amount of surplus food the owners of land had at any given time. When the fund had to be divided among many workers, wages would be low. If the fund grew quickly workers could have higher wages and greater amounts of food. A subsistence wage could last only if workers made the right choices about how to use that wage. He wrote:

> From high wages, or the power of commanding a large portion of the necessities of life, two very different results may follow; one, that of rapid increase of population in which case the high wages are spent mainly in the maintenance of large and frequent families; and the other, that of a decided improvement in the modes of subsistence. (Malthus, 1950: 224)

The course workers chose, larger families or better existence, depended on their habits and social environment and Malthus found countries in which high wages did not cause population growth. The key was in workers choosing the right course. Appeals to humanity to keep wages at reasonable level would not work, because 'common humanity cannot alter the fund for the maintenance of labour' (Malthus, 1950: 223).

Here Malthus reminds us that in our efforts to help the working poor through a living wage it matters how the working poor use the added income. More important, Malthus with his fund for the maintenance of labour posed the biggest issue for a living wage: Who will pay for it? Malthus doubted that the wealthy would be the ones to pay because he appreciated that the wealthy had a great deal of bargaining power over wages compared with workers (Malthus, 1959: 12–13). To the extent the fund was fixed, it would be other workers who paid by having their wages reduced. This is a tough argument to counter, but an answer was found in the development of utility as an economic concept by Jeremy Bentham.

JEREMY BENTHAM: WAGES AND UTILITY

Jeremy Bentham (1748–1832) is especially noted for his Utilitarianism, which he hoped would clarify the need for economic and legal reform. His philosophy of Utilitarianism had a goal of describing how individual interest could be trusted to provide sound decisions in a variety of individual and social choices. He wrote: 'By the principle of utility is meant that principle which approves or disapproves of every action whatsoever according to the tendency it appears to have to augment or diminish the happiness of the party whose interest is in question' (Bentham, 1781: 14). His contribution to economics was to reframe self-interest into the notion of individual calculations of pleasure and pain, what he called utility, and to explain how they led to the greatest good for the greatest number. His goal was to require rational approaches to policy making and to make acceptable for intellectual study the idea that individual efforts to find pleasure and avoid pain were a useful way of evaluating human behaviour. By raising the notion that the consequences of human behaviour were worth study, he hoped to counter the conservative idea that traditional values were the best indicator of how humans should behave.

Smith was one of Bentham's few heroes and *The Wealth of Nations* was 'his economic bible' (Stark, 1952–4: 14). Nevertheless, Bentham was much more in favour of limiting government intervention in the market economy than Smith and distinguished between items of agenda (things to be done) and non-agenda (things not to be done) for government to delineate where it should interfere. One case of agenda for government he found was having the government set a maximum price on corn during a famine because 'every man's subsistence is alike at stake' (Bentham, 1801: 284). To see how Bentham justified this agenda item we start with his observation that when income rose due to economic growth, if the increase went 'to the wealth of him who has the least, more happiness will be produced, than if added to him who has the most'. If low-wage workers could be made happier with an increase of income, society attained the greatest good (Bentham, n.d. [1952]: 112–15).

Underlying this argument, Bentham considered wealth to be the best measure of utility but argued that wealth and utility did not increase at the same rate. He wrote:

> Take thereupon any individual; give him a certain quantity of money, you will produce in his mind a certain quantity of pleasure. Give him again the same quantity, you will make an addition to the quantity of his pleasure. But the magnitude of the pleasure produced by the second sum will not will not be twice the magnitude of the pleasure produced by the first. (Bentham, n.d. [1954]: 441)

A wealthy person may have fifty thousand times the income of a worker, but Bentham doubted that he would thus have fifty thousand times the happiness or utility (Bentham, n.d. [1954]: 441). In technical terms, Bentham was describing the concept of the diminishing marginal utility of money, that is, additional amounts of money add smaller amounts of happiness to an individual. We will see later that his view has been criticized by more recent economists as having the problem of making 'interpersonal utility comparisons'.

In anticipation of this criticism Bentham refined the concept of utility by devising a hierarchy of what gave utility; happiness was the end, but subsistence, security, abundance and equality were the subordinate ends (means) to the ultimate end of happiness. Since existence was a necessary condition for happiness, he argued, 'Subsistence cannot be placed any where but at the head of the list of subordinate ends' (Bentham, 1801–4: 309). Security came next and Bentham meant by it the ability to count on property rights and future subsistence. A decline in either led to disappointment from lower levels of security; reducing the wealth of the rich to help the working poor might cause disappointment to the rich. As a counter, Bentham went to his next subordinate end, abundance. Once a person had abundance, his consumption had two components, 'enjoyment' from consuming a healthy subsistence and 'mere enjoyment' from partaking of luxuries (Bentham, 1801–4: 309–12). Potatoes and pineapples might give equal nutrition as means of subsistence, but since pineapples cost ten times as much as potatoes, they consisted of one part 'enjoyment' and nine parts 'mere enjoyment' (Bentham, 1801–4: 327).

Bentham then drew the conclusion that efforts to improve income equality would come at the cost to the wealthy of 'mere enjoyment' and not security. Increasing wages to improve the 'enjoyment' of workers would cause the wealthy who paid those wages to suffer the loss of 'mere enjoyment' but not the disappointment of a loss of security (Bentham, n.d. [1952]: 110). Thus a subsistence wage had to include elements of 'enjoyment' and 'security' but not 'mere enjoyment'. We can see this distinction in his strictures on how workers should use their wages. They had to be wary of indulging in 'mere enjoyment' because Bentham found a correlation 'between drunkenness and high wages'. Push-pin (a game played by the poor) was a better source of 'enjoyment', he wrote, because 'push-pin is morality in so far as it keeps out drunkenness' (quoted in Bahmeuller, 1983: 87).

Bentham did not want government interference in labour markets to improve wages, because that would interfere with everyone's self-interest in gaining their maximum income (Bentham, 1801: 284). He thought it essential that 'the income of those whose incomes is composed of the wages of labour be maximized. Reason: Of these are composed the vast majority of the members of the community' (Bentham, n.d. [1952]: 116). Still, he saw limits to where the higher wages might come from. He did not want to see them come from the profits of business, as long as those profits were used to expand business, hire more workers and increase wages. If profits were used to support the luxury consumption of 'mere enjoyment,' they might be better used to support workers. Bentham never made it clear how workers might gain the subsistence wage and we will see in the next section that John Stuart Mill remedied this omission.

JOHN STUART MILL AND PRODUCTIVE CONSUMPTION

John Stuart Mill (1806–1873) became the next synthesizer of economic thinking and his *Principles of Political Economy* replaced *The Wealth of*

Nations as the standard source of economic knowledge – a position it held for half a century. One of his analytical tools was to separate production and distribution into two distinct spheres. In this way he could argue that while production was governed by unalterable scientific laws distribution followed social laws that could be changed. This argument, he believed, would counter the claims of other economic thinkers who insisted that economic forces must 'by an inherent necessity, against which no human means can avail, determine the shares which fall, in the division of the produce, to labourers, capitalists, and landlords' (Mill, 1960: 175). Production followed the scientific laws that governed technology and human labour. Regarding labour it was an obvious scientific fact that if workers did not receive a subsistence wage there would be no work. The issue of whether they did indeed receive a subsistence wage fell into the laws of distribution, however, and resolving it was one of the tasks of political economy (Mill, 1909: 31).

To define what he meant by subsistence Mill made a distinction between productive and unproductive consumption. What workers consumed, he wrote, 'in keeping up or improving their health, strength and capacities of work, or in rearing other productive labourers to succeed them is productive consumption'. Consumption of luxuries by workers or by idle persons was not productive consumption, since it did not aim at production. Mill's dividing line between productive and unproductive consumption was sustainability, that is, whether society could exist without the item in question. If something were not produced for a year and society survived it qualified as an item of unproductive consumption (Mill, 1909: 46–52). Here Mill is following the definition of unproductive consumption that his father had provided in his book, *The Elements of Political Economy* (Mill, 1844: 8 and 220–5). He also is making a point similar to Bentham's distinction between 'enjoyment' and 'mere enjoyment' noted above. Bentham had pointed out that as items of subsistence potatoes and pineapples might have the same nutritional value, but since pineapples cost more to produce they contained an element of 'mere enjoyment'. Mill was arguing that pineapples cost more to produce than potatoes due to the laws of production, but it was the laws of distribution that gave wealth to idlers seeking the unproductive consumption of pineapples. The laws of distribution could be changed and the standard of living of workers could be improved. Mill wrote: 'Society at large is richer by what it expends in maintaining and aiding productive labour' (Mill, 1909: 73).

When he looked at what caused wages to be low Mill followed Malthus by basing wage levels on the level of population and the wage fund. But he added in his element of unproductive consumption. At any time an economy had a stock of capital with which business owners bought machinery and materials and hired workers. The overall stock of capital was derived from the surplus left over after paying workers in the previous time period, and the part of the capital stock spent on hiring workers in the next time period determined the demand for labour and wages (Mill, 1909: 54 and 163–4). But Mill saw the capital stock as the fund 'from which the enjoyments, as distinguished from the necessaries, of the producers are provided'. It was also the fund 'from which all are subsisted who are not themselves engaged in production' (Mill, 1909: 164). The point for Mill was that if the capitalists used their profits by spending on unproductive consumption, the demand for labour would be reduced and wages would be low. Moreover, Mill was less optimistic than Smith that there was a minimum level of wages at the subsistence level. Since the subsistence wage had a decency component to it that varied from time to time and place to place, it was possible to 'permanently lower the standard of living' of workers and have their 'deteriorated condition . . . become a new minimum' (Mill, 1909: 347). The decency component of the subsistence wage could be reduced. He also saw limits on how high wages could go as set by the wage fund and workers' inability to control the number of children they had. The most important direct control workers could have over their wages was to stop having children. Because wages fell under the laws of distribution and not production, however, Mill also considered indirect methods for increasing them.

Given the limited direct impact workers could have on wages one might wonder whether government policies could help to improve wages. In general Mill did not favour government intervention in economic activities on the ground that '*Laisser-faire*, in short, should be the general practice: every departure from it, unless required by some great good, is a certain evil' (Mill, 1909: 950). In holding this principle Mill wanted to avoid a parental state where the working poor became dependent on the government. He chastised the living wage advocates of his day for arguing that every employer '*ought to give sufficient wages*; and if he does not willingly, should be compelled to it by general opinion; the test of sufficient wages being their own feelings, or what they suppose to be those of the public' (Mill, 1909: 361–2). According to Mill there was no clear standard of what wages should be, no clearly defined living wage that one could use to establish what employers ought to pay. The issue was one of determining whether society could establish by law what it could afford to pay those who did the most work, which Mill doubted.

Instead, Mill argued that workers could help themselves get higher wages through the formation of labour unions, making him the first well-known economist to investigate the nature of unions and to wish to see them strengthened as a social institution. He presented his views on unions in a chapter of *Principles of Political Economy* titled 'Of Interferences of

Government Grounded on Erroneous Theories'. The erroneous theories he referred to were those that called for government interference in the form of laws against unions on the grounds that it was desirable to keep wages low. Mill objected strenuously to those erroneous theories, writing, 'If it were possible for the working classes, by combining among themselves, to raise or keep up the general level of wages, it needs hardly be said that this would be a thing not to be punished, but to be welcomed and rejoiced at' (Mill, 1909: 933–4). The question was how could workers in unions do any better in combating the limits of the wage fund than the government through mandating a subsistence wage?

The ability of unions to raise the wages of their members without harming other workers has long been an issue of contention among economists. In Mill's day, the fixed size of the wage fund implied that higher wages for workers in unions meant less of the fund was available for other workers, reducing their wages. Mill resisted this implication. First, he pointed out that the size of the wage fund depended on the amount spent on unproductive consumption. Higher wages for union workers could be paid for by employers reducing their unproductive consumption, which meant that higher wages might cause higher prices to consumers. Mill did not object. His principle was that 'the cheapness of goods is desirable only when the cause of it is that their production costs little labour, and not when occasioned by labour's being ill remunerated' (Mill, 1909: 935). Mill believed that it was better to hurt affluent consumers than to mistreat low-paid workers.

Second, Mill recognized that workers might be underpaid. After all, the laws against unions aimed at keeping wages low. Perhaps those laws kept wages lower than the 'market' level and removing those laws and promoting unions might raise wages to where they should be. Here Mill is following Smith in arguing that workers were at a disadvantage in negotiating with employers over wage rates. On Mill's account, market forces of supply and demand did not 'thrust a given amount of wages into a labourer's hand'. All prices resulted from bargaining in the market, and 'poor workers who have to do with rich employers [might] remain long without the amount of wages which the demand for their labour would justify, unless, in vernacular phrase, they stood out for it; and how can they stand out for terms without organized concert?' Because of this need for workers to organize to get the wages the market forces accorded them, Mill concluded that unions, 'far from being a hindrance to a free market for labour, are a necessary instrumentality of that free market' (Mill, 1909: 937). Bargaining power imbalances between individual workers and their employers might result in wages below the 'market' rate, and unions were needed to get wages to that rate. Indeed, Mill wondered how an individual worker would even know what the market wage was 'except by consultation with his fellows' (Mill, 1909: 937).

The important point here is that Mill was sanctioning unions as a vehicle for helping workers attain a subsistence wage. It is not likely that Mill would have ever helped workers organize a union. The idea to be wary of, Mill warned, is having workers become dependent on advocates of a living wage for pay increases, because that would be paternalistic. The lesson Mill offers is that workers in their own union are a way to have them get a living wage for themselves.

It is always difficult to make an imputation of influence in the history of economic thought. In Mill's case there are some correlations to be noted. We will see below that the two generations of economists who followed Mill had a number of members who supported unions on similar grounds. One exception to this influence would be Mill's contemporary, Karl Marx.

KARL MARX AND THE THEORY OF RELATIVE POVERTY

Karl Marx (1818–83) offers us an approach to economics that focuses on workers and not capitalists as the key element of the economy. From that perspective he saw wages as being determined under social rules that accented the rights of property and the equal exchange of commodities by free individuals. This equal exchange was mythology, however, for wage labour did not own property. Marx began his study of capitalism, *Capital*, with the conception that workers were removed from ownership of property, that is, control over access to the social means of production. This alienation of workers from the means of production meant that the only thing they had to offer for sale in the marketplace was their general ability to work, what he referred to as their 'labour-power'. The exchange value of labour-power was the cost to the worker of producing it, the subsistence wage. He wrote: 'Given the existence of the individual, the production of labour-power consists of his reproduction of himself or his maintenance. For his maintenance he requires a certain quantity of the means of subsistence' (Marx, 1977: 274). With his idea that workers were reduced to a common product of 'labour-power' with common subsistence needs, Marx might have set forth a theory that wages tended to be limited to the existential needs of workers. Instead, he followed Smith, Bentham and Mill to offer a number of explanations for wages and a social definition of subsistence.

As his starting point of his theory for the wage that workers exchanged for their labour-power, Marx contended that 'the value of labour-power can be resolved into the value of a definite quantity of the means of subsistence' (Marx, 1977: 276). He found a number of factors in labour markets that produced this outcome, but first we need an understanding of what he meant by subsistence. For Marx, as a means of existence, a subsistence level of consumption consisted of the products workers needed to be able to work the next day. What that bundle of products meant in relationship to a level of food, clothing and housing would differ depending on climate. Moreover, he went on:

> The number and extent of [a worker's] so-called necessary requirements, as also the manner in which they are satisfied, are themselves products of history, and depend therefore to a great extent on the level of civilization attained by a country; in particular they depend on the conditions in which, and consequently on the habits and expectations with which, the class of free workers has been formed. (Marx, 1977: 275)

The definition of subsistence for Marx contained 'a historical and moral element', that is, the decency component we saw in Smith's writing. It also had to include an element for replacing the workforce in the form of children 'in order that this race of peculiar commodity-owners may perpetuate its presence on the market' (Marx, 1977: 275). Here Marx echoes Smith's idea that subsistence included the sustainability of the workforce. His definition of a subsistence wage added little new to what Smith had written.

In volume 2 of *Capital* Marx expanded on his definition of subsistence by distinguishing between necessities and luxuries. To him, necessities were:

> articles of consumption, which enter into the consumption of the working class, and, to the extent that they are necessities of life – even if frequently different in quality and value – also form a portion of the consumption of the capitalist class . . . regardless of whether such a product as tobacco is really a consumer necessity from a physiological point of view. It suffices that it is habitually such. (Marx, 1967: 403)

While this definition was very inclusive, Marx narrowed it by arguing that 'articles of luxury enter into the consumption of the capitalist class only' (Marx, 1967: 403). The standard of living that workers enjoyed defined subsistence. This hardly seems a useful definition of a subsistence wage, and in the notebooks he kept to clarify his thinking, Marx added that 'needs are produced just as are products and different kinds of work skills'. He continued: 'The greater the extent to which historic needs . . . are posited as *necessary*, the higher the level to which real wealth has become developed' (Marx, 1973: 527).

This clarification of needs as being produced by the state of the economy created another difficulty in defining a subsistence wage, however. Marx noted that the economic advances made under capitalism had raised both the quantity and quality of the goods that satisfied human needs. We might see this as a positive feature of capitalism, but Marx found two problems it raised in terms of defining a subsistence wage. First, the growth of the economy increased wages but also increased the total of profits available for capitalists, giving them more to spend on luxuries. Marx argued that even though the subsistence items of a worker became greater, 'the social satisfaction they give him has fallen in comparison with the increased enjoyments of the capitalist, which are inaccessible to the worker . . . Our desires and pleasures spring from society; we measure them, therefore, by society and not by the objects which serve for their satisfaction. Because they are of a social nature, they are of a relative nature' (Marx, 1849: 180). It is futile, according to Marx, to try to define a subsistence wage in precise terms under capitalism. To him, the subsistence wage would always be a relative concept in comparison to the consumption of the wealthy.

A second problem with economic growth that Marx indicated was an unwholesome aspect of this advancement. Businesses used new needs as a way to get consumers to spend. He wrote: 'The entrepreneur accedes to the most depraved fancy of his neighbour, plays the role of pander between him and his needs, awakens unhealthy appetites in him, and watches for every weakness' (quoted in Elliot, 1981: 141). Along with Bentham and Mill, Marx found higher orders of consumption in advance of what was needed for a decent living, and he would not want to include all of them in his definition of subsistence. In terms of a modern definition of a living wage, Marx questioned whether some of our cultural advantages are really advantages to be included in a subsistence wage. For example, if the modern living wage includes cable television as a cultural necessity, and workers use it to watch violent programming, Marx might object.

Having raised the issues inherent to defining a subsistence wage, Marx extended his analysis by looking more closely at what workers had to do to earn it. For example, he indicated that there was a lower limit on wages in terms of a 'physically indispensable means of subsistence'. If workers received this low pay, it meant that labour-power was 'maintained and developed only in a crippled state' (Marx, 1977: 276–7). As a measure of that lower limit, he referred 'to the level of the Irish, the level of wage labour where the most animal minimum of needs and subsistence appears' (Marx, 1973: 285). Those workers were the epitome of exploitation. Marx's explanation for this exploitation is one with which we are already familiar, unequal bargaining power.

Smith made unequal bargaining power between masters and workers a vital element in arriving at wages, and Mill had seconded the idea. Marx agreed, but argued that unequal bargaining power was a systemic feature of capitalism and related to class struggle. The advantages employers had regarding workers had to do with their having property and workers having to sell their labour-power in order to survive. Once their bargain was made and a wage established, however, workers lost control over how their labour-power was used. They could be made to work longer than was necessary to produce the equivalent of their means of subsistence (Marx, 1977: 769). The subsistence wage also included the number of hours of 'unpaid labour' that had to be worked to earn in it.

Moreover, the growth of capital had another impact on the subsistence wage that Marx found in his analysis of machinery. Machines had a great advantage of reducing the strength and skill required of workers. While this could make life easier for workers, instead it increased the potential workforce by including 'every member of the worker's family, without distinction of age or sex' (Marx, 1977: 517). The addition of women and children to the workforce redefined the subsistence wage as the amount the whole family earned. The necessary and decency components of the subsistence stayed the same, but more than one family member had to work to earn it. This raises another issue in defining the subsistence wage: Should it be based on an individual worker or on a household? If it is based on an individual's income but all members of the household earn it, they may gain a level of affluence above what the subsistence wage should provide. When all members of the household must combine to earn a subsistence wage, the household will be in serious trouble if something happens to one of its members.

Another issue is the extent to which a subsistence wage would run afoul of Malthus's theory of population. Marx argued that when it took a family to earn the subsistence wage, the parents had an incentive to have more children to improve their household income. It was low wages, not high, that spurred population growth (Marx, 1973: 795). But following Malthus, if the birth rate was excessive, when those children were old enough to work they would become part of Marx's 'industrial reserve army of the unemployed'. They would add to the drag on wages, as they survived on below subsistence wages in crippled form, and Marx presented evidence on diets, housing and sanitary conditions to show how the quality of the workforce deteriorated as a result (Marx, 1977: 770–870).

By developing a multidimensional definition of the subsistence wage (time, effort, number of persons, and so on), Marx argued that market competition forced owners of capital to overuse the basic human resource available to them in excess of its pay and to the damage of its quality. He noted that the English Factory Acts were intended to 'curb capital's drive towards a limitless draining away of labour-power by forcibly limiting the working day on authority of the state, but a state ruled by capitalist and landlord'. We might wonder why capitalists and landlords used the government to place restrictions on what they did. Marx saw it as 'dictated by the same necessity as forced the manuring of English fields with guano. The same blind desire for profit that in one case exhausted the soil had in the other case seized hold of the vital force of the nation at its roots' (Marx, 1977: 348). The exploitation of workers threatened their sustainability as a workforce.

We saw earlier that Mill looked towards unions as a way to help workers get a subsistence wage. For Marx, unions could not be successful in helping workers unless they were organized as national associations to lead workers in the class struggle with capitalists. When unions did not take on this economy-wide role, he forecast their failure. He wrote:

> Trade Unions work well as centres of resistance against the encroachments of capital. They fail partially from an injudicious use of their power. They fail generally from limiting themselves to a guerrilla war against the effects of the existing system, instead of simultaneously trying to change it, instead of using their organized force as a lever for the final emancipation of the working class, that is to say, the ultimate abolition of the wage system. (quoted in Elliot, 1981: 291)

Unions focused on the immediate needs of their members and did not take a social outlook needed to give all workers a subsistence wage. Only a transformation of capitalism into socialism could ensure that workers got a subsistence wage.

ALFRED MARSHALL AND THE VALUE-ADDED OF INCOME

Mill and Marx signal the end of an era in economic thinking, an era dominated by the ideas of Adam Smith. Following them, economists began to study why consumers bought, that is, what where the factors that determined demand. Supply and demand became equal in terms of their impact on production. The concept that linked them together was value-added, and the new approach became known as marginalism because it stressed the increments of value-added by factors at the 'margin' of production or consumption, that is, the value-added by the last unit of consumption or the last input in production. The synthesizer of marginalism was Alfred Marshall (1842–1924). Marshall's chief accomplishment was to present the marginal utility theory of consumption in clear and understandable terms.

Marshall, however, was a very moral person who worried about the existence the poor would have from the income the market accorded them; he recognized that low levels of income were detrimental to workers' lives. He wrote: 'It may make little difference to the fullness of life of a family whether its yearly income is £1000 or £5000; but it makes a very great difference whether the income is £30 or £150: for with £150 the family has, with £30 it has not, the material conditions of a complete life' (Marshall, 1895: 2–3). In writing about the level of wages needed for a complete life, Marshall made a distinction between necessities and luxuries. To do so, he linked the notion of necessities to those items needed for keeping workers at efficient levels of effort. He wrote: 'The income of any class in the ranks of industry is below its necessary level when any increase in their income would in the course of time produce a more than proportionate increase in their efficiency' (Marshall, 1895: 137–9). As had Mill, Marshall referred to this level of income as allowing for productive consumption.

The notion of productive consumption was crucial to Marshall's version of a subsistence wage. To explain its importance he used an example of how diminishing marginal utility applied to the purchases of tea and salt. He added another element to utility calculations with his notion of the diminishing marginal utility of money using pounds (the monetary unit), stating:

> A pound's worth of satisfaction to an ordinary poor man is a much greater thing than a pound's worth of satisfaction to an ordinary rich man: and if instead of comparing tea and salt, which are both used by all classes, we compared either of them with champagne or pineapples, the correction to be made on this account would be more than important: it would change the whole character of the estimate. (Marshall, 1895: 206–7)

Here Marshall followed Bentham (Marshall, 1895: 205n) in analysing tea and salt as necessary for subsistence and of greater importance than items of 'mere enjoyment' such as pineapples (see above). Marshall made this point clearer a few pages later, when he explained, 'we may perhaps suppose that the satisfaction which a person derives from his income may be regarded as commencing when he has enough to support life and afterwards as increasing by equal amounts with every successive percentage that is added to his income; and vice versa for a loss of income'. Diminishing marginal utility only began to operate after a person had an income level that took care of necessities (Marshall, 1895: 210–11). There was a subsistence wage and Marshall linked it to a level of necessities for the sustainability and efficiency of the workforce.

To ascertain whether workers would earn a subsistence wage, Marshall investigated the many factors determining the level of wages. Like Smith and Mill, Marshall believed that firm owners combined to keep wages down, especially in dealing with lower-paid workers who needed income most. Bargaining power between individual workers and employers was unequal, because owners of large firms employing many workers acted as if they were a combination of employers while workers were unorganized

(Marshall, 1895: 646–9). To counter that power of employers, workers needed to take collective action by forming unions.

Marshall anticipated unions would counter employers who had implicit agreements to maintain low wages in order to keep profits high. He worried, however, that unions themselves might gain too much bargaining power and restrict the freedom of other workers to enter an industry (Kerr, 1969: 44–7). In the long run, market forces determined the level of wages in any industry, and unions that tried to change this by restrictive action would cause social harm. In the short run, however, collective bargaining could help workers gain a subsistence wage.

Another part of the subsistence wage was increased leisure. To look at leisure, Marshall now added the time of work to his study. In looking at the wages of a worker, he argued, 'no special reckoning [is] made for his wear-and-tear, of which indeed he is himself often rather careless; and, on the whole, but little account is taken of the evil effects of the overwork of men' (Marshall, 1895: 781). Marshall was greatly concerned about the effects long and hard work had on the sustainability of workers. Overwork led to a lower standard of living for workers and for the future generations.

Marshall used sustainability as justification for providing workers a subsistence wage and he had no qualms about having wealthy capitalists pay for that wage. But there was a catch. If the working poor were to benefit from increased consumption, it was necessary that it be the right sort of consumption. Low-wage workers had an obligation to use their subsistence wage by choosing the items of consumption that added value to their sustainability.

JOHN BATES CLARK AND THE VALUE-ADDED OF UNIONS

John Bates Clark (1847–1938) is noted for his development of the marginal product theory of wages. Simply stated this theory says that in a competitive economy, wages will equal the marginal product of labour; that is, the amount that the individual worker adds to total production. This theory makes the wage a matter of cost/benefit analysis, for a business will not hire a worker if what that worker produces cannot be sold for at least as much as the business must pay the worker; that is, the costs will outweigh the benefits. Its implications for a living wage, however, are more severe. It implies that low-wage workers are low-productivity workers. If a living wage means increasing workers' pay above their productivity, businesses will not hire them.

Clark, however, was a moral person who believed in fair treatment for workers and developed his marginal product theory with the hope that it might lead to increased wages. In his early writings, Clark argued that wages were a factor in social cohesion, that is, the process of sustaining society by having workers feel they were being treated justly. Clark lived in the tumultuous times of the second industrial revolution, which in the US included the growth of large corporations, the emergence of national unions and the political responses to these occurrences such as grangerism, populism and socialism. Because he worried that society was falling apart, he employed a standard for economic analysis that emphasized social cohesion and asked one overriding question: Did labour markets provide a wage for workers that allowed them and society to be sustained?

Clark's approach to wages was to look at bargaining power of workers versus capitalists and he agreed with Smith and Mill that the advantage went to the capitalists. The problem in setting things right was in finding a standard for where wages should be placed. Because of his adherence to utility, Clark did not see the subsistence wage as a standard (Clark, 1886: 51–4). Nevertheless, Clark accepted that every worker had a right 'to be kept, while willing to work, from absolutely starving' (Clark, 1886: 225–6). To establish a standard for wages Clark used a two-stage method. The first stage was to determine how free competition would determine wages through supply and demand. The second stage would then see how wages deviated from that competitive standard in the real world of large corporations and unions (Clark, 1886: 110). Once that standard was established, Clark felt that wages could be determined by government-led arbitration (Clark, 1886: 137). With a standard for wages in place it might be possible to avoid Smith's warning that government always sided with business in legislating wages (see above).

In his later work, Clark developed the marginal product theory as a way to establish a standard for wages. His statement of marginal productivity theory, *The Distribution of Wealth*, published in1899, gave his intention clearly in its opening words: 'It is the purpose of this work to show that the distribution of the income of society is controlled by a natural law, and that this law, *if it worked without friction*, would give to every agent of production the amount of wealth which that agent creates' (Clark, 1965: v, emphasis added). Clark clarified the emphasized statement, noting that his theory operated as 'if the changes that are going on in the shape of the industrial world and in the character of its activities were to cease' (Clark, 1965: vi). In short, the wage equalled value-added only under theoretical conditions of perfect competition.

As did all members of the marginalist school, Clark divided his analysis into statics; that is, what existed in a timeless, changeless and theoretical world and dynamics where everything changed. Static analysis gave a standard for wages equalling the marginal product of labour, but that standard had to be adjusted by dynamic laws to determine whether wages equalled the marginal product of labour in the real world (Clark, 1965: 30). To establish the static standard, Clark became highly abstract in his thinking. He wrote: 'The pay of labor in each industry tends to conform to the marginal product of social labour employed in connection with a fixed amount of social capital, as such' (Clark, 1965: 116). The additional contribution an individual unit of that social labour made to total production determined wages and the additional contribution of an individual unit of social capital determined profits. But what were these funds of capital and labour? At any time, Clark argued, society had funds of labour and capital. While economists had thought of capital as a fund, Clark argued that labour itself was 'a permanent force – a fund of human energy that never ceases to exist and to act' (Clark, 1965: 157–60).

The idea that labour was a permanent fund led Clark to consider what it would take to sustain it, and his answer was not the subsistence wage but cost/benefit analysis. To look at the general state of well-being of workers, Clark stipulated that for all workers the marginal disutility of work increased as the day went on. At the same time, the marginal utility of the products secured through work declined. In making this case, Clark resorted to a distinction between subsistence and luxuries. The first hour of work was exchanged for food, which had a high utility. The second hour might bring comforts, and so on, until the last hour might secure luxuries. In choosing how much to work, a worker 'must work during a part of the day to sustain life and he must refrain from working during a part of it for the same reason'. Somewhere in between was 'a point of balanced gain and loss. If he stops just there, the net gain from labor is at its greatest' Clark, 1965: 382–92). It was important that wages and working hours be at the right level to ensure the fund of labour was sustained and it was up to workers to choose that level using individual cost/benefit analysis.

To determine how competition established a wage equal to the marginal product of labour, Clark relied on some highly abstract technical thinking that need not concern us here (for details see Henry, 1995 or Stabile, 2000). What does concern us is that Clark is usually interpreted as having settled on the marginal productivity theory of wages and profits as providing a clear-cut standard of justice to which labour and capital could both comply. Yet Clark admitted, 'To many persons any theory based on competition may seem to have somewhat of the character of theoretical romance' (Clark, 1965: 440–1). Thus he consistently maintained that establishing a standard based on a static ideal of competition was only a first approximation and was an incomplete explanation for wages without adding in the dynamic elements of the real world (Clark, 1965: 73–4).

Clark presented his dynamic analysis in his book, *Essentials of Economic Theory* (published in 1907). In it he saw that the key fact of industry was that progress through technical innovation pulled wages upwards. It thus became a crucial question, Clark indicated, to know 'when the standard of wages rises as it naturally should' (Clark, 1968: viii). He based his discussion of labour and technical change on the supposition that industry cut costs by reducing the labour component of production. This process was not entirely advantageous to workers, because 'new machines are labor displacers' (Clark, 1968: 256–8). As a result, he argued, 'a supply of unemployed labor is always at hand' due to 'temporary displacements of laborers' by technical change. This army of the unemployed, to use Clark's term, kept wages low. Clark described the process as follows:

> The presence of even a few men able to do good work and not able to get employment is often sufficient to make individual bargaining work unfairly to the labourer . . . This strategic inequality between the parties in the wage contract becomes greater as the supply of unemployed men becomes larger. At some times and places it may force the pay of many workmen downward toward a minimum set by what the unemployed will consent to take. (Clark, 1968: 451–2)

Unemployed workers set the low end of the wage scale on which all other wages were based and workers might not earn wages equal to their value added.

To attain fairness in a dynamic economy, Clark called for collective bargaining. In defining the extent of bargaining power organized workers could obtain, Clark differentiated between unions as monopolies and as engaged in collective bargaining. Unions secured a monopoly when they had the strength to keep non-members from working in a trade or industry. The competitive alternative to the monopoly power of unions was collective bargaining. By this term, Clark meant that all workers who were willing to take a job in an industry be allowed to join a union, at a fair level of dues, in return for the union bargaining a wage for them (Clark, 1968: 487–8). Under these conditions, collective bargaining was a 'normal and democratic measure'. As a result, he concluded, 'When free from the taint of monopoly, trade unions, as has been shown, help rather than hinder the natural forces of distribution' (Clark, 1968: 503).

When unions went beyond collective bargaining to the use of monopoly practices, 'the only escape from this situation is by arbitration' (Clark, 1965: 469). When it came time to give advice to arbitrators as to where wages should be set, Clark altered his statement of marginal productivity theory as a competitive standard to the following: 'The law of final productivity works most effectively when it works automatically, as it does when competing employers make the best bargain with locally organized laborers.

The results, then, approach the theoretical standard, though they do not entirely coincide with it' (Clark, 1968: 475). It was wages set by collective bargaining that set the standard arbitration should employ.

Clark's lesson regarding a living wage is two fold. First, low wages may reflect the low productivity of the workers earning those wages. That low productivity may reflect those workers' lack of skills but it may also indicate that they are working with very little capital. Efforts to increase their wages without altering those conditions will prove fruitless. Second, and more important, low wages may also be below the productivity of workers earning them, because of their weak bargaining power. Unions are a way for workers to redress that weak bargaining but only if they remained free of the taint of monopoly. When unions gained a monopoly, the remedy was government arbitration. Clark never made it clear how often unions gained a monopoly but he seemed to oppose most unions that existed in his day. This meant he would have been in favour of government intervention to set wages at the value-added level his theory anticipated. The standard for that wage rate would be what similarly situated workers earned when they had formed unions and engaged in collective bargaining as Clark defined it. Whether or not that wage rate was a living wage Clark never made clear.

THORSTEIN VEBLEN: CONSPICUOUS VERSUS PRODUCTIVE CONSUMPTION

The economic thinkers I have considered so far constitute a line of thought with a consistent theme captured in the stereotype of the rational economic person, a distinct individual acting in his own self-interest. To be sure, they identified other forms of human motivation, and there were economists such as the German Historical School who disputed the idea of the rational economic person. Starting at the beginning of the twentieth century in the US a school of Institutional economics produced economic theories based on a general theory of human behaviour that included the insight that humans were not always the rational self-interested economic person in the lore of economics. A leader in creating Institutional economics was Thorstein Veblen (1857–1929).

To Veblen, a social institution was a habit of thought that humans used in making decisions (Veblen, 1906: 1–31). Today behavioural economists refer to humans making decisions as based on heuristics or mental shortcuts; that is, psychological approaches to working out solutions to decisions where there is limited information and time. Veblen was a pioneer in the study of behavioural economics and his major application of behavioural economics was his advancement of the idea of conspicuous consumption in what is easily his most famous book, *The Theory of the Leisure Class*, first published in 1899. In it, he argued that what the affluent leisure class spent on consumption signalled their capacity for making money. Now, the idea that humans used conspicuous displays of expensive purchases to exhibit their wealth was not a new one. We have seen that Bentham and Mill had not looked favourably upon spending on luxuries, and the idea that there was something wrong with ostentatious living can be traced back to Plato and Aristotle.

Veblen's concept of conspicuous consumption implied luxury spending, which meant that he also had to define it in terms of what constituted a necessity. He did so using collective terms, writing, 'The test to which all expenditure must be brought in order to decide that point is the question whether it serves directly to enhance human life on the whole' (Veblen, 1973: 79). Subsistence meant not just individual survival but the sustainability of the human race. The sustainability of life was a social process of consumption, and the work necessary for that sustenance meant that workers as a group needed a subsistence to enhance social efficiency. As had his predecessors, Veblen recognized that subsistence was 'not a rigidly determined allowance of goods, definite and invariable, in kind and quantity', but it meant 'consumption required for the maintenance of life' (Veblen, 1973: 83). Veblen spent little time defining this subsistence standard. Within his framework, the standard of living was a human institution that had to be explained in terms of its implications for the economy.

In writing about conspicuous consumption, Veblen referred to the display of wealth as wasteful, because the intent of the display was to show that the members of the leisure class were so well off they could afford to waste resources. Those displays, along with the conspicuous display of wasteful activities, showed that the person was flaunting the fact that they did not need to be concerned with work and subsistence. Earlier economists had deplored luxury spending by the wealthy as a wasteful use of the fund of capital. Veblen saw it as leading to distaste for work and dislike of spending on necessities by all members of society. He observed that 'With the exception of the instinct of self-preservation, the propensity for emulation is probably the strongest and most alert and persistent of the economic motives proper' (Veblen, 1973: 85). In modern society, the wealthy were a role model for all members of society, and they were not a good one.

As had all our thinkers so far, Veblen recognized that spending by the wealthy relied on their getting a very large portion of the total output of society. This unequal distribution of income caused deprivation among the poor in terms of the subsistence they could attain, and the economists reviewed earlier deplored it. They hoped that workers would get higher wages and use them to improve their sustainability. Veblen argued, however, that even if workers received higher wages, they might use the extra income to emulate the leisure class in more modest displays of wasteful consumption. Veblen worried that they would stint on necessities to keep up appearances (Veblen, 1973: 73, 138–41, 163 and 203). If they did, they would not use their increased income to improve their sustainability as previous economists had argued.

But this issue begged the question of whether workers would get a subsistence wage. In answering this question, Veblen focused on institutional rules. The wage bargain took place under a legal system that was based on contracts that were negotiated by persons with well-defined rights. Business owners had the right to use their property in any way they wanted, and workers had the right to accept or reject the wages they were offered. The evolution of the industrial system under modern technology had made these rights very unequal in negotiating a contract, however. Veblen wrote:

> A given workman's livelihood can perhaps, practically, be found only on acceptance of one specific contract offered, perhaps not at all. But the coercion which bears upon his choice through the standardization of industrial procedure is neither assault and battery nor breach of contract, and it is, therefore, not repugnant to the system of natural liberty. Through controlling the processes of industry in which alone, practically, given workman can find their livelihood, the owners of these processes may bring pecuniary pressure to bear upon the choice of the workmen; but since the rights of property which enforce such pressure are not repugnant to the principles of natural liberty, neither is such pecuniary pressure repugnant to the law. (Veblen, 1935: 277)

Following our previous thinkers, Veblen found that business owners had advantages over workers when it came to bargaining over wages.

He found those advantages to be based on a legal system in which courts sided with business against workers out of institutional habits of thought. We must remember that Veblen wrote when in the US minimum hour laws were overturned by courts as an abridgement to freedom of contract. To him, this bias of the courts was a matter of what he called 'cultural lag', by which he meant that institutional habits of thought had become outmoded by the changed technology of economic production. The legal system based on precedents and laws thought of as common under earlier economic life where workers were individual artisans, no longer matched the circumstance of the modern industrial economy.

Efforts to change the antiquated institutions faced an uphill battle, however, even in the context of popular democracy where working-class voters outnumbered businessmen. Because 'the common man is enabled to feel that he has some sort of metaphysical share in the gains which accrue to the business men who are citizens of the same "commonwealth" ', policies that helped business were 'felt to be beneficial to all the rest of the population' (Veblen, 1935: 286–9). In addition, business owners attained status as members in good standing of the leisure class. As a result, Veblen argued, policies that helped business and the wealthy were socially legitimate and those that hurt business were viewed as detrimental to social welfare. Business had too much legitimacy in terms of the institutional habits of thought of society and efforts to reform it would prove difficult.

Veblen's dour outlook raises an important point about the living wage. As we saw above, the living wage has a basis in medieval Christian notions of a 'just wage' centred on a concept of social justice rooted in the golden rule. But as Veblen once wrote, 'the place in men's esteem once held by the church . . . is now held by pecuniary traffic, business enterprise' (Veblen, 1919: 48). Business success was taken as a sign of wisdom, even among workers who did not profit from business activities. Consequently, when businessmen say that paying a living wage will have dire consequences, their word carries great weight due to the institutional habit of equating wisdom with making money. The economists in this book developed economic arguments in support of the subsistence wage but they overemphasized the ability of rational arguments to serve as a counter to institutional habits of thought. That was Veblen's message to them and to anyone advocating for a living wage.

As dour as this message was, Veblen went beyond it to try to identify social groups who would develop an industrial outlook that would set aside business habits of thought and take a social approach to work and a subsistence wage. In looking at labourers, Veblen found it to be a hopeful sign that they worked with the methods of modern production. Due to the advanced technology of mass production, what Veblen called the machine process, workers had to engage in rational thinking to function. Under the influence of the working with technology, workers might become more rational and question the pecuniary sagacity of their bosses. Working through their unions, they sought to place limits on the rights of property underpinning business (Veblen, 1935: 155–7). When he looked at unions, Veblen was impressed by their outlook as having social values. When he investigated that outlook more fully he found that unions functioned using the same principles as businessmen in terms of placing the gains of their members above the needs of society for efficient production (Veblen, 1914: 346–7). This interpretation was consistent with the views of Marshall and J.B. Clark, presented above, that unions could turn into a monopoly power seeking gains only for their members. But Veblen never made a clear distinction as to when they did so.

VILFREDO PARETO: ELITES AND THE SCIENCE OF WAGES

The ideas of the economists surveyed so far had an element of morality in them, coming from their own version of Smith's moral economy based on 'mutual love and affection'. Even the marginalists, with their stress on value-added, found ways to keep morals in economics. Among economists today, there are many who would not consider the moral economy as part of their concern, with the result that their interest in the subsistence wage and the consequences for not paying it has diminished compared to their predecessors. Instead, their thinking ignores the problem that there are moral judgements in every economist's choice of theories and questions. Still, most economists today would view economics as a pure science free of personal values and would find that the subsistence wage was not a scientific concept. A prominent thinker in the development of such scientific economics was Vilfredo Pareto (1848–1923).

As had the other economists in this book, Pareto considered social forces to be an important part of economic analysis. To him, however, the social force to be studied was the function of elites in society rather than the position of workers. Moreover, his study of elites had no particular policy implications. Instead, he insisted that his interest was strictly scientific. He wrote: 'one wants to know, *to understand*, no more' (Pareto, 1971: 2). While there might be limits to how economics might operate as a science, he believed that economists could use pure theory as an analytical method that did 'not have to take morality into account' (Pareto, 1971: 13). Armed with this ideal of a scientific economics, Pareto altered the meaning of utility from 'socially useful' to 'desired' (Cooter and Rappaport, 1984: 514). He then applied this concept to issues surrounding changes in the distribution of income. One of the problems in thinking about a living wage is that someone has to pay for it. Every change in the distribution of income has benefits for the persons gaining additional income but costs for those who must pay. In arguing for such a change it thus becomes necessary to consider whether the total gain is positive by comparing what the payers must give up in terms of lost utility to what the recipients gain. We have seen that Bentham and Marshall, for example, had written of how the wealthy might give up some pineapples so the poor could have more potatoes. For them, it was worth it, because to pay workers a subsistence wage, the wealthy would be asked to sacrifice little so the poor could gain much.

Pareto took aim at such 'interpersonal utility comparisons'. To avoid the need to make these comparisons, Pareto argued from the perspective of a pure model of exchange between two individuals with a set amount of two goods. They would only trade with each other if they both benefited from the exchange; that is, if they both gained utility. In that case, each one was better off and the total utility increased. When only one of them would benefit from the trade, no exchange would happen. As a consequence, Pareto concluded, when free exchanges take place in the market we can be sure that both parties are benefiting from greater utility and the welfare of society is increasing. To the extent that these individuals were forced to exchange when at least one of them did not want to, it was not possible to determine the total effect on the welfare of society. One of them would gain utility but the other one would lose, making the total effect immeasurable. Moreover, Pareto could claim he was being scientific, because he was not making value judgements about the merits of what each trader was consuming. From a scientific approach, pineapples and potatoes counted equally as satisfying human desires and it was difficult if not impossible to gauge the total effect of taking pineapples from the wealthy to give potatoes to the poor. There could be no statement of the effect on total welfare of forced exchanges where one party gained while the other lost. To him, measures for taking income from one sector of the economy such as the rich and giving it to another such as the working poor had to be judged on the basis similar to that of a voluntary trade by asking if the sector benefiting could compensate those who were paying and still have enough left over to retain some of the benefits. If so, then society was better off (Schumpeter, 1965: 131; Marglin, 2008: 180–2).

Pareto's approach raises a thorny issue for a living wage. The living wage is often justified as a moral right on the basis that it is unjust for workers to earn less than a living wage. It is only justice to pay them one. Who would argue with helping the poor? Well maybe Pareto did, for he raised the issue of justice for the persons who had to sacrifice in order for workers to get that living wage. When pay for one sector of the economy is increased, someone else must pay for it such as consumers through higher prices or owners of capital with lower profits. What about justice for them? How do we know that their pain from giving up pineapples is less than the benefit of workers having more potatoes, to use a familiar example? Advocates for a living wage might believe that the answer to this question is obvious, but Pareto wanted scientific proof.

His version of scientific proof gave rise to the principle of 'Pareto optimality' with its idea that it is hard to identify an optimal distribution of income. The test is whether we can develop a policy that improves the lives of some members of society without making other members of that society worse off. If we can, then we have increased the total utility of society. If at least one member of that society experiences a reduction in utility, then from a scientific perspective the results are ambiguous. That person's losses of utility may be greater than the benefits conferred on those who gain from the policy. Only voluntary exchanges in a free market give unambiguous results, because they imply that all parties to the exchange have gained. Aquinas had required that a just wage be set in the absence of coercion. To Pareto, taking income from the wealthy violated this requirement (Marglin, 2008: 180–2).

In reaching this conclusion, Pareto had little to say about work or workers' lives. Individual humans had unequal abilities and these were the reason for 'economic and social inequalities'. Still, he did not think that workers would earn incomes below a subsistence level. Persons whose ability would only entitle them to below subsistence wages were either helped by others or allowed to perish (Pareto, 1971: 281–93). Given that there were no policies that Pareto could approve of for altering the distribution of income, we might ask why he even raised the issue of aid going to workers earning below a subsistence wage. Pareto would respond from his understanding of the needs of elites. He wrote: 'It is easy to understand that if the workers were to disappear the owners of the factories where they worked and those who, in the so-called liberal professions, derive their income from these factory owners, all fall into poverty' (Pareto, 1971: 304). Given that those elites understood this possibility, their own self-interest would encourage them to recognize the sustainability issue and voluntarily improve the conditions of workers.

In terms of defining a subsistence wage, Pareto noted that there was a 'lack of precision in this term "means of subsistence"'. He described the problem as follows: 'Though different as between people and countries, it certainly includes, in addition to food, protection from the elements, that is, clothing and shelter, and also fuel in cold countries. And all these components vary according to circumstances' (Pareto, 1971; 305). This approach represents a basic subsistence and does not include the decency component that so many of the previous thinkers had included in the subsistence wage. To some degree we may attribute Pareto's defining the subsistence wage in this way as a component of his scientific approach. The biological needs for survival can be determined with more scientific precision than the decency component that earlier economists had included in the subsistence wage.

The voluntary nature of Pareto having the elites solve the problem of a subsistence wage was consistent with his opposition to unions. His *Manual of Political Economy* is a studied attack on the way he believed unions forced their views on employers under the sanction of the legal system of the countries of the European continent. He wrote: 'The historian of the future will say: although France at the beginning of the twentieth century was not yet a state dominated by a privileged caste drawn from the working class, nevertheless the elements were already developing from which was to come the domination of that caste' (Pareto, 1971: 351; see also 77–8 and

355–68). In making this attack, Pareto did not consider whether unions might be redressing the unequal bargaining power that workers had compared to employers. They were simply an impediment to a free market that was the best way to secure an optimal economic outcome.

JOSEPH A. SCHUMPETER, CREATIVE DESTRUCTION AND RISING WAGES

Joseph Schumpeter (1883–1950) has an enduring reputation for his theory of the entrepreneur and the entrepreneur's role on the process of creative destruction. To Schumpeter, the entrepreneur was the pivotal figure in capitalist development; the entrepreneur was the person with the drive to get new products and production processes introduced, thereby making capitalism the dynamic economic system that it was. Whenever an entrepreneur introduced a new product or production process, the economic world turned upside down and everyone in the economy had to change what they did. In the process, new industries were created that destroyed old ones – think of how much the internet has changed the way businesses must now operate – but the overall outcome was better and cheaper products for consumers. As a reward, the entrepreneur earned high profits, but these lasted only until the next entrepreneur came along and destroyed what the previous entrepreneurs had created.

Because of his belief in the process of creative destruction, Schumpeter was particularly annoyed by measures taken to eliminate poverty. To him, poverty was a part of the process of creative destruction. When Henry Ford turned the automobile into a mass production item, he destroyed the jobs and wages of nearly everyone involved in using the horse as a transportation item. These displaced workers surely suffered from earning less than a subsistence wage. Following Adam Smith, however, Schumpeter argued that the best way to eliminate poverty was to promote the wealth of the nation. In his classic book, *Capitalism, Socialism and Democracy*, he argued that another half century of growth as capitalism had experienced in the past 'would do away with anything that according to present standards could be called poverty'. To be sure, he was aware that the term 'present standards' was difficult to define. He noted that there were some things the workers of his day had that were not attainable by the wealthiest kings of the eighteenth century, but the main gain for workers was that things available to the royalty of the past, he used silk stockings as an example, were now available to workers and their families. If this process continued, he wrote, 'It is easy to see that all the desiderata that have so far been advanced by any social reformers . . . either would be fulfilled automatically or could be fulfilled *without significant interference with the capitalist process*' (Schumpeter, 1962: 68–9, italics in the original). To advocates of a living wage, he raised an important point. More recently, it has been calculated that the official US government poverty line is at a level of real income that only 10 per cent of the population earned about 100 years ago (Wheelan, 2002: 107). The capitalist system did reduce absolute poverty, according to Schumpeter, but for the capitalist process to work effectively, all members of society needed to take the long-term perspective of a half century.

LUDWIG VON MISES AND THE SCIENCE OF CHOICE

The next step in the development of pure economic theory is the Austrian school of economics, a name given to a group of economic theorists who studied in Vienna in the early decades of the twentieth century. The early members of the school, such as Carl Menger (1840–1921), had made original contributions to the marginalist revolution. The next generation from the school focused their attention on the study of the effectiveness of markets as the best way to solve economic problems. One prominent example of this school was Ludwig von Mises (1881–1973).

Mises created his version of economics from the idea that humans always actively sought the achievement of goals and their economic choices in terms that the behaviour they chose to follow reflected their pursuit of those goals. Economists did not need to investigate what those goals were, however. A scientific approach to economics could settle for an understanding of how individuals made choices in pursuit of their goals. A basic goal that all humans faced was survival. One of the great discoveries of humankind was that the division of labour enhanced the prospects for survival by increasing the human ability to produce goods and services. For the division of labour to work, humans made the choice to cooperate in work through the market exchange of goods and services. This choice to cooperate was a central human decision, and economics should study how that cooperation was socialized and coordinated by markets.

Here again we are reminded of Adam Smith and his moral economy versus the market economy. Mises dismissed the moral economy as not in line with the realities of economic life. In arguing for this point of view, he wrote: 'One must study the laws of human action and social cooperation as the physicist studies the laws of nature' (Mises, 1963: 2 and 15). In making this scientific study, an economist would find that well-being was only one of the ends an individual might choose. Mises argued:

> It is a mistake to assume that the desire to procure the bare necessities of life or health is more rational, natural or justified than the striving after any other goods or amenities . . . The impulse to live, to preserve one's own life, and to take advantage of every opportunity of strengthening one's vital forces is a primal force of life, present in every living being. However, to yield to this impulse is not – for man – an inevitable necessity. (Mises, 1963: 19)

Veblen argued that when humans emulated the leisure class their goals became contrary to the goal of the survival of society. Mises disagreed. To him, the goals of emulation or social survival were beside the point for economics. Consequently, he disparaged attempts by economists to develop any scale of human needs. A nutritionist could indicate how alcohol and tobacco were detrimental to health. Economists had to accept humans as flawed beings who might be motivated by goals that were inimical to their health and well being (Mises, 1963: 96–7). They should not be in the business of telling the subjects they were studying how to behave (Mises, 1963: 154).

In short, the attempts by previous thinkers to justify a subsistence wage on the basis of its impact on the sustainability of workers and their children were misguided. Workers might not choose to consume the items that improved their health and economists like Marshall and Veblen were wrong to tell them that they should. What items workers or any other individual consumed were ends. The best that an economic study of the results of individual choices could say is that those choices indicated the priorities of the individual, but economists had to be silent on the wisdom of those choices (Mises, 1963: 125–6 and 215–17).

When he looked at the choice individuals made in determining to work, Mises argued that work gave workers negative utility but as with consumption the degree of that disutility could not be known as all workers differed. The ends workers might gain from work did not matter. All that mattered to Mises was that workers went to work to gain the income they needed to buy the goods and services they wanted. They would work until they had enough income to satisfy their wants and then they would stop. Some might become workaholics who labour long hours to maintain an affluent lifestyle. Others might be minimalists who chose less work to support an austere standard of living. Economics should be studying the ways workers chose when, how and where to work and nothing more (Mises, 1963: 131–8).

To Mises, supply and demand in labour markets allocated workers to the production of items that consumers wanted the most. Their innate ability established where an individual would land in the division of labour. The income that a worker's ability earned was decided by whether or not consumers wanted what that worker produced. To the extent that large numbers of consumers paid high ticket prices to see films, actors would earn high pay. They had not always earned high pay and there was no guarantee that they always would. Economists should not be critical of a market system that gave high incomes to persons who supplied what consumers wanted, even when they thought those consumers chose badly. They should stick to the reality that in a market economy individual incomes reflected consumer choices. When consumers changed what they bought that would change the distribution of income.

With this approach Mises rejected the idea prevalent among the thinkers in the previous sections that workers suffered from unequal bargaining power in labour markets. Given his free market views, he believed that when an employer mistreated workers, those workers should choose another employer. They would be able to find other jobs as long as they did not try to bargain for wages that were above what the market deemed a fair wage for their ability. As for employers being in a better position to outwait workers in the struggle over wages, Mises argued that the existence of what we now call frictional unemployment indicated that many workers could take their time when searching for a new job. Workers would earn low wages only by choosing not to search for better jobs (Mises, 1963: 283–90, 590–1, 596–7 and 624) and efforts by unions or the government to aid workers would not change this outcome.

Rather, Mises saw all of the gains made by workers in terms of reduced hours or improved pay as having been the result of the prosperity brought about by the capitalist economic system. This prosperity also gave workers more choices. Long before Mises, Adam Smith had argued that a growing economy was the best way to improve the wages and working conditions of labour. Smith had written of a rising subsistence. Mises, however, set aside the idea that there was a subsistence wage, including a decency component, as having no pertinence in the determination of wages (Mises, 1963: 610). To him, prosperity had eliminated the idea that workers earned below subsistence wages. To be sure, there was still insecurity in economic life, but efforts to give workers or anyone else economic security were simply misguided attempts to protect income from the marketplace. Instead, Mises found insecurity to be a valuable economic motivator, because it compelled workers to choose actions that kept them healthy and able to work (Mises, 1963: 852).

Mises' perspective regarding the effectiveness of individual choices made in the marketplace went beyond the respect Smith had for the market. In terms of our interest in a living wage, it poses a number of challenges. First, if advocates for a living wage are concerned for workers who do not earn one, they need to first consider what choices those workers made to put themselves in their straitened condition and what choices they might make to get out of it. Low-wage workers might be capable of earning higher income, but they must search for other jobs to get it. To Mises, their failure to search for better jobs indicated a priority for stability over the chance of increased income. Giving them a secure income would only strengthen that priority. Second, Mises did not think economists or anyone else should be telling workers what choices they should make in terms of where to work or what to consume. Advocates for a living wage might not be economists, but Mises would not have given them any privileged standing as having the wisdom to supersede whatever results human choice created in the marketplace.

FREDERICH A. HAYEK: SUBSISTENCE AND SERFDOM

Frederich A. Hayek (1899–1992) was another leading member of the Austrian school who argued for the benefits of the free market. As a result in 1944 he published an attack on the modern welfare state, *The Road to Serfdom*. His viewpoint on economics was based on 'the fundamental principle that in the ordering of our affairs we should make as much use as possible of the spontaneous forces of society, and resort as little as possible to coercion' (Hayek, 1994: 21). He interpreted this principle by treating the market as a spontaneous force and government planning as involving coercion. The problem with planning was that its goal, social welfare, was too vague to serve as a guide for any government policy. Following Bentham's edict that the goal of any policy was to produce the greatest good for the greatest number, economists had translated that goal into enhanced social welfare. To Hayek, the well-being of a society with a large population was caused by many factors which could be combined in a multitude of ways. He wrote: 'It cannot be adequately expressed as a single end, but only as a hierarchy of ends, a comprehensive scale of values in which every need of every person is given its place' (Hayek, 1994: 64). As a result, he argued, no person could know what would advance the well-being of anyone they did not know personally. Hayek doubted that anyone was wise enough to make judgements about what would unambiguously lead to enhanced social welfare. The task of advancing social welfare would thus be left to experts, who would impose their own standards of social welfare on those they would be expected to help (Hayek, 1994: 66–71). Collections of individuals put together in some central planning body would not have the wisdom to make decisions about what would contribute to the welfare of others.

Hayek interpreted such coercive efforts to enhance social welfare as placing humanity on 'the road to serfdom'. Here he had in mind the same warning we saw John Stuart Mill give earlier, that government programmes might make those helped by them dependent on the government just as feudal serfs were dependent on their lords. Feudalism, however, was also a system of mutual obligations and the locus of the Christian notions of the just price and the just wage as indicative of social justice. Hayek would have none of it. He asked, 'Have we not all some idea of what is a "just price" or a "fair wage"? Can we not rely on the strong sense of fairness of the people?' He responded that 'there is little ground for such hopes'. The level of wages in any industry was the way a market economy motivated workers to move into occupations where labour was needed the most. Any attempt to establish a 'fair rate of pay' would impede the flow of labour to the areas of the economy where it would be put to its best use (Hayek, 1994: 122). In the market, every individual took care of their welfare by selling resources, in this case their human labour, for the most money possible and then using the proceeds to purchase whatever goods and services gave them the most satisfaction. The free market produced the most welfare possible and efforts to change market outcomes would very likely reduce that welfare.

Hayek understood the goal of efforts to give workers a fair rate of pay as providing them with economic security. He considered this concept to be as fuzzy as the proposals based on social welfare. Nevertheless, he gave some ground on this issue by agreeing that there were two types of security, a limited version that everyone should have and an absolute one that no one could be guaranteed to have. The first included 'security against severe physical privation [and] the certainty of a given minimum of sustenance for all' while the second was 'the security of a given standard of life'. Here Hayek could be seen as supporting a living wage as a minimum of subsistence and to some degree he did. But he also believed that for the market system to work effectively, some declines in income were needed. The question was how much of a decline should take place. In answering that question, Hayek saw that there were 'difficult questions about the precise standard which should thus be assured . . . but there can be no doubt that some minimum of food, shelter, and clothing, sufficient to preserve health and the capacity to work, can be assured to everybody' (Hayek, 1994: 131–2). Getting the level of help right was important, because Hayek believed that 'the more we try to provide full security by interfering with the market system, the greater the insecurity becomes' (Hayek, 1994: 143).

In this way Hayek set a loose standard for how far society should go in establishing a living wage. It should not go so far in pursuit of this goal so as to impede the wealth-producing power of the market process. The market system had done more to help the poor than any programme of social justice. Still, the government should try to give its citizens some degree of security and Hayek gave an interesting reason for why it should do so. He wrote:

> As a result of the dissolution of the ties of the local community, and the development of a highly mobile open society, an increasing number of people are no longer closely associated with particular groups whose help and support they can count upon in the case of misfortune . . . The assurance of a certain minimum of income for everyone, or a sort of floor below which nobody need fall even when he is unable to provide for himself, appears not only to be a wholly legitimate protection against a risk common to all, but a necessary part of the Great Society. (Hayek, 1989, vol. III: 554–5)

Because Smith's moral economy of mutual assistance no longer existed, workers had to become part of a market system that made them dependent on themselves for taking care of any difficulties they might encounter in life. They could not expect similar moral treatment from the market as they would from the moral economy of mutual obligations, for the market has no morals. As a result, Hayek argued, the market system was asking workers to choose between the security of mutual caring versus the risk and reward approach of the market. Given that choice, few workers would take the risks involved with the market when they realized that it would abandon them when, 'through no fault of their own, their capacity to earn a living ceases'. Some form of assistance to low-paid workers was needed for the market to function smoothly. In terms of how much assistance they should be given Hayek agreed that it depended on the per capita wealth and income of the particular nation. He warned, however, that anti-poverty programmes should not use the concept of justice to turn a living wage into a system that totally protected individuals from the market process (Hayek, 1989, vol. III: 55).

What challenges does Hayek present to the realization of a living wage, especially since he seems to agree with it? The key is in ensuring that a living wage does not interfere with the market process. Wage levels in a market economy operate to encourage workers to move from low-paid, low-productivity jobs to higher-paying ones where they can add more value to the economy. Interference with this process will reduce overall productivity in the economy. By impeding the functioning of the marketplace, Hayek would argue, advocates for a living wage will create unintended consequences that they could not anticipate nor resolve. That is the primary challenge Hayek raises for them.

He also raises two minor challenges. First, his belief in the importance of individualism captures the spirit of many persons in the US who believe in individual responsibility. That individualism also meshes well with the ideology of the free market. On both accounts, these persons will not be sympathetic to proposals to set aside market outcomes and give workers a living wage however measured and justified. Second, Hayek reminds us that some of the best minds in economics grappled with the idea of a living wage, but never defined it in a form that was operationally robust or socially acceptable. He would find current advocates for a living wage who think they could do better than Smith, Mill, Marshall, Marx and Veblen to be guilty of a fatal conceit.

MILTON AND ROSE FRIEDMAN: WAGES AND FREEDOM

Milton Friedman (1912–2006) and his wife Rose Director Friedman (1911–) did more than any other economists to produce accounts of their version of economics that were accessible to a wide audience, producing two best selling books and a popular television series that set forth in clear terms the benefits of free markets. Those books are important because they have proven very effective in influencing several generations of individuals in the US of the virtues of a free market approach. Here I will put forward the ideas presented in the earliest book, *Capitalism and Freedom*. Even though Milton Friedman gave Rose Friedman title page credit for her assistance, I will follow his lead and refer to the book as having a single Friedman as the author.

Friedman began the book by making it clear that he was a minimalist where government was concerned. To him, government activities had two sides; they could preserve freedom or they could threaten it. These two sides related to two types of freedom. Economic freedom gave each individual the freedom to choose what to buy and sell in the marketplace. Political freedom provided individuals political rights to vote, speak freely, and form political organizations. According to Friedman, economic freedom and political freedom had developed together with the capitalist free market economy. But they did not always work together. Individuals could use political freedom to promote governmental policies that reduced economic freedom through coercive measures. The problem was that those coercive measures could also then be used to diminish political freedom. Consequently, Friedman argued that a reliance 'on voluntary co-operation and private enterprise' could counter the potential abuse of power by the government (Friedman, 1982: 3–4).

In holding to this view, Friedman credited Bentham for emphasizing how the extension of political freedom by giving votes to the masses would help them establish economic freedom for themselves (Friedman, 1982: 10). The problem with these government activities was that however well intended they were, they interfered with the economic freedom necessary for the market system to work effectively. Freedom of exchange was needed in order for the coordination of production to take place through the division of labour. Friedman described the importance of this economic freedom for workers as follows: 'The employee is protected from coercion by the employer because of other employers for whom he can work' (Friedman, 1982: 14–15). Here we have Smith's market economy in all its purity, with no morality needed. Competition in the marketplace will ensure that every individual is protected from coercion regardless of the morality of individuals who buy or sell.

What about workers who earn a low wage? Let us recall from above that Smith anticipated that the market system would ensure them a subsistence wage. But he also recognized that unequal bargaining power might permit employers to keep wages below that level. Writing later, John Stuart Mill added that unions were needed for workers to gain a market wage. Neither Smith nor Mill looked for government aid to workers because they did not trust the government, especially a government that in their day was controlled by the wealthy. Friedman also did not trust the government in part because who controlled it could change and in part because it had the potential to be coercive. He also did not trust unions because he found them to be coercive as well. This view came through in his opposition to minimum wage legislation and unions. Regarding the minimum wage legislation he found that while its proponents 'quite properly deplore extremely low rates' the minimum wage law, while it might raise the wages of some workers, could not 'require employers to hire at that minimum all who were previously hired at wages below that minimum'. As a result, some workers would lose their jobs and the amount of poverty would increase (Friedman, 1982: 180). In the same manner, unions might raise the wages of their members, but they would reduce employment in unionized industries. Moreover, unions were not truly effective because workers would have got those increased wages anyway, as long as the market operated effectively (Friedman, 1982: 123–4). Here Friedman considered unions to be a monopoly, pure and simple, and not a vehicle for helping workers get what the market should have granted them had employers not had greater bargaining power, as many previous writers in this chapter had argued.

At its heart, Friedman's version of economics was marginalism without morals. The wage of any worker was equal to what the worker added to production and the market through competition ensured that this result took place. Anyone who questioned the morality of this process was engaged in special pleading that could only interfere with the market and produce less than optimal results. Because the market system had worked so effectively for the previous two centuries, in countries where it existed poverty had been reduced in absolute terms although many persons still lived 'under conditions that the rest of us label poverty' (Friedman, 1982: 190). In Smith's small, moral economy, mutual love could compel acts of charity to alleviate poverty. The large-scale society of the modern world should cause no such expectation. Freidman agreed and saw this difference as 'justifying governmental action to alleviate poverty; to set, as it were, a floor under the standard of life of every person in the community' (Friedman, 1982: 191). The questions to be decided were how much of a floor and how to do it.

In determining how much the standard would be, Friedman believed that there was no way to decide beyond the amount society as a whole was willing to pay in taxes to support anti-poverty programmes. As to how to do it, he stressed that no anti-poverty programme should be allowed to 'distort the market or impede its functioning'. That was why he opposed minimum wage laws. Instead, he proposed a 'negative income tax'. Under this system, everyone would file an income tax and persons below a threshold of income would not pay a tax and would receive money back. That is, they would get a subsidy from the government to be paid through the tax system. In this way they would work at their jobs and earn whatever pay their productivity would gain for them. If that pay fell below the poverty limit, they would get a subsidy from the government, but that subsidy would not affect their market wage directly. While this approach might reduce their incentive to find a new job, it would not interfere with the market in the way a minimum wage law would. Moreover, the 'negative income tax' would not involve government coercion by making employers pay higher wages and would not require a government bureaucracy to administer it (Friedman, 1982: 191–2). Today the Friedman's 'negative income tax' has become the earned income tax credit, and its existence will affect any calculation of a living wage. For example, Thomas Sowell cites 'the fact that Americans living below the official poverty level spend $1.75 for every dollar of income' as evidence that studies of the income levels of the poor understate the resources available to the poor (Sowell, 2008: 129).

Friedman presents a series of challenges to a living wage for workers. The biggest challenge is the issue of the extent to which the quest for a living wage impedes the functioning of labour markets. From Adam Smith on, economists have argued that wages send a signal that attracts workers to the jobs where they will be most productive. Workers who are dissatisfied with their pay should do what it takes, change jobs or improve their skills, to get a higher paying job; using the political process to get them a living wage will impede that process. Moreover, unless the living wage is set as a national standard, it will only help a few workers in the jobs where it is mandated and some of them may lose their jobs. Is there not a way to give those workers a better standard of living without the living wage, Friedman would ask, and his negative income tax was one possible answer. Inclusion of government transfer payments to the poor in calculations of a living wage may alter estimates of the number of persons who do not earn it.

A final challenge Friedman presents is the issue of how to define a living wage. Only here the Friedman in question is Rose and not Milton. In turning to her analysis of the problems of poverty we will shift usage and refer to her as R. Friedman. R. Friedman wrote her analysis of poverty during the 1960s, when the federal government of the US had declared war on poverty. She was curious why poverty was such a 'major public issue' given that the US was 'enjoying an unprecedentedly high level of income that is widely shared'. To her, the problem was clearly one of definition, because 'poverty is relative, not absolute' (Friedman, 1965: 1–2). For an absolute standard of poverty, she turned first to history, pointing out that in the eighteenth and early nineteenth centuries poverty was defined as 'getting enough to eat'. She described the situation of poverty studies at the time as follows: 'It did not occur to students of living standards of that day that the working classes might have essential needs over and above subsistence' (Friedman, 1965: 5).

Because R. Friedman did not mention who those 'students of living standards' were, we must wonder the extent to which she understood the history of her own discipline. As the bulk of this chapter has argued, the major figures in economics during the late eighteenth and nineteenth centuries all saw the subsistence wage as including more than biological subsistence due to an additional decency component. She made her opposition to this idea clearer when she criticized a definition of poverty that referred to the poor as 'those who are not now maintaining a *decent* standard of living' (Friedman, 1965: 30, original italics). This definition did not give 'an objective criterion' for determining who was poor. She wrote: 'Standards of decency, like fashions, change from year to year, and mean different things to different people. How do we decide what wants are "needs" and what "needs" are basic and in what amount?' (Friedman, 1965: 30). Thanks to technological innovation and the growth of the economy, many persons at the lower end of the income scale in the US were able to consume a broad array of items. Most families had television sets and automobiles and public education ensured that all children attended school. How could one classify persons owning such items and getting a free education as poor? (Friedman, 1965: 7–8). The problem with a relative definition of poverty was that it was 'tantamount to saying that poverty will always be with us' (Friedman, 1965: 26).

To give a more objective definition of poverty, R. Friedman used the 'income level which provides nutritive adequacy', which is still the US government's standard (Waltman, 2004: 56–62). To be sure, she found ambiguities in even this measure. Nutrition was still an imprecise science and it was not clear how many poor persons actually spent their incomes on nutritious food. Moreover, since there were no objective standards for adequacy for clothing and shelter, these had to be estimated in terms of their cost as consistent with what the poor would spend in attaining nutritive adequacy (Friedman, 1965: 15–16). Nevertheless, R. Friedman argued that her definition was less ambiguous than that used by the federal government. Her measure of the poverty level of income was also lower than that used by the government, which allowed her to conclude that, 'there is negligible poverty in the United States today' (Friedman, 1965: 17).

When Adam Smith defined subsistence as basic needs plus what the community deemed a decent lifestyle, he had in mind more than the biological sustainability of the workforce. He also included the idea that workers needed to have a decent life as defined by the standards of the community in which they lived. Now that idea is much harder to define than basic human needs in terms of calories, clothing warmth, and homes with electricity and indoor plumbing. A decent standard of living in this sense is truly relative because it is always changing. R. Friedman raised an important issue in terms of how you define an objective standard for poverty in a country where the economy keeps changing. Regarding the living wage she presents a large challenge. There must be either an absolute measure of the living wage such as she has offered or there must be a rising living wage that must be revised continuously. This latter approach was set forth by Ben Seligman.

BEN B. SELIGMAN AND THE DEFINITION OF POVERTY

Ben B. Seligman (1912–70) considered himself to be a member of the institutional school of economics and took to heart the ideas of Veblen (Stabile, 2008). He used those ideas in his book, *Permanent Poverty: An American Syndrome* (Seligman, 1968). The book is a thorough review of the state of the poor in the US in the 1960s. Of special interest here is Seligman's analysis of the methods used to define poverty.

The public attention being paid to poverty in the 1960s had created a number of government and academic studies of the extent to which poverty existed in the US. Seligman reviewed all of those studies and found that they broke down on the issue of defining the 'poverty level'. Seligman recognized that they faced a daunting task of determining 'what society believes is essential for minimal living' (Seligman, 1968: 21). The problem was in finding a measure of poverty that took into account different family size, age of members of the family, and the health needs of the family (Seligman, 1968: 23).

The approach Seligman approved of was the use of a 'poverty band', a range of income levels that would fix low and high limits on poverty. This poverty band approach would give a measurement of poverty that did not have to rely on a set of commodities that all persons needed to meet minimal needs. Seligman described the advantages of such a measure of poverty as follows:

> Clearly, there is a measure of flexibility in defining poverty, especially if needs are taken into account. With needs representing an expression of social standards, poverty becomes an indication of the extent to which sectors of the population participate in the larger society. Electricity, automobiles, and televisions may appear to some sociologists to be luxuries, but today they do provide measures of involvement in the habits of western civilization. (Seligman, 1968: 27)

In writing about conspicuous consumption, Veblen had made a distinction between products that contributed to the life of the human race and those that did not. Seligman followed that distinction but indicated that its measure had changed. An automobile may have been an item of conspicuous consumption when Veblen wrote in 1899, but by the 1960s it had become a necessity for many workers who needed one to get to their jobs. And it is hard to imagine any person following social and political events without television. Seligman felt so strongly about the need for the poor to participate in society that he devoted a chapter to the legal needs of the poor, arguing that without legal counsel the poor would be separated from many social amenities, such as tenant protection and divorce, that were available to the rest of society (Seligman, 1968: 143–59).

In opposition to such an expansive view of what constituted basic human needs, Seligman presented and criticized R. Friedman's study that based poverty on the number of calories consumed per day. The difficulty of this approach was that it 'would equate poverty with hunger and since no one in his right mind would assert that hunger is rampant in the United States, *ergo* there is little or no poverty to be observed' (Seligman, 1968: 33). Poverty had social aspects to it as a gauge to how well the poor enjoyed the advantages of economic development. Seligman thus brings us back to Adam Smith's moral economy and the decency component of the subsistence wage.

CONCLUSION

The starting point in the sustainability argument is with Smith's writing that if wages were not sufficient, 'the race of such workmen would not last beyond the first generation' (Smith, 1976b, vol. I: 76). Smith lived in a time when starvation for the poor remained a social problem and it continued to remain one for the next century; Bentham, Mill and Marx continued to worry over the issue of the sustainability of the workforce. Smith anticipated that economic growth would take care of the problem of starvation and eliminate absolute poverty, but again we must recall that a subsistence wage for him and all the other early thinkers meant more than fighting off starvation and sustaining the workforce. Hence they also began thinking in terms of relative poverty, poverty as related to the standard of living of the wealthy, as Marx described it. By the time of Alfred Marshall, the worries over starvation had abated and we have seen that by the 1960s Ben Seligman argued that the poverty level meant more than enough food to eat.

The diminished need to worry about bare subsistence is reflected in the writings of the market economists. Bentham had argued that utility calculation began only after subsistence was provided and Marshall agreed. Market economists made this argument implicit by setting forth theories of utility that did not bother to take the need for subsistence into account. Without this assumption that subsistence had been provided, they would have had a difficult time working out their ideal of perfect competition. It is hard to imagine a starving person acting rationally and with perfect information. Could Pareto optimality have coexisted with starvation? Would it really have been difficult to make an interpersonal utility comparison between a wealthy person and a starving one? These are all questions market economists have been able to avoid.

Given that workers in the US, in most of Europe and in parts of Asia can be sure they will be sustained, does that mean advocates for a living wage should give the points on the issue of sustainability to the market economists and forgo this argument as justifying a living wage? The answer to this question depends on why workers are sure they will be sustained and how sure they are. One of the reasons the moral economists worried over the sustainability issue was that they believed that bargaining power in labour markets favoured employers. Starting with John Stuart Mill, two generations of economists argued that unions were necessary for workers to get the higher pay a growing economy should produce for them. They preferred unions to government programmes to avoid interference in the market and to stay away from the paternalism they thought government would bring. Market economists argued that the market automatically gave workers the higher pay economic growth has allowed and that unions were not a part of it. Unions in the US are in decline in the private sector and the wages of workers who formerly would have joined unions are not keeping pace with economic growth. If those wages fall back to basic subsistence then the issue of sustainability will be back on the table.

Moreover, in the global economy the sustainability issue continues to be vital. Low-wage workers throughout the world, and they are the norm, barely make a sustainable wage and in many cases it takes an entire family's wages to sustain the family. In such cases we may follow Adam Smith's hope that economic development can increase those wages but that outcome would depend on how economic development changes the bargaining power between workers and employers and whether it is accompanied by the development of institutions that place limits on how employers treat workers. Until those institutional changes are in place, sustainability will be an issue for most workers around the world.

3. Capability: work and wages, virtue and skill

INTRODUCTION

The capability approach takes seriously the idea that society should set a number of objectives for its members. It wants them to be effective producers and effective citizens. In the language of modern economics, this requires that workers develop their human capital and their social capital if they are to participate in life in a meaningful way. In using these terms, however, modern economists are dressing up old concepts – virtue and skill – in their particular jargon. The early economists, while their jargon was not so specific, were also concerned with capability. To some extent, as noted in Chapter 2, that concern coincided with their concern of sustainability. Workers with low levels of sustenance could not very well aspire to high levels of capability. In this chapter we will see that the early economists had higher standards for what levels worker's capability could reach and they related them to the issues of work and wages.

To them, the capability approach meant that in looking at work and wages society needed to consider whether they enabled workers to improve their abilities as workers and as members of society and to enhance those abilities in their children. As the market economy developed, however, economists began thinking that the enhancement of worker capability was more an issue for individual workers than for society. In the world of the advanced economies, it means that individuals must make informed choices in how to spend the income the market provides them. Still, if the market does not provide them with a living wage, they will not have many choices to make, and certainly not the sort of choices that will improve their capability. Hence the idea that income must be sufficient to include the development of capability must be part of any discussion of the living wage. It also means that workers who earn wages under conditions that diminish their capability may not have a living wage. This was an idea that Plato and Aristotle understood very well.

PLATO, ARISTOTLE AND AQUINAS: WEALTH AND VIRTUE

We saw in Chapter 2 that Plato clearly disliked the competition of the marketplace and the persons who used it to accumulate wealth. To him, they placed the love of money above all other activities, which meant that the pursuit of wealth was inimical to creating an effective society based on virtuous behaviour. Virtue was thus the highest capability and calculations of self-interest, to the extent they influenced human behaviour, had to be controlled in the interest the community had in having virtuous citizens. Plato did not believe in using wealth as an incentive to induce a person to choose an occupation; persons involved in money-making (especially the sophists) were more attached to money than to the community (Plato, 1888: 50–4 and 109–10). They could not aspire to virtue.

Virtue was especially important for the guardians and rulers of the state. That was why Plato proposed in his *Republic* that to keep them from being distracted by the lure of money they live a communal life with only the minimal livelihood they needed (Plato, 1888: 266). Even he had to admit, however, that the minimal livelihood they needed would vary in terms to the capability their function required of them. To be sure, he believed, much of human capability was created by nature. A person either had the capability to be a philosopher or did not. That was why potential guardians and rulers had to be selected carefully. But their gaining the different skills and virtue needed for their respective capabilities required the fulfilment of different needs. Guardians had to have weaponry, fighting skills and valour and the means to produce them would be different from the means needed to provide the wisdom, thought processes and political courage of rulers. The development of capability might mean a different level of a living wage.

As was the case with his more expansive view of the market, Aristotle took a broader view of the need for virtue by all citizens. To him, household management involved the acquisition of the resources needed by a household, because they contributed to a person's efforts to live the good life of virtue that Aristotle deemed important. He recognized the obvious notion that the good life was not possible without a minimal amount of necessities (Aristotle, 1986: 28). The focus on money-making by specialists in trade helped to improve the resources available to the household, and the purpose of trade was to allow members of society to earn a subsistence that enabled them to live the good life of virtue. The problem was that persons engaged in the pursuit of wealth were eager for an affluent life but not for the good life of virtue. In making this argument Aristotle could thus draw a distinction between money-making that was acceptable because its goal was to meet basic needs and achieve virtue and money-making that was not acceptable because its goal was profit and wealth. In the same vein, he found work and wages to be antithetical to virtue, writing 'no man can practice virtue who is living the life of a mechanic or laborer' (quoted in Mokyr, 1990: 196). This denigration of money-making and work as evils to be minimized is based on the capability approach in the sense that Plato and Aristotle's version of a living wage was the least amount a person needed to develop the capability for virtue. Regarding wealth in general Plato and Aristotle especially did not care for conspicuous consumption (Spengler, 1955: 376–7) and Aristotle's version of a living wage intended to get his contemporaries to think about virtue more than they did about the display of their wealth.

Aristotle also worried that the poor members of society would not have enough income to provide themselves with the basic necessities and they would suffer a decline in capability as a result. He wrote: 'What a true friend of the common people should do is see to it that the multitude is not kept excessively impoverished, because this causes a people's rule to be vicious' (Aristotle, 1986: 182). Poverty, Aristotle is arguing, can reduce the capability of the mass of people to participate in democracy. The state should help them gain a level of wealth that would enable them to attain sufficient virtue to function effectively as members of a democracy. Moreover, it was in the interest of the wealthy to contribute taxes to pay for eliminating poverty. Aristotle's argument parallels the 'civic republicanism' justification for a living wage that Jerold Waltman uses in his book, *The Case for a Living Wage* (Waltman, 2004: 11–17).

By making virtue an objective superior to the accumulation of wealth, Aristotle and Plato made a principled stand against the market, value-added approach and in favour of their capability (virtue) approach. We must recall, however, they had personal and family wealth (as well as slaves) to give them the leisure to study virtue. Still, their idea that the purpose of income was to develop the capability of virtue remains influential. As in the last chapter, this influence was mediated through the writing of St Thomas Aquinas.

We saw in Chapter 2 that Aquinas started from the proposition that it was morally proper for humans to seek after material possessions to provide for their sustenance. To him, the support of life through material possessions was necessary to make possible the attainment of the higher human goal of 'spiritual possessions'. His views on the relationship between subsistence and higher goals reflect his study of Aristotle, only he has changed the definition of virtue to that of Christianity. In particular, St Benedict in 530 AD had begun to change Christian thinking regarding work to a more positive attitude than Plato and Aristotle had held by making work a potential path to salvation (Mokyr, 1990: 204).

In a money-based society, Aquinas thus found, work, trade and money-making were acceptable as long as prices were just. The market price was just as long as buyers and sellers were virtuous Christians who followed the golden rule. Moreover since each had to have sufficient food, clothing and shelter in order to be virtuous, the just price was a part of the process of creating virtue; work might be a path to salvation but not when it led to starvation. A wage rate, for example, that pushed a worker below a subsistence level eroded the worker's chances for being virtuous and was therefore unjust. The wage had to ensure that a worker's needs were met in order that the worker might find salvation (Aquinas, 1968: 124–5 and Aquinas, 1953: 145). A living wage, to use our modern term, was necessary for a worker and that worker's family to be able to strive for the virtuous life (capability) that was part of Christianity.

ADAM SMITH'S VIRTUE

Adam Smith has always been accorded high praise for pointing out the benefits to society of having economic decisions based on self-interest. Market economists have focused on his espousal of self-interest as the force that makes markets work, leading them to a principle that free markets produce optimal results. Moral economists use the same focus on self-interest to insist that markets based on greed cannot support the right moral principles needed for a just society. But there is another side to Smith that these divergent caricatures of his ideas have missed. In his earlier book, the book of which he was proudest, *The Theory of Moral Sentiments* (Smith, 1976a), Smith wrote these opening words, 'How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortunes of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it' (Smith, 1976a: 9). Self-interest to Smith never meant that humans could not care about other members of their community. Unlike more recent market economists, Smith saw people as part of a community, as social beings (as Aristotle said).

The moral economy that Smith wrote of as being based on 'the agreeable bands of love and affection' was better equipped for this caring about other members than was an economy organized by 'a mercenary exchange of good offices according to an agreed valuation' (Smith, 1976a: 85–6). To give an example, Smith recognized that the growth of trade and large urban centres created isolation and social distance. He described a man of 'low condition' who had to be careful of his behaviour while living in a small community because mutual obligations required him to conduct himself morally. In the anonymity of a large city, however, he became part of a large multitude where no one noticed nor cared how he behaved, at which point he might 'abandon himself to every sort of low profligacy and vice' (Smith, 1976b, vol. II: 317). It takes a village to build a community and the market economy could not solve this problem. The moral economy must balance off the market economy through the cultivation of the capability of virtue. Still, the moral economy could not tell the worker what job to seek in the market. That was a matter of self-interest.

Consequently, the central part of Smith's case for the market system was that the market let individuals act on clear monetary incentives to follow their self-interest and produce items that would do the most good for society. As a justly famed quotation put it, 'It is not from the benevolence of the butcher, the brewer or the baker, that we expect our dinner, but from their regard for their own interest' (Smith, 1976b, vol. I: 18). We do not ask for meat from the butcher from an appeal to kindness but from money. Monetary trade motivated by self-interest was an important component of Smith's argument for the division of labour, the source of the largest increases in the productive power of human labour. As his example of the pin factory indicated, the division of labour had increased individual productivity from 20 pins per day to 4000 pins per day. This meant that no worker could be productive except in cooperation with other workers. A small-scale society where each person knew and loved each other would not be able to make full use of the division of labour, however. No one could have enough intimate friends and family to operate a pin factory that made full use of the division of labour. Smith's moral economy had limits to what it could accomplish in terms of increasing the productivity of labour.

Instead, the division of labour had to take place under conditions of trade to reach its full potential, that is, Smith's market economy. The market economy established trade on the basis of prices and led to Smith's idea that advancements in the division of labour depended on the extent of the market. It did no good to produce 4000 pins per day if they could not be sold; it was not possible to hire the workers needed to perform all the steps in producing those pins without a market for labour. Smith's genius was in recognizing this process and explaining the part self-interest played in bringing it about. Self-interest might not be a virtue on a scale of moral principles, but its use had positive consequences for making society better able to increase its wealth, under the right conditions of competition.

There is a conflict in Smith's writings that he observed and tried to reconcile. The butcher, the brewer and the baker had higher levels of skill than the worker making pins, even though all were engaged in the division of labour. This meant that Smith needed to consider the conditions under which workers earned their wages. This he did and his statement of the impact of the division of labour on the capability of workers is at odds with his favourable comments on the productivity of division of labour. He wrote:

> In the progress of the division of labour, the employment of the far greater part of those who live by labour, that is, of the great body of the people, comes to be confined to a few very simple operations, frequently to one or two. But the understandings of the greater part of men are necessarily formed by their ordinary employments. The man whose whole life is spent in performing a few simple operations, of which the effects are perhaps always the same, or very nearly the same, has no occasion to exert his understanding or to exercise his invention in finding out expedients for removing difficulties which never occur. He naturally loses, therefore, the habit of such exertion, and generally becomes as stupid and ignorant as it is possible for a human creature to become. The torpor of his mind renders him not only incapable of relishing or bearing a part in any rational conversation, but of conceiving any generous, noble, or tender sentiment, and consequently of forming any just judgment concerning many even of the ordinary duties of private life. Of the great and extensive interests of his country he is altogether incapable of judging, and unless very particular pains have been taken to render him otherwise, he is equally incapable of defending his country in war. The uniformity of his stationary life naturally corrupts the courage of his mind, and makes him regard with abhorrence the irregular, uncertain, and adventurous life of a soldier. It corrupts even the activity of his body, and renders him incapable of exerting his strength with vigour and perseverance in any other employment than that to which he has been bred. His dexterity at his own particular trade seems, in this manner, to be acquired at the expense of his intellectual, social, and martial virtues. But in every improved and civilised society this is the state into which the labouring poor, that is, the great body of the people, must necessarily fall, unless government takes some pains to prevent it. (Smith, 1976b, vol. II: 302–3)

Because of their work in the division of labour, workers lost the wherewithal to take part in society and the result might be social decay. What a dim outlook. The common labourer leaves the village and goes to the city to work at making pins. The labourer's isolation in the city prompts the labourer to the pursuit of vice and his work in the pin factory qualifies him for little else. Smith worried that as society expanded workers would experience social distance and create social disorder (Stabile, 1997: 307–8).

As a remedy, Smith proposed that the government provide free education for the children of workers, because he did not think workers could afford schooling on their own. In considering what items to tax to pay for public education, he proposed taxes on the wealthy, especially in the form of taxes on luxury items. His disapproval of conspicuous consumption, while not as harsh as Aristotle's utter contempt, allowed him to advocate taxing the wealthy. He particularly opposed taxes on wages (Smith, 1976b, vol. II: 246).

One other working condition Smith worried about was overwork. Workers might be paid based on a piece-rate, but that gave them an incentive to work too hard. Rest was necessary for work and moderate levels of work were needed to enable a worker to 'preserve his health' and make him effective for a longer period (Smith, 1976b, vol. I: 91–2). If workers have to put in long hours to earn a living wage, they might eventually have shorter work lives and produce less work in the long run. This overuse of workers could lead to the deterioration of capability of the workforce. In this case Smith suggested that employers 'listen to the dictates of reason and humanity' and offer workers better working conditions (Smith, 1976b, vol. I: 91–2). To a large extent Smith's writings on labour in *The Wealth of Nations* aimed at a voluntary approach to having employers make life better for workers with the wages and working conditions that made for a decent life. It also reminds us of his precepts for a moral economy and mutual caring. To understand why Smith would employ this voluntary approach of his moral economy of mutual caring we must now turn to his other book, *The Theory of Moral Sentiments*.

In *The Theory of Moral Sentiments* Smith was concerned with how human beings developed the capability for virtue and a caring attitude towards other human beings. His espousal of self-interest never meant that humans could not care about other members of their community. As he put it, 'And hence it is, that to feel much for others and little for ourselves, that to restrain our selfish, and to indulge our benevolent affections, constitutes the perfection of human nature; and can alone produce among mankind that harmony of sentiments and passions in which consists their whole grace and propriety' (Smith, 1976a: 35). Self-interest may tell us what we want to do, but it does not tell us whether we ought to do it. There must be standards of behaviour a society should expect of its members. While self-interest led humans to pursue every activity imaginable, virtuous behaviour, Smith employed the term sympathy, would restrict them to doing what they ought to do. Smith established sympathy as checking self-interest and leading to virtue. The market economy needed to retain as much of the moral economy as possible.

Here I must make it clear that Smith did not see self-interest as an unmixed virtue, as his later interpreters have argued. Instead, he recognized that self-interest glorified the individual by placing him at the centre of the world. Such an individual might feel compassion for the deaths of masses of people on the other side of the world from a natural disaster, but that person would feel even worse if he stubbed his toe. This type of compassion was not the same as sympathy for Smith. He found the key to the development of the type of sympathy that led to virtue in self-command, calling it the virtue that made all other virtues feasible. Through the exercise of self-command individuals would curb their self-interest in cases where it might cause damage to others.

There was a problem in this exercise of self-command in pursuit of altruism, however. Altruistic acts may be done in self-interest for the good feeling those acts provide, for the social acclaim they bring or for the future favours one might anticipate in return through a systematic reciprocity. Smith worried about these possibilities and set a higher standard for moral behaviour than self-interest seeking benefits from others through kind acts:

> But this desire of the approbation, and this aversion to the disapprobation of his brethren, would not alone have rendered him fit for that society for which he was made. Nature, accordingly, has endowed him, not only with a desire of being approved of, but with a desire of being what ought to be approved of; or of being what he himself approves of in other men. The first desire could only have made him wish to appear to be fit for society. The second was necessary in order to render him anxious to be really fit. The first could only have prompted him to the affectation of virtue, and to the concealment of vice. The second was necessary in order to inspire him with the real love of virtue, and with the real abhorrence of vice. In every well–formed mind this second desire seems to be the strongest of the two. (Smith, 1976a: p. 117)

Humans endowed with sympathy acted virtuously even when no one was present to approve, although Smith portrayed them as imagining an 'impartial spectator' watching their behaviour. Such a well-formed mind was capable of virtue that was not in its self-interest.

How often did he expect to see this well-formed mind? After all, he spoke of nature endowing persons with the wish to be moral. Was this a 'natural law' of the moral economy that conflicted with the 'natural law' of the market economy? Smith understood that at a low level of existence self-interest and self-preservation were often joined together as the same force. If wealth made self-preservation irrelevant, then it might be possible for sympathy to control self-interest in the pursuit of virtue. He thus argued that commerce and the wealth it produced were necessary antecedents to more virtuous behaviour. As Plato, Aristotle and Aquinas had argued, one had to have sufficient income to develop the capability for virtue. Smith outlined how this capability might develop in a market economy. Through the invisible hand self-interest increased the wealth of the nation thereby making it possible for more virtuous behaviour to take place. Affluent societies have the wherewithal to cultivate more well-formed minds that aim at virtue than poor ones (Stabile, 1997: 300).

One does not have to have Smith's astuteness to recognize that Plato and Aristotle were able to spend their time thinking about virtue because they were wealthy. Aristotle himself admitted to this when he set forth his natural level of wealth. One should accumulate wealth up to the point where basic needs could be met, at which point it was time to worry about virtue. Smith likely agreed with this view, and his genius was in seeing that competition would limit the self-interested pursuit of individual wealth to that natural level while raising the wealth of the nation, making it possible for the concomitant budding of virtue through increased affluence. Affluence among employers was a necessary but not sufficient condition for their enhanced virtue. Employers who became more virtuous might then take better care of their workers with higher wages and better working conditions, creating the conditions where those workers too could become more virtuous.

Smith's main argument in favour of the market economy was that persons acting in their own interest were led to produce social good even though that was not their intent. We can see this argument as Smith's theory of unintended consequences. One possible consequence of greater wealth was enhanced virtue among the affluent. Smith's own virtue was in wanting to make sure this process included workers, so they too had a chance to have the capability of becoming virtuous. In a sense, he hoped they would regain the spirit of mutual assistance that motivated his moral economy, but it was clearly a hope and not a prediction. To Smith, the concept of capability infused elements of the moral economy into the market economy.

JOHN STUART MILL: WORK AND MORAL CHARACTER

As noted in Chapter 2, the Utilitarianism of Jeremy Bentham took an entirely different perspective on human behaviour than had Adam Smith. To Bentham, traditional precepts of virtue had no meaning and ethics boiled down to the costs and benefits of any action. Because he was a disciple of Bentham, John Stuart Mill might be expected to follow this calculating approach to virtue. Mill, however, went beyond Bentham and aimed at considering what impact the pursuit of pleasure and the avoidance of pain through calculations of utility had on the human personality. In his youth he had defended Utilitarianism against charges that it was nothing but 'cold calculations'. As he matured, he appreciated that 'the habit of analysis has a tendency to wear away the feelings' (Mill, 1960: 77, 96). To be sure, Mill did not hold hope for social reform from a noble quest for social justice, as such terms usually masked personal self-interest. But he did believe that the cultivation of a moral sense based on feelings had to take place to put calculations of utility on their highest plane. Bentham, Mill acknowledged, had added precision to the idea that persons acted in their self-interest. The problem with Bentham's Utilitarianism was that no one had the capability of knowing all the consequences of their actions. In addition the distinction between self-interested acts and acts that affected others was vague; every human act had consequences for others. Finally, there might not be time to make the calculations utility required before reaching a decision.

Mill's continued study of utility taught him that there were higher and lower utilities, writing, 'It is quite compatible with the principle of utility to recognise the fact, that some kinds of pleasure are more desirable and more valuable than others' (Mill, 1863: 11). Moreover, some persons had a better capability to calculate pleasure and pain than others. The formation of moral character made some humans better calculators of their own pleasures as well as the pleasure and pain of others. Mill added the potential for a broader social interest to the standard of behaviour for Utilitarianism, writing:

> That standard is not the agent's own greatest happiness, but the greatest amount of happiness altogether; and if it may possibly be doubted whether a noble character is always the happier for its nobleness, there can be no doubt that it makes other people happier, and that the world in general is immensely a gainer by it. Utilitarianism, therefore, could only attain its end by the general cultivation of nobleness of character, even if each individual were only benefited by the nobleness of others. (Mill, 1863: 14)

Persons with this higher capability for utility calculations were more suited for Smith's moral economy than persons without it.

Mill highlighted this higher capability, writing: 'It is better to be a human being dissatisfied than a pig satisfied, better to be Socrates dissatisfied than a fool satisfied. And if the fool, or the pig, are of a different opinion, it is because they only know their own side of the question. The other party to the comparison knows both sides' (Mill, 1863: 13). This statement signified that Socrates was a better judge of higher utilities than the fool was or even the common folk of the masses. Mill, however, believed that his environment had shaped Socrates' higher facility. With a proper environment others could attain his higher capability for utilitarian calculations. He wrote:

> I saw that though our character is formed by circumstances, our own desires can do much to shape those circumstances; and that what is really inspiring and ennobling in the doctrine of free-will, is the conviction that we have real power over the formation of our own character; that our will, by influencing some of our circumstances, can modify our future habits or capabilities of willing. (Mill, 1960: 119)

Mill looked to education as a way of elevating an individual's cultivation of these capabilities and leading him to an appreciation of the higher utilities. Regarding workers, for example, Mill believed that they had many erroneous ideas and were poor judges of utility. The fault was not theirs, but the result of 'the present wretched education, and wretched social arrangements'. Those social arrangements were widespread and meant that being without happiness was 'done involuntarily by nineteen-twentieths of mankind, even in those parts of our present world which are least deep in barbarism' (Mill, 1863: 16, 18). It was in the interest of the wealthy to promote the education of workers. Somewhat whimsically, Mill said he hoped that socialist ideas would spread among workers not because he believed in those ideas but so that 'the higher classes might be made to see that they had more to fear from the poor when uneducated than when educated' (Mill, 1960: 121). He believed any form of education enhanced the capabilities of the working classes and improved their social functioning.

In holding to this view, Mill followed in the footsteps of Smith, who also hoped that workers would learn to conduct themselves better. Smith had hoped higher wages and education would do the job of creating more well-formed minds. Mill looked for education, the enactment of just laws by the government and the force of public opinion to lead workers to self-betterment and a broader social outlook. He defined that outlook as follows: 'Those who desire virtue for its own sake, desire it either because the consciousness of it is a pleasure, or because the consciousness of being without it is a pain, or for both reasons united' (Mill, 1863: 38). Following Smith, he determined that this outlook, when applied to finding a sense of justice for others, came in part from a feeling of sympathy. Persons capable of this outlook, he wrote, were 'capable of sympathising, not solely with their offspring, or, like some of the more noble animals, with some superior animal who is kind to them, but with all human, and even with all sentient, beings' (Mill, 1863: 49–50). Regarding labour, Mill believed that labour unions had the potential to instil this outlook among workers.

Recall from Chapter 2 that Mill did not favour government intervention in economic activities related to low wages because he wanted to avoid a parental state where the working poor became dependent on the government. For as long as they were dependent on others to help them, the working poor would not develop the moral character they needed to enhance their capability to make utility calculations of their interests and society's interests. Here Mill was under the influence of Alexis de Tocqueville's *Democracy in America* (1835), which he indicated had taught him the dangers of the centralization of government. For him, its message was that 'the performance of as much of the collective business, as can safely be so performed, by the people themselves', was the wisest approach (Mill, 1960: 135).

Regarding workers and wages, Mill used this principle to argue that workers could help themselves get higher wages through the formation of labour unions, but he worried so much about dependency and coercion that he had doubts about making union membership compulsory. Mill recognized that voluntary efforts to gain union members had contradictory aspects. Unless all workers combined to bargain over wages, they would fail. If membership and dues were voluntary, non-members would get the same wages as members without joining the union and paying dues. If too many workers followed this path, the union would fail. Mill recognized this problem for unions but still believed that union membership should be voluntary. He wanted unions to encourage workers to join through convincing arguments. The union members would gain in capability by making those arguments, and the workers who were getting a free ride to a better wage should be gaining the moral character to be convinced by the arguments of union members. Mill wanted workers to retain their individual freedom in the hope that they would gain the moral character to exercise that freedom judiciously, pursuing their own interests as well as society's (Mill, 1909: 938). Humans could control the circumstances that shaped their capability and it was important for the shaping of their capability that they be free to choose those circumstances.

This growth of human capability was important to Mill for he did not think that the social division between workers and employers could be sustained. Both sides found the relationships between them to be inadequate and disliked 'the total absence of justice or fairness' in their relations (Mill, 1909: 761–2). Once the relationship between workers and employers became based on justice, society would be on its way towards Smith's moral economy. Mill confessed that he did not think that the market economy with its 'struggling to get on' was 'the most desirable lot of human kind'. Rather he wanted a society of well-paid workers and few if any wealthy employers, so that everyone had the leisure 'to cultivate freely the graces of life' (Mill, 1909: 748–51). In this optimistic hope he followed Adam Smith's vision of a moral economy, but on utilitarian grounds to which Smith might have objected.

KARL MARX: ALIENATED LABOUR

While we cannot know whether Smith would have objected to Mill's Utilitarianism, we do know that Karl Marx did. He wrote of Bentham: 'He that would criticize all human acts, relations, etc., by the principle of utility, must first deal with human nature in general, and with human nature as modified in each historical epoch' (quoted in Ollman, 1977: 73). On his account, Bentham's notion of humans as rational calculators of pleasure and pain was a projection of the nature of English shopkeepers on all of humanity. Marx was especially critical of Mill, perhaps because they were contemporaries, and referred to Mill's *Principles of Political Economy* as 'his fat, pedantic *magnum opus'* (Marx, 1973: 616). What Bentham and Mill had missed with their notions of utility was that human nature was very complex. Their misunderstanding resulted from their not seeing that their view of humans as calculators of pleasure and pain left out that this view was based on human beings who were stunted by alienation.

Marx's concept of alienation helped him consider the nature of human beings and their society and it implicitly followed Smith's approach of writing about moral and philosophical issues before studying economics. Smith had written on moral character in *The Theory of Moral Sentiments* before focusing on self-interest in *The Wealth of Nations*. He only hinted at moral sentiments in the latter book. Marx's philosophical concept of alienation remained a core element of his life's work as an ideal of how human's existences ought to be lived. One approach to setting forth Marx's theory of alienation is to have him describe what it meant to workers in a factory under capitalism:

> Labour is *external* to the worker, i.e., it does not belong to his essential being; that in his work, therefore, he does not affirm himself but denies himself, does not feel content but unhappy, does not develop freely his physical and mental energy but mortifies his body and ruins his mind. The worker therefore only feels himself outside his work, and in his work feels outside himself. He is at home when he is not working, and when he is at work he is not at home. His labour is therefore not voluntary, but coerced; it is *forced labour*. It is therefore not the satisfaction of a need; it is merely a *means* to satisfy needs external to it. (Marx, 1844: 60)

This view of work was at odds with nearly all the other economic thinkers included in this book and it sets Marx apart from nearly every other thinker in the history of economic thought. Starting with Aristotle, economic thinkers viewed work as a means to get enough necessities to pursue the noble end of virtue. Smith had hoped that work would achieve a decent life for workers, which might then give them the potential to improve their moral character, and Mill had argued that social forces such as unions and education might elevate the moral character of workers.

They had not thought of work itself being a part of improving the worker. Marx had, writing, 'How could work ever be anything but a "development of human capacities"?' (quoted in Ollman, 1977: 100). Through their work, he believed, humans ought to improve all of their capabilities, physical and moral. When work enhanced the capabilities of humans, then those capabilities would continue to improve. With this philosophy Marx stands out for indicating strongly that the conditions under which workers labour had to be part of the calculation of the living wage.

There was a similarity between Marx's alienation and Smith's insistence on the numbing impact of the division of labour, but we must recognize that Marx did not see it that way. He cited with approval Smith's passage on the negative affects of the division of labour quoted above. Nevertheless, he derided Smith for not discussing this feature of the division of labour much earlier in his book, that is, along with his discussion of the benefits of the division of labour (Marx, 1977: 483–4). With more information, Marx saw working conditions as worse than Smith had. Machinery used in production had replaced the division of labour as the primary determinant of working conditions, and with a big difference. In Smith's world 'the worker makes use of a tool'. The worker in the pin factory at least filed down the point on the pin. For Marx's worker in the factory, 'the machine makes use of him . . . it is the movements of the machine he must follow'. Under those conditions the worker found no enjoyment or satisfaction in work (Marx, 1977: 548).

In writing this way, Marx implicitly assumed a specific nature for humans from which they were being alienated; specifically he assumed that people had an intrinsic need to work and be productive. Smith and Mill had argued that behaviour came from environmental factors, although Smith's well-formed mind was an endowment of nature that the right conditions would nurture. Marx included the environment of work as a crucial influence on human behaviour, but he also saw how work should influence humans properly when it was not alienated. Marx's evaluation of how his view of work differed from Smith's will shed light on what he meant by unalienated work. Smith argued that the underlying cost of work to labour was its sacrifice of its ease and liberty. In commenting on Smith, Marx quoted him freely on this issue and then observed:

> It seems quite far from Smith's mind that the individual . . . also needs a normal portion of work, and of the suspension of tranquillity. Certainly, labour obtains its measure from the outside, through the aim to be obtained and the obstacles to be overcome in attaining it. But Smith has no inkling that this overcoming of obstacles is in itself a liberating activity. (Marx, 1977: 611)

When labour was in charge of its working conditions and able to determine what was to be produced, it would not be alienated. Marx recognized that the independent craft workers and small-scale farmers of a previous time and even of his day had elements of being in charge of their working conditions. Workers in factories did not. His dare to capitalism was to restructure the mass-production technology brought about by the industrial revolution in a way that ended the alienation of labour. By raising such a high standard for working conditions Marx reminds us that a living wage for workers does not guarantee that they will live the good life, however defined, if their workday alienates them. In thus reminding us Marx put the capability argument at the heart of economics. This is an important lesson for advocates for a living wage who might see a higher wage as the solution to the labour problem.

RICHARD T. ELY: THE MORAL ECONOMIST

Throughout this book I have argued that a group of moral economists were sympathetic towards workers and wanted to see them gain better wages. Although they tacitly followed Aquinas in wanting this 'just wage' for workers, they did so with their own versions of a secular moral economy organized by market exchanges. Richard T. Ely (1854–1943) went against this tradition of secular argument. For him, 'ethical aims' were 'an essential part of economic activity' and political economy did 'not tell us merely how things are, but also how they ought to be' (Ely, 1893: 101). The study of the economy should not just aim at understanding what takes place in the economy, it should uncover wrongs – Ely cited child labour – and figure out what society ought to do about those wrongs. In this way there would be progress as society increasingly met higher standards of 'humanity and justice' (Ely, 1893: 38).

For those higher standards to be met, workers needed to have wages and working conditions sufficient to enhance their capability and they had to use their wages in the right way. In looking at wages, Ely offered several explanations for them. First, he set forth an idea that wages were set by the standard of living of workers. He wrote: 'Laborers have an habitual standard of life, a certain style of life, and what they receive as wages enables them on average just to keep up this standard, but to do no more'. This standard, what Smith called the subsistence wage, might vary among different occupations, but those occupations did not see much of an increase in the standard. Rather, Ely found that when women and children went to work to improve the standard of living for the family, household income fell to where all members of the family needed to work to attain the standard of living the male had previously earned. He defined this standard as follows: 'It should include provision for all real needs and provision for accidents; future emergencies, disability on account of old age, and the like should be included. A deposit in the savings bank and insurance policies ought to be part of the habitual standard of life' (Ely, 1893: 222). The standard was not always met, however, and at times workers suffered from a reduced standard – there could be an absolute decline in the standard or a relative decline when the standard did not keep pace with the growth of wealth in society as a whole (Ely, 1893: 69). Ely has here raised the two crucial issues of a living wage, whether or not workers earn it in the market and what 'real needs' should a living wage meet.

Regarding whether or not workers earned a living wage in the market Ely found that wage levels were determined by bargaining power that tilted towards employers. As he put it, 'Economic equalities place the ordinary employer in a very different position from the ordinary employee, and thus the natural tendency is for the industrially strong to show their superiority in free labor contracts' (Ely, 1893: 77). This superior strength came from staying power: 'The one who can wait while the necessities of the other press him makes the best terms' in a free labor contract, and the fact that the supply of labour increased at rates faster than the supply of capital added to the bargaining power of employers (Ely, 1893: 171). To combat this superior bargaining power workers formed unions.

Ely looked at unions of his day in the US and found them to be divided between the trade unions of artisans organized around the American Federation of Labor and the industrial unions of the Knights of Labor. Both types of unions were a natural growth as workers responded to the accumulation of capital into large corporations. Since capital was represented by one voice in the form of the head of the corporation unions must organize workers to speak with one voice as well. Opposition to unions as had taken place in England and the US was misguided (Ely, 1893: 230–2).

If unions succeeded in raising the living standard for workers, however, it was imperative that workers use their improved standards properly. Ely believed that increased standards of living should give the worker 'opportunity for the completest development of all his faculties' (Ely, 1893: 85). In this way he has continued Mill's notion of productive consumption. This required him to distinguish between desirable and undesirable wants. 'Wants satisfied by those things which serve as a basis for the full and harmonious development of our faculties are desirable wants; wants satisfied by other material things which are not positively helpful or a positively injurious are undesirable wants'. The consumption of luxuries fell into the category of undesirable wants to the extent that they catered to the individual's vanity and smugness and thereby hindered 'the development of a better manhood in us and in all those whom we could influence' (Ely, 1893: 153).

At the heart of this development of human capability, Ely saw the importance of every person having the virtue needed to make the proper consumption decisions. He wrote, 'Expenditures are justifiable which tend to the development of our faculties. The requirements of ethics are that we should develop ourselves and help to perfect the rest of humanity. If we neglect our own highest development humanity suffers' (Ely, 1893: 275). This is a high ethical standard and Ely believed that unions had educational and social value for workers, which meant they were 'preparing the way for a better civilization' by showing workers 'how to pursue the good, and to inspire them with a faith in that righteousness which alone can exalt the masses in a nation' (Ely, 1893: 233).

Ely's moral tone would not sit well with the market economists we have encountered in this book. To them, economics was not about ethics but about rational market decisions based on cost/benefit analysis. Still, the precursors of the market economists, the marginalists, retained the same ethical attitude towards the capability of workers as Ely did.

ALFRED MARSHALL: THE MORALS OF MARGINALISM

As the synthesizer of marginalism, Alfred Marshall set economics on a new course that changed the method of economics from what Smith, Bentham and Mill had used. These changes in the method did not mean that Marshall had discarded the economic thinking of the past. He characterized his work as 'an attempt to present a modern version of old doctrines with the aid of the new work, and with reference to the new problems of our own age' (Marshall, 1895: ix). In Chapter 2, for example, we saw that Marshall used Bentham's distinction between enjoyment and mere enjoyment to explain the diminishing marginal utility of money and Mill's productive and unproductive consumption to define a subsistence wage. In terms of the capability approach he also followed Smith and Mill. Moreover, although he found the Greek philosophers to have been very modern in some of their thinking, Marshall chided them because while they tolerated farming, 'they looked upon all other industries as involving degradation'. Their impatience with 'the anxious cares and plodding work of business' became a hallmark of the academic mind ever since, and led academia to neglect the study of economics especially as it related to the organization of business (Marshall, 1895: 18–9). That neglect was unfortunate, Marshall argued: 'For a man's character has been moulded by his everyday work, and by the material resources he thereby procures, more than any other influence unless it be that of his religious ideals'. Ethical character was fashioned by work and the income it produced (Marshall, 1895: 1). As had Mill, Marshall took human nature as greatly influenced by the social environment, in this case the work environment. When the conditions of life improved, human character became more sympathetic and altruistic in its ethical concerns.

In writing about the level of wages needed for a complete life, Marshall had linked the notion of necessities to keeping workers at efficient levels of effort, such 'that the income of any class in the ranks of industry is below its necessary level when any increase in their income would in the course of time produce a more than proportionate increase in their efficiency' (Marshall, 1895: 137–9). As had Mill, Marshall referred to this as productive consumption. If the poor were to benefit from increased consumption improving their capability, it was necessary that it be the right sort of consumption. Thus it is not surprising that Marshall investigated:

> the conditions on which depend health and strength, physical, mental and moral. They are the basis of industrial efficiency, on which the production of material wealth depends while conversely the chief importance of material wealth lies in the fact that, when used wisely, it increases the health and strength, physical mental and moral, of the human race. (Marshall, 1895: 274)

Marshall advanced on the thinking of Smith and Mill by elaborating in detail how these necessities and comforts made workers more capable.

He was especially concerned with the effect of education and training, which he had included as part of the necessities of life. Since the person paying for education did not capture the direct benefits of it, employers had no incentive to provide general training and parents only a small incentive. For workers to afford education for their children, they needed foresight and income. Marshall was concerned with whether this income would come to them. The working classes had only enough income to 'invest in the physical strength of their children'. If they had enough income to invest in the education of their children, they would do so. Marshall concluded that giving more 'to the wage receivers and less to the capitalists is likely, other things being equal, to hasten the increase of material production' (Marshall, 1895: 311).

In anticipation of the efficiency wage theory Marshall stressed the importance of high wages, arguing that 'any increase in consumption that is strictly necessary for efficiency pays its own way' through a greater increase in production. Perhaps some increase in wages would be spent unwisely on 'harmful indulgences', but these instances were rare. Parents were more likely to spend increases in wages on improving their children. Hence, he concluded, 'an increase in wages, unless earned under unwholesome conditions, almost always increases the strength, physical, mental and even moral of the coming generation' (Marshall, 1895: 596–7). Marshall saw a cumulative process where high wages directly improved the capability of the present generation and indirectly enhanced the capability of the next generation. The next generation, being more efficient, would raise its standard of living, do a better job of educating its children, and improve their prospect. Onward the cycle would go, leading to improvement of workforce capability. Marshall allowed that the reverse scenario was possible, with lower wages setting off poorer children. As he put it, 'The worse fed are the children of one generation, the less will they earn when they grow up, and the less will be their power of providing adequately for the material wants of their children: and so on'. Equally important, they will be so uneducated they will not see any value to education for their children (Marshall, 1895: 641).

Marshall supported unions as a way for workers to gain higher wages. He also took a favourable view of unions as being outlets for self-government, sources of self-respect and essential to democracy. Following Mill he wanted unions to be a positive influence on the moral character of workers. Properly run, unions could build the character of their members and leaders and add to their sense of public virtue. In addition to unions, Marshall believed that government programmes of assistance to the poor were necessary, and he even postulated a system for classifying the poor with respect to the kind and amount of help they needed. He would use the tax system to pay for these programmes and favoured progressive taxes, inheritance taxes and taxes on items of unwholesome consumption. He believed that economic progress was bringing about a better life for workers in terms of higher wages. His principle of cumulative causation found a correlation between the standard of living and the capability of labour as essential to economic progress. It meant that workers would be able to engage in the nobler pursuits of life (Marshall, 1895: 779–90).

Whether they would spend increased incomes wisely was arguable. Marshall observed that 'perhaps £100 000 000 annually are spent even by the working classes, and £400 000 000 by the rest of the population of England, in ways that do little or nothing towards making life nobler or truly happier'. Since he found that GDP in the UK at the time was estimated as being between £1 billion and £2 billion, this amounted to a 5 to 40 per cent component of unproductive consumption (Marshall, 1961: 689). Given this penchant for wasteful consumption that workers and other classes displayed, Marshall was being optimistic about how workers would use the fruits of their higher incomes. Part of his confidence rested on the improved character resulting from education and work. Prosperity would lead workers to gain the capability to make wise judgements about what items they spent their money on.

Another part of the standard of living was increased leisure. To look at leisure, Marshall now added the time of work to his study. He was greatly concerned about the effects long and hard work had on the mental capacities of workers. When there was not enough leisure time for the needs of workers' capability 'then the labour has been extravagant from the point of view of society at large'. Gains in leisure time benefited society, because 'the fact that inefficient and stunted human lives had been replaced by more efficient and fuller lives would be a gain of higher order than any temporary material loss that might have been occasioned on the way' (Marshall, 1895: 781).

HERBERT J. DAVENPORT: MARKETS WITHOUT MORALS

Herbert J. Davenport (1861–1931) is a unique figure in the history of economic thought. He studied economics at various universities but started his adult life in business, making and losing a fortune in real estate speculation. He eventually finished his degree at the University of Chicago where he worked closely with Veblen, whom he greatly admired. We cannot characterize him as a Veblenian Institutionalist, however, because he accepted marginalism and because he did not take Veblen's social viewpoint to heart. Moreover, Davenport would later have a strong influence on Frank S. Knight, one of the early members of the Chicago School of market economics (and definitely not an Institutionalist). He thus represents an important link in a transition from the ideas of the moral economists to the ideas of the market economists. He is also of interest because his market economics led him to criticize the marginal product theory of wages and income distribution, in part from a unique perspective on capability.

In his most comprehensive work on economics, *The Economics of Enterprise*, published in 1913, Davenport made it clear that there was 'danger in mixing ethics with economic doctrine' (Davenport, 1943: 255). To avoid this danger, Davenport left out of his economics such notions as productive consumption, because they had ethical baggage associated with them. To him, there was no such thing as the right type of consumption nor a subsistence or living wage. He wrote: 'A standard of living is merely a level of consumption so fixed in habit that any falling short is felt as a privation. America has a high standard because the per capita production in America is great: people have, therefore, acquired the habit of consuming much. The level of production fixes the standard' (Davenport, 1943: 3). The level of production, in turn, depended on human capability in terms of physical fitness, intelligence, motivation, organization, and so on. Some of this capability might be inherent to human character while another part might be due to social conditions, but it was human capability that determined productivity and thus the standard of living (Davenport 1943: 6–16).

When he came to define the elements of that capability, Davenport used the purely economic concept of gain, that is, the value-added by the capability. Any human trait that earned a return was a capability as far as the market was concerned. He did not hold to a notion of value-added to society, however, for that would 'go behind the market fact and set up a social philosophy of ultimate appraisals'. He elaborated:

> Always and everywhere in the competitive regime the test of competitive production is competitive gain – proceeds. Whatever effort serves the acquisitive end

> is labor. Profits are merely one form of individual pecuniary return for personal pecuniary activity. Speculators, lobbyists, quacks, painters, abortionists, and prostitutes are producers: that they are paid is the adequate and ultimate proof. This is surely not to deny the fact of parasitism in society. But parasitism is not a competitive category but an ethical appraisal. In the economic sense, productivity in a competitive society – the proceeds concept – is a concept unrelated to ethical criteria and unconcerned with any social accountancy. (Davenport, 1943: 127)

In a market economy the test of productivity was production for gain and that was what economists should concern themselves with.

Given this test of productivity as gain, we might expect Davenport to assent to the marginal product theory of income distribution with its explanation of income as based on the value the individual adds to total output as measured by gain (for labour the wage equals the sale price of what the worker added to production). Davenport addressed the issue as follows:

> What is known as the productivity theory of distribution attempts to show that, under perfect competition, each individual will receive out of the aggregate social income precisely what he has contributed to this aggregate income, his share being thus – it is urged – precisely commensurate with his deserving: what he gets he deserves, and what he deserves he gets. (Davenport, 1943: 137)

The issue to him was whether this was a tenable theory that was precise enough to be practical.

To address the issue Davenport started from the position that the market system was a price system that was managed by the entrepreneur. Economists often speak of supply and demand as abstract concepts that interact to produce an equilibrium price without describing how they function operationally. At some point they may liken the market to a bidding process at an auction. To Davenport, the force behind much of the bidding was the entrepreneur, who made all decisions about what to produce and how to produce it based on the entrepreneur's perception of potential gain. In deciding what and how to produce, the entrepreneur had to purchase an assortment of resources and put them to work. Here Davenport eschewed the economist's usual resource categories of land, labour and capital because they left out too much that was crucial to the success of the entrepreneur. To him, entrepreneurs went out with a shopping list of the factors they needed for production and purchased them just as consumers might decide on what items to buy with their wages.

This approach led to Davenport's first criticism of the marginal product theory. In consumer theory, the demand for a product represents the summation of the individual desires of all consumers in the relevant market. Each consumer makes a unique calculation in terms of the utility the product will give and settles on a reservation price as the most the consumer will pay for the product and not go without it. Once the market price is determined, consumers whose reservation price is below the market price do not buy the product. There is a marginal consumer for whom the market price equals the reservation price. But there are also consumers whose reservation price was above the market price. Because they would have been willing to pay more than the market price, they get a bonus in the form of a lower price. Marshall had recognized this bonus and called it consumers' surplus. Davenport recognized it as well and described it this way: 'Buyers, then, do not pay for any commodity according either to utility or to their respective price-paying disposition' (Davenport, 1943: 145).

Davenport applied the same reasoning to the purchase of all of the factors of production. The entrepreneur went out to purchase those factors not based on their utility but on their efficiency in production. But estimates of that efficiency differed from entrepreneur to entrepreneur, just as utility differed from consumer to consumer. And like the consumer purchasing a product on the market, the entrepreneur had a reservation price that was the most that would be paid for a particular factor; this reservation price would reflect the estimate of what the factor would add to the total gain. The entrepreneur then looked at market prices for factors of production and if they were above the reservation price something else was purchased. If they were below the reservation price there was a bonus of a price below the estimate of what the factor added to the potential gain. Davenport summed up his case by pointing out that no entrepreneur was wise enough to calculate the productivity of any factor of production they might want to use in their business nor to relate that productivity to the price of the factor. The most the entrepreneur could do was to 'attribute to each factor a degree of serviceability for his ends commensurate with what he has to pay for it'. If the entrepreneur made a profit using those factors it could be attributed to the entrepreneur's own activities, but to Davenport, 'his profit is partly due to the fact that his is able to make an intermediate good or agent signify more to him in gain than he has to pay for it in wages or rent' (Davenport, 1943: 148). He referred to this portion of profit as employers' surplus (Davenport, 1943: 151).

The problem Davenport raises here is what economists now call information asymmetries where both sides of the market have different information about the qualities of the item being purchased. In this case workers might know more about their capabilities than employers and thus could gain a wage above their value-added. But workers would not know their value-added until they went to work, so they might underestimate their reservation wage in terms of the value they added once they went to work. Moreover, once the employment bargain was made and the wage set, the entrepreneur faced the principal-agent problem where it cannot be determined whether the agents (workers) that were hired perform to their best capability. Under these circumstances the entrepreneur would find it difficult to equate the wage to the worker's valued-added.

The idea that employers might not pay the most they were capable of to gain the services of factors of production, when applied to labour, reminds us of the earlier concern of unequal bargaining power between capital and labour. To Davenport, however, broad categories such as capital and labour were collective terms that incorporated 'the social point of view'. This point of view did not hold because 'we are in a competitive society into the language of which the collectivist doctrine need not translate and upon the phenomenon of which the collectivist analysis may throw scant light'. In that society competitive individual gain was the guiding force and resources added value only by adding to individual gain. Definitions of capital and labour had to be made in the context of an economy where 'patents and monopolies are capital; where burglars' jimmies are productive goods; where advertising is one of the costs of product . . . gambling a trade, speculation a career, circumventing the law a profession; . . . where wages may be had for demoralizing public taste'. In such a society, the challenge was 'how to limit the receipt of private income to the rendering of social service' (Davenport, 1943: 415–6).

Given all of the possible capabilities (both positive and negative from an ethical standpoint) that such a society could value, Davenport insisted that 'the distributive outcome is the more favorable to the factor that is relatively scarce'. Bargaining power among individuals tilted towards those whose capability was in short supply. Relative scarcity of a capability, however, had nothing to do with its productivity. Davenport noted: 'As highly trained men become less rare relatively to the men who are to be supervised and directed, salaries will fall relatively to wages' (Davenport, 1943: 448). Until that happened the entrepreneur had to pay more for scarce capability, whether for supervising workers or lobbying legislatures, and they might even have to pay more than the value that capability added to their total gain. According to Davenport because economists had treated factors of production as broad categories they often saw them as antagonistic classes and as substitutes for one another. If labour's wages become too high relative to the costs of capital, the entrepreneur would substitute capital for labour.

By looking at resources as individual factors of production, Davenport highlighted cases where certain types of labour and certain types of capital were complements. He wrote: 'The different factors of production must work together to achieve their greatest effectiveness. Land without tools, labor without land, tools without land or labor, would return a meager product. It is to this fact of joint employment that most of the product is due'. Because the employment was joint, so was the product it produced which raised a problem for the marginal product theory: 'How then proceed to attribute to any one of the factors the increase of the proceeds due to the joint employment?' (Davenport, 1943: 147). Using value-added as a standard for wages or the income of any other factor of production was not feasible when the factors were all necessary ingredients for production. The price of resources, which determined the distribution of income, depended solely on what the entrepreneur had to pay to outbid all the other entrepreneurs who also wanted the resource. While there might be some correspondence to the value the resource added, it was not precise enough to serve as a standard of distributive justice. Moreover, Davenport concluded, 'When distributive justice may be in some sense attained, it must solely be a justice between employer and employed. Society is not a participant in the distributive equity of competitive business' (Davenport, 1943: 154).

In terms of our interest in a living wage, Davenport holds a mixed message. The idea that wages equal the value-added of workers to total production has been and is a strong challenge to advocates for a living wage. If workers earn low wages they must have low productivity and a living wage cannot alter that. Davenport has blunted part of that argument by showing that wages do not necessarily equate to value-added, especially in the many cases where output is a joint result of the cooperation of a number of factors of production and it is impossible to calculate the value-added of any individual factor. He has also noted that economists needed 'to get to the heart of the growing poverty of some part of our present population' (Davenport, 1943: 523). These parts of his message point towards an interest in a living wage. Against this interest, however, Davenport insisted that it was 'a vastly dangerous doctrine to assert . . . the dependence of wages . . . on the standard of living' (Davenport, 1943: 451). Indeed, early in his book he insisted that any society that 'unsettles the connection between industry and reward' would be guilty of 'enfeebling its productive forces' (Davenport, 1943: 9).

What was to be done? Davenport called for a new type of economics that went beyond 'the painting of utopias and the capitalizing of dreams' such as the moral economy or the market economy to a proper understanding of how the economy worked. Davenport never produced this new type of economics, however, and his influence has never been great among economists. His idea that economists needed to explain a world where the quest for gain could cause individuals to forget their morals or to subvert the market remains perceptive. To call such negative capabilities productive, however, may have been too cynical for either moral economists or market economists.

JOHN R. COMMONS AND COLLECTIVE CAPABILITY

Although Davenport was influenced by Veblen he did not credit him as a precursor to a new type of economics. Another prominent institutional economist, John R. Commons (1862–1945), offered an analysis of workers, unions and collective bargaining that might have complemented Davenport's approach of seeing distributive justice as being decided by employers and workers. Commons set forth his own definition of institutional economics. He wrote: 'If we endeavour to find a universal principle common to all behaviour known as institutional, we may define an institution as Collective Action in Control of Individual Action' (Commons, 1934: 69). Society to Commons was filled with conflicts of interest and it thus had to place limits on those conflicts through laws, customs and habits. Collective action prompted changes in those laws, customs and habits, which meant that it required collective capability. Although he investigated collective action and collective capability in a variety of forms he was especially interested in the conflicts of interest in labour relations and the way unions took collective action to limit those conflicts (Kaufman, 2006: 296; Rutherford, 2006: 162–5). His experiences as a college student, when Commons had worked in a union printing shop, taught him how the union in his shop had negotiated better conditions for the workers than existed in a similar, non-union shop where his brother had worked (Commons, 1934: 1).

To explore conflicts and collective action in economic affairs, Commons distinguished between an exchange and a transaction. He meant by this that any purchase in which commodities were exchanged was also a transaction that took place within an institutional framework of legal rights and obligations, morality and the bargaining power of both parties to the exchange. Transactions established legal ownership of the commodity, and the political and legal system had to establish a set of 'working rules' to eliminate 'coercive and unreasonable values arrived at in transactions' and to legitimate 'persuasive transactions and reasonable values' (Commons, 1934: 4). Reasonable values included a proper amount of pay for workers and the most important issue in transactions was to ensure that everyone concerned with the transaction was treated fairly, which meant that they had to have a capability for judging fairness. This was especially true regarding transactions between employers and workers.

In transactions between employers and workers, however, Commons did not agree with the idea of the marginalists such as John Bates Clark that the standard for reasonableness was that wages equalled value-added. He saw that every economic transaction contained a conflict of interest with each bargainer 'trying to get as much and give as little as possible'

(Commons, 1934: 118). The use of a standard that related pay to value-added would not resolve this conflict, because 'mental, managerial, and manual labor' all contributed to increasing productivity. As a result, he noted, 'We cannot tell whether the manager is more efficient than the errand-boy. We know that he gets more wages, but that is because managers are scarcer, not because they are more efficient. If they were as abundant as errand-boys, their wages would probably be no higher' (Commons, 1934: 293). Wages were due to bargaining power based on supply relative to demand but since productivity did not enter into the transaction it was not part of the determination of wages. If a class of workers received less than a living wage, it was because there were too many of them compared with the number of jobs available. This numbers' disparity meant to Commons, as it had to Adam Smith, that workers had unequal power in the bargaining process with employers.

The bargaining process was based on either persuasion or coercion, depending on how scarce a particular type of labour was in relation to the number of employers and the capability of the bargainers. Reasonable value in bargaining placed limits on the amount of coercion that could be applied and it was the function of unions to establish it. Commons believed that unions had developed this capability, writing, 'Labor organizations were the first to move towards this later doctrine of reasonable bargaining power by collective action, because they were the first to feel the pinch of the limited number of jobs and the resulting discriminations and destructive competition' (Commons, 1934: 345). Unions were a method of collective action that aimed to control individual workers in their attempts to secure jobs by accepting low wages. Collective action to limit the behaviour of individuals enhanced the capability of union members.

Commons recognized that many economists did not find collective decisions to be effective, because those decisions took precedence over individual self-interest. To him, collective action had the potential to protect the individual from being harmed by arbitrary actions taken by those in authority over him. Unions were a way for workers to use collective bargaining to gain better wages and working conditions for themselves. To do so, in the nineteenth century they gave up on ideas of socialism and worker-owned cooperatives to use collective bargaining for wages while accepting managerial prerogatives that left the employer in control of the factory. When labour attained too much control over the labour supply in an area, it could attain a 'labor dictatorship' that practised coercive bargaining transactions. Collective bargaining only existed when both sides were 'organized equally'. It then became a set of working rules for setting reasonable value in wages (Commons, 1934: 758–9).

When collective bargaining did not work well because of a lack of collective capability, Commons looked for arbitration by governmental agencies. These agencies would have as a goal the determination of what would be a reasonable value for labour 'if coercion, secrecy, and inequality were eliminated from economic life' and he listed railroad commissions, courts, and business and labour arbitration boards as examples of agencies that had been created to solve the problem of conflicts on interest in bargaining. When those agencies were administered by impartial, professional experts, they could have the capability to keep their independence and ensure that collective action resulted in bargaining transactions that established reasonable value for all parties involved.

In terms of the theme of this book, we might ask if Commons would have wanted a 'Living Wage Commission' charged with seeing that collective decisions made regarding wages gave workers a reasonable value in terms of their standard of living (the UK now has a Low Pay Commission (Waltman, 2004: 120)). Commons recognized that the evolution of the economic system meant that changes in the institutional framework had to take place if workers were to get that reasonable value. Collective action by business on the demand side of the labour market required collective action on the supply side as well. Someone, presumably workers or their leaders, had to foster a countervailing power to make up for the bargaining advantages collective action gave to businesses. Marshall and Clark had written about the need for workers to take collective action through unions, and Commons agreed.

In looking for ways to handle the new world of collective action, Commons did not believe that there was one best way to eliminate social problems. Rather, he promoted the idea of using trial and error and experimentation to investigate a mix of possible answers to the problems being brought about by collective action. He rejected the 'naïve fallacy of the Age of Reason of the Eighteenth Century, that man was a rational being who needed only to see the right in order to do it'. Instead, organizations that took part in collective action were 'founded on passion, stupidity, inequality, and mass action' (Commons, 1934: 753). Unions might be a way to attain a reasonable wage for workers, but their passion and stupidity might do them in. Government action was based on politics that also featured irrational behaviour. Business might take the lead, but its leaders were also often misinformed. Still Commons believed that all of these units should be given a chance to develop their capability and find a reasonable value for labour before resorting to some sort of 'Living Wage Commission'.

Regarding the organizations that would bring collective capability to bargaining between management and labour, Commons found it likely that they could 'start with the employer as with the employees'. From his perspective, the employer could bring about a 'newly awakened spirit of collective action' in 'his own shop'. Once a few employers organized their workplaces in ways that workers approved of, Commons hoped that businesses would all have to compete in the labour market by providing workers with better pay and working conditions; they would use persuasion instead of coercion in bargaining, which would nurture the goodwill of workers towards their employers. Where workers already had unions, he recommended that they cooperate with management at individual plants to bring about this 'industrial goodwill' (Commons, 1919: 112–16). The idea of 'industrial goodwill' was that successful collective organization with good worker morale could be productive.

To address how this collective capability of 'industrial goodwill' could be achieved, Commons and his colleagues at Wisconsin studied it in a book, *Industrial Government*. In keeping with their experimental approach, the book found no unique system of industrial government in the 18 cases that it presented. Instead, each case offered examples of systems of industrial governance that were evolving. The only overriding principle that the authors noted was 'the sudden or gradual moral conversion of an employer from business to humanity' (Commons *et al.*, 1921: vi). As an example of this 'moral conversion of an employer' Commons provided a case study of the Ford Motor Co. In that study, Commons applauded the auto magnate Henry Ford for the way he treated workers. Because he had been having trouble recruiting workers for jobs on his assembly line, Ford had increased wages well above those of other auto manufacturers. As a result, he had many workers who applied for jobs; to keep track of how well they functioned he set up a 'Sociology Department', the forerunner of today's human resource managers. Under the Ford system of industrial governance, Commons found that 'efficiency was to be a by-product of the clean and wholesome life'. Marshall would have approved of Ford's efforts to tie higher wages to moral character and economic efficiency and so did Commons. To be sure, Commons observed that Ford's Sociology Department had been much too intrusive in the lives of workers, especially their home life outside of the factory. Yet Commons found these intrusions to have had minimal impact on workers. Moreover, Ford had increased wages for his workers and found that labour productivity increased. This greater capability meant that the programme had paid for itself, much as efficiency wage theory might have predicted. To Commons, this was an example of 'industrial goodwill' at work. Ford had taken a beneficial collective action on behalf of his workers, using persuasive bargaining by offering them pay in line with Commons' 'reasonable value'. In the process the collective capability of the industry was enhanced (Commons *et al.*, 1921: 13–25).

Still, Commons did not pin his hopes for improved industrial relations on similar transformations of other employers. In drawing lessons from the cases studied in *Industrial Government* he presented data to demonstrate that less than one quarter of US employers had wages and working conditions that exceeded what unions gained for their members. With this benchmark, he concluded that most employers remained 'backward'. In their case, he remarked, 'only the big stick of unionism or legislation' would make them offer comparable conditions for their workers (Commons *et al.*, 1921: 263). When business did not initiate action to achieve 'industrial goodwill', workers needed action from unions or from government to get better treatment. In making this argument, Commons relied on a concept of a public interest in private transaction to justify union or government action. For example, he observed that under the non-union conditions of the steel industry, workers had to accept a job schedule based on a 12-hour day, seven days a week. As a result, steel industry owners gained enhanced profits yet still provided low prices to the purchasers of steel, which meant that the ultimate consumers of products using steel gained from those deplorable conditions. In this case, managerial efficiency took precedence over persuasive bargaining with a goal of reasonable value. Businesses that reduced wages to benefit themselves and consumers were more efficient than those who increased wages but they lacked collective capability (Commons *et al.*, 1921: 264–5).

We might find support in Commons's argument here for having unions play a key role in helping workers gain a living wage. Because Commons rarely generalized, however, it is difficult to generalize about him. For example, he estimated that only about 10 to 25 per cent of 'unionists' took enough interest to 'voluntarily do more for the welfare of others than the best that can be expected from any kind of compulsion' (Commons, 1934: 860). This was not a very good track record for unions, but the absence of unions was no better. In looking at how business treated the bargaining advantages the lack of unions gave them, Commons wrote: 'the open shop may be either a cloak to hide long hours, competitive wages and voiceless workers, or it may be freedom for managers in furnishing reasonable hours and fair wages' (Commons *et al.*, 1921: 266). Freed from the pressure of unions, management had the choice of whether or not to give workers fair treatment and 'reasonable value' in wages.

One way that workers could apply that pressure on business was to use the political process to have the government bring about reforms in the legal system and in economic policies to attain better conditions for themselves. Commons described how government mandated safety regulations and worker compensation laws had compelled businesses to cut down on the number of accidents by in effect using a tax on them. 'Likewise,' he added, 'it may be expected that a tax on absenteeism through sickness and a tax on unemployment through layoffs will bring capitalism as a whole' to provide the same working conditions, secure jobs and reasonable wages as found in the exemplary firms that Commons and his associates had studied (Commons *et al.*, 1921: 271).

One example of such a tax is unemployment insurance where employers pay into an unemployment insurance fund for laid-off workers based in part on the individual employer's track record of prior layoffs. Commons was a pioneer in developing this type of insurance in Wisconsin through his help in proposing such a plan that was put in place in 1932. The law was intended 'as a "preventive" measure designed to induce the employer to *prevent* unemployment instead of only a *relief* measure designed to pay unemployment benefits'. The law made each employer responsible only for his own workers, which Commons saw as an advantage (Commons, 1934: 842). Its aim was the enhancement of collective capability for workers.

Unemployment laws help workers who are temporarily unemployed by paying them a portion of their previous incomes for a set time period while they look for new jobs. Here again, we must wonder what Commons would have advised regarding ways to help low-wage workers attain a living wage. We could apply his approach to safety and unemployment by placing a 'low-wage tax' on employers who did not pay a living wage and have a 'Living Wage Commission' staffed by experts determine whether or not a company owed the tax. If the tax were high enough, employers would have an incentive to pay a living wage to avoid the tax. Commons never proposed such a plan but it would be consistent with his other plans. Certainly he hinted that wage levels and working conditions should ultimately be determined through the activities of a government agency, much as public utility prices are now established. This approach indicates his support of a system of regulated markets that would result in a 'reasonable' capitalism. He relied on governmental commissions because he questioned whether business or unions would be reasonable on their own. In doing so, he raised the issue of capability as a collective one, and he wondered whether business or labour had the collective capability modern life required. His experiences with government assured him that its impartial experts did have such a capability.

JOHN R. HICKS: THE LIMITS OF PRODUCTIVE CONSUMPTION

Although Davenport and Commons challenged the marginal product theory of wages as impractical in an operational sense, the generation of

English and US economists who followed Alfred Marshall were more influenced by the Austrian economists. Just as they had a diminished interest in the subsistence wage and unproductive consumption, the Austrian economists did not worry much about the capability approach, arguing as they did that capability was simply a market valuation of natural abilities. John R. Hicks (1904–89) combined Marshall's interest in capability with an Austrian preference for free market outcomes. Under the influence of the ideas of Pareto, Hicks was drawn towards pure economic theory. Our interest in him here is with his early work, *The Theory of Wages*. (In fairness to Hicks I should point out that he later indicated that he did not like this book.) The book sets forth in clear terms how wages reflected the price established for labour by markets, as with other commodities, and all that made labour appear to be different from other commodities was the existence of union or government regulations as efforts to give workers a better wage. Despite his use of the free market as the standard for wages, Hicks stated that he would begin with the same type of analysis as the Marshall tradition had (Hicks, 1964: 112–13). For example, he considered whether the payment of high wages would improve the capability of workers, an issue that had concerned Marshall, as well as other thinkers in this book. Hicks, however, analysed the issue in a different way. He agreed that high wages correlated with improvements in worker efficiency and it was possible to set off Marshall's process of cumulative causation of increased wages, enhanced capability and additional wage increases. There were limits to how far the process could go, however, and Hicks found that limit with the law of diminishing returns.

When wages started out very low, increased wages would induce a significant gain in worker capability. At some point, however, as wages kept increasing, the marginal gain in worker capability would fall. Moreover, increased wages would ultimately encourage employers to purchase labour-saving machinery to reduce their costs. When the capability gains from higher pay were large and immediate, as in the case of raises for low-paid workers, employers would not substitute machines for workers. At some point, however, when wages increased and the capability gains diminished, they would find better gains from using machinery and Hicks found that the economic history of capitalism confirmed this result (Hicks, 1964: 117–20, 124 and 207–8).

Hicks raised another challenge for a living wage: Will increasing the wages of low-wage workers result in their being replaced by machines? Of course increases in wages might enhance workers' capability and increase their productivity. The dilemma is in knowing how much their productivity will increase in comparison with the increase in wages. If the relationship between wages and worker capability is at the point of diminishing marginal returns, then employers will be motivated to replace workers with machines when they can. It is not an easy matter to know whether the relationship is at that point, however, so it is difficult to predict what employers will do when faced with an increased wage.

GARY S. BECKER: CAPABILITY AS HUMAN CAPITAL

Throughout this book, I have indicated that one of the most powerful arguments against the living wage is that wages reflect the value-added of the workers. Low wages are a symptom of low-value added, that is, the low productivity of workers. We have also seen that several of our thinkers, John Bates Clark, for example, linked productivity to the amount of capital that workers had available to them at their jobs. To be sure, Clark also recognized that skill levels also had an impact on wages and Marshall added in knowledge and health as adding to productivity. The idea that a variety of factors affected wages goes back to Adam Smith, who argued that wages reflected skill, responsibility, risk, trustworthiness, pleasantness of the job and so on as raising or lower wages. All of these factors can be included under the broad term of capability.

In the 1950s economists began paying more attention to how these other factors created differing levels of wages in society. They used the generic term 'human capital' to describe those factors, and the first important theorist of human capital was Gary S. Becker (1930–). His book, *Human Capital*, was a provocative and influential one, because it turned education into an economic concept, something most advocates for education were loath to do (Stabile, 2007). He did so by refining the concept of a rate of return to an investment in education and showing that education had a positive influence on monetary incomes. He wrote, 'Inequality in the distribution of earnings and income is generally positively correlated to inequality in education and other training' (Becker, 1964: 2). For persons earning below a living wage, it follows, the problem may be that they do not have enough education and training; that is, they suffer from low levels of human capital.

There are many reasons why those persons may have low levels of human capital and Becker examined them in detail. The biggest obstacle from an economic perspective is that education and training have costs. A college education, for example, requires payment of direct costs of tuition, room and board, along with the indirect cost of the income a student may give up by not working while in college. Job training might also involve payment of direct costs by a worker as well as lost income. If the worker's employer pays for the training that is a direct cost to the employer and an indirect cost from the loss of productivity while the worker is being trained. Those direct and indirect costs represent the investment made in the human capital of the worker, either by the worker or by the employer. Investments in human capital will not be made unless they produce a return.

If investments in human capital do pay off, advocates for a living wage might be wise to propose ways to increase the human capital of low-wage workers. The problem is in finding ways to accomplish it. Here Becker provided an insight into the problem of providing the sort of on-the-job training that low-wage workers need. To do so, he elaborated on two types of training: general training that the worker could use in jobs for many employers and specific training that the worker can use only in the job for the current employer. The problem with general training is that while it increases the productivity of the worker, the worker can use that training to get a better job with another employer. Employers would have no incentive to give workers general training unless they could have the workers pay for it through lower wages during the training period. After the training period, the employer would then pay the worker the market wage (Becker, 1964: 11–16). Since workers earning a living wage or lower could not afford to take lower wages in return for general training from their employer, it is not likely they will get such training. Nor could they afford to pay for it themselves, since the result would still only net them the market wage, which might still be below a living wage.

Specific training gives workers skills that are not transferable to other employers. To be sure, Becker noted, most training is a mix of specific and general training. In the abstract, specific training would not improve the worker's ability to change jobs for higher pay and as a result the worker would not be willing to pay the costs of such training. Employers would be willing to pay for such training if it increased the value-added by the worker and the employer saw enhanced profits as a result. At first glance, Becker indicated, employers might not have an incentive to pay higher wages to those workers in order to gain all of the benefits of the increased productivity from the training. If a worker decided to change jobs, however, the employer would lose the investment in training that worker. Therefore the employer might pay the worker a higher wage to keep the worker's loyalty (Becker, 1964: 19–21). Here then specific training might increase the pay of low-wage workers. The question then becomes whether workers earning less than a living wage have the sort of jobs that would benefit from specific training. If they do not have such jobs it is not likely that their employers will pay for their training voluntarily.

There is one other aspect of the living wage that Becker sheds light on, what he called 'productive wage increases'. In earlier sections we have seen that nearly all of our economic thinkers believed that higher wage increases would improve the well-being of workers and enhance their capability. Consequently it would benefit employers if they paid higher wages, at least to some point of diminishing returns. Becker agreed with the potential for higher wages to improve 'emotional and physical health' and thus to enhance human capital. But the factors that improve the health of the worker were outside of the employer's control. The problem was whether higher pay would actually result in increased capability from better health. Becker wrote:

> The effect of a wage increase on productivity depends on the way it is spent, which in turn depends on tastes, knowledge, and opportunities. Firms might exert an influence on spending by exhorting employees to obtain good food, housing, and medical care, or even by requiring purchases of specified items in company stores. Indeed, the company store or truck system in nineteenth century Great Britain has been interpreted as partly designed to prevent an excessive consumption of liquor and other debilitating commodities. (Becker, 1964: 55)

This type of system of seeking a *quid pro quo* for a wage increase should remind us of the sort of paternalism John Stuart Mill wanted to avoid. Yet it raises perhaps the biggest question that the advocates of a living wage need to answer: If employers are to be obligated to pay their workers a living wage, are those workers equally obligated to spend those wages wisely in ways that enhance their capability?

By raising this question, albeit indirectly, Becker has brought us back to Adam Smith's moral economy. To see how, let us recall that Smith wrote of that economy:

> All the members of human society stand in need of each others assistance, and are likewise exposed to mutual injuries. Where the necessary assistance is reciprocally afforded from love, from gratitude, from friendship, and esteem, the society flourishes and is happy. All the different members of it are bound together by the agreeable bands of love and affection, and are, as it were, drawn to one common centre of mutual good offices. (Smith, 1976a: 85–6)

The emphasis in it is on 'mutual injuries' helped by 'reciprocal assistance'. In sum, the moral economy requires of its members some sense of mutual obligation along the lines of Aquinas's reasoning that a just price required both buyer and seller to follow the golden rule and consider the needs of the other party to the transaction. If the living wage represents a just price for labour, what needs of employers do workers given a living wage need to consider?

BEN B. SELIGMAN: AUTOMATED CAPABILITY

If market economists such as Becker followed Smith's moral economy it was more from inadvertence than design. One example of an economist who recognized the importance of the moral economy would be Ben B. Seligman, who brings us back to Smith's concerns for worker capability as human agents in a caring community. From his early days in college Seligman considered himself to be a member of the Institutional school of economics and he combined elements of Veblen and Commons in his thinking. He also acknowledged Marx's influence, especially his theory of alienation. Seligman's interest in Marx's theory of alienation was part of a rediscovery of the concept in the 1950s by writers such as Herbert Marcuse and Hannah Arendt. Here is Seligman's especially clear statement of what alienation meant to him:

> The fundamental question for the individual worker must be the shape and form his work assumes. When technology was less structured and more amenable to human control, the individual could mold his work directly, lending a pride of craft, even joy in bending oneself against resisting forces to compel them to assume shapes unheard of in a rude state of nature. Material was torn out of nature and converted into a product of man. This, indeed, was his true social condition. (Seligman, 1965: 339)

He footnoted Marx's 'Alienated Labor' from the *Economic and Philosophic Manuscripts of 1844* as a reference for this passage making Marx's influence apparent (Seligman, 1965: 339n).

As had Marx, Seligman applied alienation to the issue of worker capability in the workplace. We can see this application clearly in his book on the costs of automation, *Most Notorious Victory* (Seligman, 1966). In that book he noted that technology had been static for most of human existence, but for the past two centuries the pace of technological change had increased dramatically due to the combination of science, technology and business. From the beginning, businessmen had used technology to reduce their reliance on craftsmen by replacing their skills with machines (Seligman, 1966: 10–11). The result was a fascination for machines that has persisted throughout the economic history of capitalism. Automation was a different type of technology from what had been used previously. It resulted in 'The automatic factory which would function as if it were a set of synchronized watches with split-second timing' (Seligman, 1966: 29). Under the strict control of automation, work changed. Seligman described it as follows:

> Work becomes a mechanical reaction of those pursuing the dictates of a single set of values; it loses its spontaneity and its creativeness and is converted into

> automatic behavior. . . . Meaning disappears as work takes on the character of continuous improvement. When it does, those humans utilized by the process become mere automatons. (Seligman, 1966: 362)

Here Seligman is using Marx's theory of alienation to show how a society composed of human capability does not always mesh well with technology. Work in an automated factory would neither require nor develop human capability.

Seligman drew upon Commons's idea of collective capability to look at the response to automation by unions. He was very critical of the union leadership noting that unions sacrificed their members by accepting the job losses that went with automation; they also attacked each other over which union would keep the jobs' automation left behind (Seligman, 1966: 240–7). The upshot of this and other cases, Seligman concluded, was that 'the only answer to automation through collective bargaining is to take care of those who are inside the plant. Little can be done for the worker already shunted aside and even less for the younger who wants to get in' (Seligman, 1966: 244).

These unions were not able to use collective bargaining to resolve the issues of automation, because they were being much too business-like, which meant that they lacked the collective capability to find a reasonable approach to the issues automation brought up. Seligman then asked whether the unions' inability to address those issues meant that unions faced a future 'of declining power and influence' (Seligman, 1966: 267). To him, unions had never had the sort of countervailing power that Commons had hoped for and that Pareto and Friedman had feared. In recognizing their inability to fight the affects of automation, he saw the potential for the decline of unions at a time when few others, Solomon Barkin (see Chapter 4) stands out as an example (Barkin, 1961), would have thought union decline was imminent.

Seligman worried that the decline of unions would also impair the capability of workers. He believed that humans at all levels of society could be active agents capable of organizing their work lives. If unions had been stronger, they could have done more for workers by making sure that automation was used to reduce workers' hours of work. Seligman tied the reduction of hours of work to capability, much as Marshall had. He wrote, 'It is also clear that increased time for one's self and one's family is a necessary condition for a rounded useful and satisfying life. The fuller development of individual capacity, better care of children, greater attention to community obligations, better education and a general improvement in the quality of life makes for higher productivity' (Seligman, 1960: 20–1). We will see this same attention to humans whose status as active agents could be enhanced by the improvement of their capabilities in the writings of Amartya Sen.

AMARTYA SEN: CAPABILITY AND FREEDOM

Amartya Sen (1933–) addresses an issue often left out by market economics. In Chapter 2 we saw that Milton Friedman argued that economic freedom and political freedom had developed together with the capitalist free market economy, but they did not always work together because individuals could use political freedom to promote governmental policies that reduced economic freedom (Friedman, 1982: 3–4). He left out an important issue, however. How had the capitalist free market economy developed the capability among its members to judiciously exercise economic and political freedom?

This is the issue that Sen has addressed by arguing that economic development should be seen 'as a process of expanding the real freedoms that people enjoy' (Sen, 1999: 3). From this perspective, he believed that economic development had to eliminate all the obstacles to freedom, including, in terms of our interest in the living wage, poverty. The removal of these obstacles was important because 'achievement of development is thoroughly dependent on the free agency of people' (Sen, 1999: 4). Here Sen can be interpreted as following a form of Marshall's principle of cumulative causation. If development expands the freedom of individuals, those individuals will then have the capability to enhance the process of development, bringing about more freedom and more development. The key to the process was the development of human capability.

Sen recognized that this cumulative process of economic development as linked to the growth of human capability was embedded in the market system. The free exchange of goods was on par with the process of the free exchange of ideas and each was a component of the way human beings interacted. For this reason he saw free labour contracts as an advance over slavery and indentured servitude; the latter represented adverse regulation of labour markets in a way that prevented workers from participating in them, which limited workers in their efforts to be a part of the social fabric (Sen, 1999: 6–7). To highlight this point, Sen asked a question that might have vexed Hayek and Mises.

They had argued that markets were more efficient than collective, centralized planning because the markets organized information and offered incentives for humans to act on that information. But suppose, Sen asked, a dictator (Plato's philosopher king) had the wisdom to make all the correct decisions and attain a result comparable to what a market system could achieve. Would individuals then be indifferent as to whether or not they lived in a market system or a dictatorship? Sen answered no, because freedom would 'be missing in such a scenario'. The individual might end up in the same job with the same income and ability to buy the same basket of commodities, but 'she may still have good reason to prefer the scenario of free choice over the submission to order'. The process of getting to the outcome was also important and the attention that economists pay to utility had caused 'the neglect of the central value of freedom itself' (Sen, 1999: 27–8).

Freedom, however, depends on capability, and Sen identified a relationship between low income and capability by arguing that we should view poverty in terms of its impact on human capability and not simply as low income. To be sure, Sen found other influences that diminished the capability of human beings and observed that the relationship between income and capability varied in different societies and among individuals. Social institutions such as a preference for the enhancement of the capability of males over females in some societies altered the relationship. Relative poverty could also alter the relationship, as in the case of being poor in an affluent country versus being poor in a poor country, a point Sen attributed to Smith (Sen, 1999: 87–9). Workers in the US with incomes much higher than workers in Third World countries still might suffer from diminished capability.

With this argument Sen countered the idea of Hicks that there was a diminishing amount of capability added from increasing incomes. He might also have found limitations to Rose Friedman's definition of poverty in terms of a basic need for food, clothing and shelter, as described in Chapter 2. Instead, the capability argument meant that the definition of poverty as linked to capability deprivation must be more diverse. Sen described this linkage as follows:

> The need to take part in the life of a community may induce demand for modern equipment (televisions, videocassette recorders, automobiles and so on) in a country where such facilities are more or less universal (unlike what would be needed in less affluent countries), and this will impose a strain on the relatively poor person in a rich country even when that person is at a much higher level of income compared with people in less opulent countries. Indeed, the paradoxical phenomenon of hunger in rich countries – even the United States – has something to do with the competing demands of these expenses. (Sen, 1999: 89–90)

This implies that wages have a capability component to them, and Sen linked that component to workers having the capability and the opportunity to participate in all of the activities the community deems to be important.

In addition to requiring a broader definition of poverty, Sen's version of the capability approach also carried the idea that capability was a much broader term than human capital. To him, the concept of human capital as the enhancement of the capability for productive effort was important, but it had to be supplemented with a viewpoint that 'human beings are not merely the means of production, but also the end of the exercise' (Sen, 1999: 295–6). By making human capability the end of economic activity, Sen has returned to the issues first raised by Plato and Aristotle, who argued that the purpose of consuming items of basic need was to enable humans to attain that all-encompassing capability they called virtue. Plato and Aristotle did not see the market as allowing humans to gain that capability. Sen, however, followed Smith in believing that the market did provide the wherewithal for the development of virtue. Indeed, he credited Smith with seeing that to view humans simply as a productive resource, as the concept of human capital does, overlooked what it meant to be human. Thinking of humans in terms of utility and not in terms of the development of capability, Smith once told David Hume, meant that 'we should have no other reason for praising a man than that for which we would commend a chest of drawers' (Smith, 1976a: 188).

CONCLUSION

The capability approach starts with the premise that human beings have many functions to carry out as members of their society. In terms of a living wage, the capability approach means that we need to take into account whether the wages workers earn enables them to improve their abilities as workers and as members of society and to enhance those abilities in their children. We can start with Smith on this issue, for he worried that low wages and the numbing affect of work under the division of labour would impair the capability of workers while education and higher wages would enhance their capability. Mill and Marshall followed him and elaborated on what was necessary for workers to enhance their capability. They all made higher wages a component of enhanced capability, but only if workers spent their increased income on the right items of consumption. Mill and Marshall went further and looked for other social forces to enhance the moral character of workers. They were especially interested in unions because they thought unions allowed workers to develop their own moral character without anyone else and especially the government telling them what to do. In between Mill and Marshall stands the imposing figure of Marx, reminding them that neither unions nor education could enhance the capability of workers as long as they laboured under conditions of alienation.

Market economists had less concern with the capability argument. To them, humans already have the capability to be rational, self-interested individuals able to make informed decisions. The decisions that concern market economists are economic ones and the only capabilities that concern them are productive ones. Given that workers make rational self-interested decisions about what to buy with their incomes, there is no sense in telling them that they need to choose wisely in what they consume in order to enhance their capability. In addition, in choosing what skills to acquire and what jobs to pursue, they also make informed choices. Whatever job and wages workers wind up with, their choices are what got them there.

When workers join a union, it has nothing to do with enhancing capability as far as market economists are concerned. To them, workers will join a union only if the costs are less than the benefits, that is, only if the union can gain greater wages and benefits for its members than the dues it collects from them. Pure economic reasoning does not need to take into account the development of capability. Moreover, even if unions could gain higher wages for their members, which the market economists doubted, the gains in capability that those wages might bring about face the same diminishing returns as any other expenditure, as Hicks argued. Finally, as Becker has pointed out, the incentives for training that might enhance capability are skewed with neither business nor workers having a strong incentive for enhancing their capability.

To advocates for a living wage, this chapter has mixed lessons. Yes, the capability approach offers a solid justification for a living wage. Increasing worker pay can improve workers' capability and set off the process of cumulative causation that Marshall found to be important. It poses a vexing question, however: does anyone have the wisdom to tell workers how to spend their money in ways that will enhance their capability? Mill and Marshall believed that how workers spent their income mattered in terms of enhancing their capability, but were leery of having anyone tell those workers how they ought to spend their income – they wanted to avoid paternalism and anticipated that workers would develop the capability to make spending decisions that would further enhance their capability as workers and citizens. The market economists found this issue to be beside the point. Still, it is an important issue. If workers get a living wage, what will those workers do with their additional income? Will the extra income be beneficial for them in developing the freedom Sen considered an essential capability? And if the living wage comes to them through the efforts of others how will that affect their capability?

4. Externality, community and wages

INTRODUCTION

An externality exists when a person or a business takes an action that harms or helps another person or the community at large without the payment of any compensation. In most cases we tend to think in terms of a negative externality, such as the air pollution that many believe causes global warming. The concept of externality is not usually applied to workers, however. Given their assumption that individual human behaviour is rational and motivated by self-interest, there is an inference among economists that workers can only harm themselves through their labour market activities. We will see in this chapter, however, that economic thinkers argued that low wages and poor working conditions did spill over and affect not only the workers involved but the community as well. Those cases usually involved consideration of how reduced levels of labour force sustainability or capability due to low wages imposed a cost on society.

It was not until the early years of the twentieth century that the issues involved in an externality were clarified. Since then, economic thinkers have discovered an array of policies for handling the problem of a negative externality, including policies to address the needs of low-wage workers. In developing those policies, I will also argue, a group of them were motivated by their own version of Smith's moral economy. To them, that meant that there was a community interest in interfering in the market to take care of externalities of work and wages. Another group of economists, however, resisted such interference because they believed that tampering with labour market outcomes had the potential to harm the economy. Consequently, the issues surrounding the concept of externality replicated the debate between the sophists and Aristotle and Plato over markets and morals that started in ancient Greece. In this chapter, however, the starting point will be with Adam Smith.

ADAM SMITH AND UNINTENDED CONSEQUENCES

As the quintessential champion of the market system, Adam Smith now epitomizes the idea that individual decisions based on self-interest always lead to the good of the community. Smith's writing, however, was an ingredient of the intellectual climate that came to be known as the Enlightenment. The goal of the Enlightenment was to apply scientific principles based on reason to understand the world and to use the knowledge gained to have social organization based on rational thinking instead of personal opinions or superstitions. Smith's version of the application of reason to social affairs was to base policy on 'natural laws'. Policies not in accord with 'natural law' would have negative consequences. A proper understanding of Smith's writings must include an appreciation for his consequentialist thinking. For him, self-interest as channelled by competition in the marketplace was a part of 'natural law' but their efficacy still had to be judged by the positive consequences (benefits) they had for human society. For Smith, natural law applied to the consequences of particular actions, but individuals were free to choose their goals. He urged them to concentrate their energies and pursue material goals rather than power and dominance because the consequences for society would be better. When self-interest and markets combined to produce negative consequences (costs) for humans, however, Smith pointed them out.

We can see this application of unintended consequences in one of his few passages regarding the invisible hand of competition. Writing about the typical business person, Smith observed:

> He is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good. (Smith, 1976b, vol. I: 477–8)

The case he is discussing is free trade versus protectionism and the issue is how a merchant might pursue protection against imports out of self-interest even though it was against the interest of society. The point is that the unintended consequences of self-interest could be adverse to society, which is why Smith qualified the linkage between self-interest and the promotion of social good with 'frequently'.

By looking closely at his analysis of labour and wages in Chapters 2 and 3, we have already seen that he was a friend of labour and argued that workers should receive a living wage, what he called a subsistence wage, or else society would experience negative consequences. In this chapter I will argue that he saw those negative consequences as an externality. To be sure, he anticipated that the market system had the potential to result in a living wage for workers, but in cases where it did not he determined that the community itself was damaged.

A starting point is with his case for higher wages for workers, where Smith used arguments that touch on the modern concept of externality. To be sure, employers would gain a direct benefit from higher wages because they would improve the physical condition of workers and make them more industrious. He wrote: ‘Where wages are high, accordingly, we shall always find workmen more active, diligent, and expeditious than when they are low’ (Smith, 1976b, vol. I: 91). A better workforce was more productive which would have the benefit of increasing the wealth of the nation. James Buchanan has found this benefit to be an indication in Smith’s writings of a ‘work supply externality’. As more individuals choose to work, the market can expand and thus extend the division of labour. ‘One means of internalizing these externalities’, Buchanan argued, ‘is through the installation and maintenance of a work ethic’. For a work ethic to succeed, however, workers had to thrive, that is, their increased effort had to result in higher wages (Buchanan, 1992: 105–11). This would then give workers an incentive to continue to work once they had attained a subsistence wage of basic needs plus the decency component. Along the same lines, if low wages eroded a work ethic, that would imply a negative externality.

Moreover, if wages fell below subsistence workers might not bother to work, instead turning to begging or to crime. These would impose a cost on society and can more readily be construed as a negative externality. Thus Smith argued that a further consequence of low wages was that, ‘Want, famine and mortality would immediately prevail in that class [workers], and from thence spread to all of the superior classes’ (Smith, 1976b, vol. I: 82). Here too we have an example of low wages producing a negative externality.

In addition to low wages, Smith found a negative externality that resulted from working conditions regardless of the wage level. One such case was the one considered in Chapter 3, the negative affects of the division of labour. Recall that he argued that work under the division of labour rendered a typical worker ‘not only incapable of relishing or bearing a part in any rational conversation, but of conceiving any generous, noble, or tender sentiment’. Such a worker could not participate in ‘the great and extensive interests of his country’ and was ‘equally incapable of defending his country in war’ (Smith, 1976b, vol. II: 302–3). In short, workers in the division of labour suffered a decline in capability, which inflicted a negative externality on society. Smith made a case that government activity, public education, was needed to prevent the damage caused by the externality. (Smith, 1976b, vol. II: 246).

One other work condition Smith worried about was overwork. Workers might be paid based on a piece-rate, but that gave them an incentive to work too hard. Rest was necessary for work and moderate levels of work were needed to enable a worker to ‘preserve his health’ and make him effective for a longer period (Smith, 1976b, vol. I: 91–92). We are now back to the issue of sustainability. If workers have to put in long hours to earn a living wage, they might eventually have shorter work lives and produce less work in the long run. This overuse of workers could lead to the deterioration of the workforce with the implication that it caused a negative externality to society.

In this case Smith suggested that employers 'listen to the dictates of reason and humanity' and offer workers betting working conditions (Smith, 1976b, vol. I: 91–2). We can categorize this suggestion as using a voluntary approach to an externality, with employers using reason and humanity (but not self-interest) to eliminate the problem. Indeed, to a large extent Smith's writings on labour in *The Wealth of Nations* aimed at a voluntary approach to having employers make life better for workers with the wage and work conditions that made for a living wage. That was why he thought the development of the capability for virtue, as described in Chapter 3, was so important.

Starting with Plato and Aristotle intellectuals have always had an interest in defining the standard of living in terms of its influence on the capability to be virtuous. From Smith's perspective, the individual development of virtue had a positive externality for society. It would infuse elements of his moral economy into the market economy and help create a healthier community. Smith's main argument in favour of the market economy was that persons acting in their own interest were led to produce social good even though that was not their intent. We can see this argument as Smith's theory of unintended consequences, an inchoate theory of externality, whereby activities in the market caused side effects for society. Overall, Smith saw these externalities as positive and a benefit for society. Perhaps the greatest external benefit was that self-interest led to increases in the division of labour, greater wealth and the wherewithal for enhanced virtue among the affluent.

In arguing for extending this case to workers he used the idea that low wages and poor working conditions had a negative externality. As a policy for internalizing these external costs, he did not argue for government intervention; he astutely recognized that intervention by the government of his day would be on the side of business. Rather, he hoped that businessmen would become more enlightened and virtuous and voluntarily provide a rising subsistence, that is, a living wage, for workers. The biggest lesson Smith has regarding the living wage is that he recognized the importance for society of ensuring that workers earn a living wage and that recognition came about from his holding as an ideal a moral economy which created greater social happiness than a market economy. He appreciated, however, that since the moral economy was not realizable we must work with the market economy and be careful not to interfere with how it works. Still, even in the market economy a living wage was important to Smith because low wages impose costs on a society with a market economy and it is in everyone's self-interest to eliminate them.

BENTHAM AND THE SIDE EFFECTS OF SELF-INTEREST

Because his utilitarian principles had as an ultimate goal the production of the 'greatest good for the greatest number', Bentham should naturally have created a concept of externality as cases where individual self-interest reduced that greatest good. His development of that concept and how to resolve it was hindered, however, by his individualistic definition of the community.

To highlight self-interest as a reliable social force Bentham analysed all human action through his pleasure/pain principle. He believed that what gave one pleasure or pain was a matter of individual taste. As he put it, the 'quantity of pleasure being the same, push-pin is as good as poetry' (quoted in Oser and Blanchfield, 1975: 120). It was a daring stance for Bentham to take, for he elevated the pleasures of the working classes to those of the high born. Push-pin was a game played by children of the poor, while only the higher ranks enjoyed poetry. Equality of pleasure was possible among all members of society, which meant that legislators had to treat all persons equally in their deliberations. At the same time, Bentham placed individualism and self-interested individual actions at the centre of his definition of the community.

For example, he cautioned that legislators must be wary of persons who claimed to act in the public interest. Bentham postulated that there was always a conflict between the private interest of the self-regarding individual and the public interest of doing good acts on behalf of others. The winner in this conflict, he determined, was usually private interest. He admitted that this was a dour view of the world, but thought it was a realistic one. To be sure, there were examples of philanthropy and Bentham himself wrote in an effort to improve society. Concerning such persons, Bentham wrote, 'public virtue in this shape cannot be reasonably regarded as being so frequently exemplified as insanity' (Bentham, 1954 [n.d.]: 431–2). The well-formed mind that Adam Smith had written about was not to be counted on in public affairs. The best course was to rely on the individual's calculation of his own interest as measured by utility and be wary of those who claim to act in the public good. Most likely they have a self-regarding, hidden agenda.

Despite his holding to this utilitarian individualism, Bentham did not condone all activities and pleasures that individuals might pursue. However much pleasure criminals might derive from criminal activities, for example, they were not tolerable because of their impact on society when they hurt other persons. The individual gain from criminal activities had to be weighed against the total personal loss to society from all crimes. Bentham did not accept the idea that the individual's pursuit of utility necessarily promoted the greatest good. An individual might be the best judge of their utility, but it was up to society through its legislators to judge the overall impact of individual actions on the tally of utility for the community.

Here we must consider in more detail what Bentham meant by the community and what it meant to add to the community's utility. Bentham did not accept the idea of a community interest. To him, the community was a fictitious entity, as most communities were composed of isolated individuals with separate interests. To advance the interest of the community legislators had to consider ways to increase the utility of its individual members on a per person basis (Bentham, 1781: 15). This meant that to determine the impact of a law on the community, legislators first had to calculate the total pleasure and pain the law gave an individual: 'The balance, if it be on the side of pleasure, will give the *good* tendency of the act upon the whole, with respect to the interests of that *individual* person'. Then the legislators should make the same calculation for every individual whose interests were affected by the law and sum up the total pleasures and pains; if the total pleasure was greater than the total pain the action was a good one. This was a cumbersome process, as Bentham knew, writing, 'It is not to be expected that this process should be strictly pursued previously to every moral judgment, or to every legislative or judicial operation. It may, however, be always kept in view: and as near as the process actually pursued on these occasions approaches to it, so near will such process approach to the character of an exact one' (Bentham, 1781: 32–3).

To keep that process in view, legislators had to think of the interests of the individual members of the community. Bentham espoused a philosophical individualism that made defining a community interest or social justice very difficult. He wrote:

> The good of the community cannot require, that any act should be made an offence, which is not liable, in some way or other, to be detrimental to the community . . . But if the whole assemblage of any number of individuals be considered as constituting an imaginary compound *body*, a community or political state; any act that is detrimental to any one or more of those *members* is, as to so much of its effects, detrimental to the *state* . . . An act cannot be detrimental to a *state*, but by being detrimental to some one or more of the *individuals* that compose it. (Bentham, 1781: 158)

Crime had to be stopped because it had direct, negative consequences by causing pain to its victims. It also had an externality effect by setting a bad example that encouraged other individuals to turn to crime, which created even more victims. Laws to punish crime were items of agenda for government and interference with the self-interest of criminals was justified on the basis of the greatest good for the greatest number.

What does this have to do with a living wage? For Bentham, paying workers a low wage was not a crime and government interference was not warranted. If crime resulted from low wages, however, we are on better grounds for thinking of low wages as producing a negative externality. Bentham we may recall from Chapter 2 had a theory of a hierarchy of human ends that included subsistence, security and abundance. If workers earned low pay they could either turn to crime, which imposed a cost on the individual members of the community, or they might turn to social unrest that threatened the stability of the community. In either case, their actions threatened the security of the rest of the members of the community, creating a negative side effect. As individuals, Bentham argued, the affluent members of society might spend some of their wealth on improving their individual security to ward off the direct threats (externality) that came from crime because employers paid low wages. The result would be that they might have to give up some pineapples to pay for security guards. It would be better in terms of the security offered, he continued, to give up those pineapples to provide potatoes for the working poor in the form of higher wages (Bentham, n.d. [1952]: 110–11). It was in the self-interest of the wealthy to enhance their security by paying for higher wages for the working poor. Bentham followed Smith in seeing a voluntary solution to the externality caused by low wages, but he based that voluntary solution on the self-interest of the wealthy and not on humanity and reason as Smith had.

Bentham's view of society looks forward to the ideas of the market economists that the economy consists of individual utility maximizers who act only in their self-interest. In such a society laws that might mandate a living wage needed to be considered on a case-by-case basis to determine how they would impact each individual who gains the living wage as well as those who must pay for it. Mutual assistance in an urban society mediated by self-interest would be difficult to accomplish and Bentham doubted that government intervention would be able to do the job.

MILL'S CASE FOR GOVERNMENT INTERVENTION

Mill followed Bentham in not favouring government intervention in economic activities on the grounds that it created negative consequences for society. These consequences were direct, however, and could not be construed as an externality. His principle for government intervention was that 'the performance of as much of the collective business, as can safely be so performed, by the people themselves', was the wisest approach (Mill, 1960: 135). At the same time Mill recognized that the government mandated sanitary laws that aimed not at making people take care of their own health 'but to keep them from endangering the health of others' (quoted in Hollander, 1985, vol. 2: 677). This is a classic statement of individual actions imposing an externality and the use of government regulations to stop them and Mill made it a more general principle by writing: 'The only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others' (quoted in Frank, 1985: 215). Would Mill have extended this argument to low wages, given that he had recognized that they impaired the capability of workers with a negative affect on society?

Mill hedged on answering this question. We have seen in Chapter 2 that he did not want government intervention to remedy the negative affects of low wages but preferred that the government take steps to legalize the formation of unions. Consequently, we might categorize him as seeing unions as a way for private activities to take care of a negative externality from low wages. To him, unions were communities of self-interested individuals who could gain the moral character to recognize the community interest while Bentham thought only a few persons could gain that capability. Mill saw unions as another way to develop a voluntary approach for resolving the externality problem of low wages.

MARX AND THE FALSE COSTS OF CAPITALISM

With his wide-ranging, holistic approach to economics, Marx investigated almost every activity involved with economic production. At the same time, he had a clearly defined sense of community and was constantly looking at how the activities of the capitalist class damaged that community. We saw in Chapter 3 how he used his concept of alienation to show how capitalist production damaged the capability of workers. In one example of an externality, Marx observed that without meaningful work, workers 'preferred vagabondage, beggary, etc. to wage labour' (Marx, 1977: 769). This example of Marx's idea that work and working conditions had an externality for society in terms of the potential crime they fostered parallels the ideas of Smith and Bentham. In its application Marx focused on this relationship in terms of the length of the working day.

In his writings, Marx dedicated many words to the length of the work day and the conflict between capitalists and workers over its duration. He saw this conflict as being related to his theory of exploitation, because the more hours workers put in each day, the more surplus they would generate for the owners of capital. The capitalists thus had an incentive to expand the hours of work as much as they could, with a limit set by 'the deduction of a few hours of rest without which labour power is absolutely incapable of reproducing itself' (Marx, 1977: 375). Smith had warned of the dangers of overwork, as noted above, and Marx used him as a source in arguing about the detrimental impact of it on workers and their capability (Marx, 1970: 268–72).

By expanding the workday, capitalists diminished the lifespan of workers. Marx wrote: 'Capitalist production . . . not only produces a deterioration of human labour-power by robbing it of its normal and physical conditions of development, but also produces premature exhaustion and death of this labour-power itself'. He cited studies that made public the reduced life span of workers in Manchester and Liverpool, who lived only half as long as members of the middle class. To bring home the issue regarding the length of the workday, Marx asked rhetorically whether the decline in workforce quality from long hours gave capitalists an incentive to determine a sustainable workday. His answer was that a conservation of the precious resource of labour never took place, due to market competition. He wrote: 'Looking at these things as a whole, it is evident that this does not depend on the will, either good or bad, of the individual capitalist. Under free competition, the imminent laws of capitalist production confront the individual capitalist as a coercive force external to him' (Marx, 1977: 381). Capitalists were caught up in a prisoner's dilemma problem whereby a capitalist who arranged for workers to have a shorter working day (but for the same pay) would be at a competitive disadvantage; with higher labour costs he would likely fail in the marketplace. Meanwhile, the capability of the workforce deteriorated. The costs of that lost capability were a false cost to Marx because they only existed under capitalism

Marx found this same process of competition in his analysis of machinery. By making workers more productive through the use of machinery, capitalists could reduce the length of the working day or pay higher wages. While this could make life easier for workers, instead the capitalists used machinery to increase their share of total production. As an example, he gave a hypothetical case where labour's productivity in the production of cotton doubled. The cotton mill owner thus would need two days of work to produce a profit that previously took four days. At the same time, workers could produce the identical amount of cotton (and profit) in half the time. The capitalist would not reduce the work time of workers nor increase their wages, because that would give workers and not capitalists the benefit of the new technology. They would have no incentive to advance technology in that case (Marx, 1977: 702). Moreover, machinery allowed them to reduce the number of workers they hired, with the result of forming the industrial reserve army of the unemployed – another false cost of capitalism.

Although he did not specify an externality from these false costs, Marx identified an externality in the unhealthy circumstances of the industrial reserve army of unemployed workers. He referred to those conditions – illness, pauperism, undernourishment – as 'part of the *faux frais* [incidental expenses] of capitalist production; but capital usually knows how to transfer these from its own shoulders to those of the working class and the petty bourgeoisie' (Marx, 1977: 797). This reference comes close to the modern explanation of an externality as a cost that exists in production and is shifted to other parties not involved in the transaction of buying and selling, in this case labour. One policy for shifting the costs back to the producer is regulation, and England had tried to regulate working conditions. Marx found that most manufacturers ignored the regulations when they could and combined to fight them in court when they had to (Marx, 1967: 88–96).

To Marx, the problem was that no one under capitalism could take a community perspective, which meant that capitalism and the free market would find it difficult to resolve any issue relating to the false costs of an externality. He anticipated that the proletariat through its revolutionary activities might transform capitalism into a more community-oriented economic system (socialism or communism). That economic system would provide workers with a living wage and unalienated working conditions and thus take care of the work externality cases that Marx identified. How would Marx have solved the practical problem of defining a living wage for workers under socialism or communism? His clearest statement of the issues involved in determining that wage can be found in his *Critique of the Gotha Program*. The Gotha Programme was a platform set forth by the disparate members of the German social democratic movement to unify themselves into the German Social Democratic Party that its members hoped to form at a congress in the town of Gotha in 1873. As was usual for him, Marx was critical of what the party leaders had set forth. Regarding the wages to be accorded to labour under the socialism envisioned in the Gotha Programme, his comments addressed 'statement three' of the programme: 'The emancipation of labour demands the promotion of the instruments of labour to the common property of society and the co-operative regulation of the total labour, with a fair distribution of the proceeds of labour' (Marx, 1875: 385).

Marx immediately raised questions about the notion of a 'fair distribution of the proceeds of labour'. He first considered the issue of whether to define the proceeds of labour as labour's product or the value of that product; whichever definition was used, one then had to ask if the wage was to be based on the total product of all labour or the amount that the particular labour added. Whatever the definition of what was to be distributed, the next issue was what was meant by 'fair', and the resolution of that issue he believed would depend on the social system. A capitalist society had one definition of 'fair' and its leading members thought the existing level of wages represented a fair distribution. In the same way, he asked, 'Have not also the socialist sectarians the most varied notions about "fair" distribution?' (Marx, 1875: 385).

The notion of fairness set forth in the Gotha Programme was that in a society with common ownership of capital and a cooperative regulation of the supply of labour, 'the proceeds of labour belong undiminished with equal right to all members of society'. Marx retorted, 'To all members of society? To those who do not work as well? What remains then of the "undiminished" proceeds of labour? Only to those members of society who work? What remains then of the "equal right" of all members of society?' Moreover, the product of labour would be diminished by other factors. Part of the total social product must go to replace capital and raw materials used up in production and part of it must be used to provide for future increases in production. Another part needed to be set aside to cover emergencies or accidents. There had to be a deduction to cover the costs of administering the distribution of this amount. Moreover, a portion of the social product had to be earmarked for the consumption of public goods, such as schools and healthcare. Another portion had to be set aside to provide for those unable to work. Fairness had nothing to do with these economic costs, which had to be paid. Marx considered these deductions acceptable because they meant that 'what the producer is deprived of in his capacity as a private individual benefits him directly or indirectly in his capacity as a member of society'. What was left could then be distributed to workers for their consumption (Marx, 1875: 385–6).

What should each individual then get as a share of the diminished product of society? In the early stages of a communist society, in the form that it would take right after capitalism, Marx wrote: 'The individual producer receives back from society – after the deductions have been made – exactly what he gives to it. What he has given to it is his individual quantum of labour'. Workers should be able to take from the stock of consumption items in an amount proportionate to what they contributed to that stock (that is, the value they added). But there was a problem with this approach. Marx wrote:

> The right of the producers is proportional to the labour they supply; the equality consists in the fact that measurement is made with an equal standard, labour. But one man is superior to another physically, or mentally, and supplies more labour in the same time, or can labour for a longer time; and labour, to serve as a measure, must be defined by its duration or intensity, otherwise it ceases to be a standard of measurement . . . Further, one worker is married, another is not; one has more children than another, and so on and so forth. Thus, with an equal performance of labour, and hence an equal in the social consumption fund, one will in fact receive more than another, one will be richer than another, and so on. To avoid all these defects, right, instead of being equal, would have to be unequal. (Marx, 1875: 386–7)

The reason for these problems – Marx might have called them contradictions – is that the idea of equal rights was a carryover from a capitalist society and had no place in socialism.

Since the current notion of a living wage is based on paying it in a capitalist society, it carries the same problems. In that society workers have different natural endowments as well as financial endowments which contribute to what they add to total social production by an hour's work. If pay is to be proportionate to that contribution, then higher endowments will lead to higher pay. A top executive who adds a high level of value in an hour may justifiably feel he deserves more pay than a low-paid worker earning below a living wage. He also might feel justified in thinking that he has more needs to be met than a lower-paid worker. Marx would retort that this feeling was misplaced since work was a social process that produced a joint product. Still, he recognized that under capitalism that feeling and the distribution of income it produced could not be changed. That was why he fought for socialism and a transition phase before the final development of a communist society. Marx believed that only under communism could he find support for his ultimate goal of a living wage, 'From each according to his ability, to each according to his needs!' (Marx, 1875: 388)

Marx has brought us back to his version of Smith's moral economy based on reciprocal assistance from 'bands of love and affection'. Marx, however, was more optimistic than Smith that it could be realized instead of relying on a 'mercenary exchange' to supply members of society with what they needed. His entire life's work aimed at showing how that moral economy could be realized. Once it was realized there would be no issue of a living wage for the issue would be moot. Each person would know their own and their neighbour's needs and would be happy to contribute to supplying them. Work would lose its alienating character and everyone would want to work to add to the good of all.

ARTHUR CECIL PIGOU DEFINES EXTERNALITY

Arthur Cecil Pigou (1877–1954) had a lengthy career and his contribution to economics resulted from his development of welfare economics. Our interest here is in how he used welfare principles to investigate workforce capability as a function of wages and working conditions in two prominent books, *Wealth and Welfare* (Pigou, 1912) and *The Economics of Welfare* (Pigou, 1932). Pigou's general approach was to judge any policy by its effects on economic welfare as measured by 'the national dividend', what we now call gross domestic product (GDP). Changes in the national dividend, up or down, he argued, indicated similar changes in welfare. As had Marshall before him, he argued that increased income for workers created an improved life for their children who would then be more able to help their own children, setting off a cumulative process that was capable of modifying human capability (Pigou, 1932: 110–20).

To lend precision to his measure of the effect of changes in the size and distribution of the national dividend, Pigou came up with the concept of externality as the difference between social product (the impact of production on society) and private product (the proceeds from the sale of that production). If the private product exceeded the social product, there was a negative externality while cases where the social product exceeded the private product were a positive externality. Because the social product did not enter into the economic calculations of private production, it was not taken into account by decision makers in business (Pigou, 1932: 131–6). This result meant that private enterprise did not guarantee maximum welfare. When that happened, Pigou believed that the government should take action to improve social welfare.

One form of divergence between social product and private product was given by Pigou's classic statement of what is now called an externality. He wrote:

> Here the essence of the matter is that one person A, in the course of rendering some service, for which payment is to be made, to a second person B, incidentally also renders service or disservice to other persons (not producers of like services), of such a sort that payment cannot be extracted from the benefited parties or compensation enforced on behalf of the injured parties. (Pigou, 1932: 183)

From the examples he gave of this principle Pigou included the general public as among the other parties to these effects.

If the production of goods and services imposed a negative externality on society, measures should be taken to eliminate it. Did mistreatment of workers constitute such an externality? Pigou never made a general argument to that effect. In one case where he did apply the concept of externality to labour he wrote:

> Perhaps, however, the crowning illustration of this order of excess of private over social net product is afforded by work done by women in factories, particularly during the periods immediately preceding and succeeding confinement; for there can be no doubt that this work often carries with it, besides the earnings of the women themselves, grave injury to the health of their children. (Pigou, 1932: 187)

A society that obliged women to work during periods of pregnancy and in the important child-rearing years was reducing its welfare now and into the future. By counteracting the process of cumulative causation, injury to the health of children imposed costs on them and on society and impaired the future capability of the workforce. While we can interpret this stress on family life as antiquated and sexist, we must also remember that it allowed Pigou to define a decent wage as based on the pay of a male head of a household and not on total household income. Laws to keep women from working might improve total welfare, especially if, as Pigou recommended, they were accompanied by assistance to those families which needed the earnings of women to survive.

Pigou raises an important issue regarding the living wage. In today's world in many developed countries the issue of working women and childcare in the early months of life is handled in a tentative way by parental leave. How much parental leave a worker should be given and whether he or she is paid during that leave are still unsettled issues for many workers. Still, some form of parental leave is equally important to workers barely earning a living wage, especially if it is a household wage. Without such a leave the process of cumulative causation that Pigou and his mentor Marshall prized, where each generation took better care of the next one, might not have its full effect. Pigou recognized this case as a cost to society that might qualify as an externality but he did not make a case for a low-wage externality.

Even though he did not make a general case for a low-wage externality, Pigou did analyse the relationship between wages and growth in the national dividend. He started from the notion that as long as the wage equalled the value of what the worker added to production it was fair. He understood that wages depended on a number of factors, including age and experience, discrimination, skills, education, location, industry structure, demand for the product and state of the economy. His definition of a fair wage was his way of bringing order to all these variables. Unfair wages (less than marginal product) were often caused by businesses' exploitation of market power. As had his predecessors, Pigou found that bargaining power in markets tilted towards employers. He observed that when workers were not organized it was likely that low wages below the value workers added to production would result and those wages would not be fair. Intervention to induce a fair wage would have a variety of effects but on balance would not diminish the national dividend. Imposition of a fair wage could drive out bad employers whose only competitive edge was in exploiting their workers by paying them less than their value-added or force those employers to improve their production methods to offset the higher wages they should be paying. Intervention to raise unfair wages was proper if the national dividend grew because workers had enhanced capability from better nutrition and working conditions (Pigou, 1932: 553–63).

Pigou set forth three forces that might intervene in labour markets to bring about fair wages: consumers, government regulation and unions. Consumers could use lists of unfair employers and boycott their products. These boycotts were easy to evade however. The government had special powers that eliminated this difficulty. It could legally impose a wage and penalize employers who did not meet it. If used with vigour, legal remedies were very strong and no employer could resist them (Pigou, 1932: 531–40). In between the all-powerful government and the weak power of consumer boycotts, Pigou placed unions. He recognized that unorganized workers were likely to earn unfair wages. This was especially true with regard to piece-wages. Pigou felt piece-rates to be especially useful for relating pay to productivity. He understood, however, that employers might abuse the system, cutting the rate whenever workers increased their output to earn higher pay, thereby reducing wages below the value-added by those workers (Pigou, 1932: 410–4, 451–3 and 475–82). In the case of piece-rate wages, Pigou found that unions were a benefit. He wrote: 'the interest of the national dividend, and, through that, of economic welfare, will be best promoted when immediate reward is adjusted as closely as possible to immediate results, and that this can, in general, be done most effectively by piece-wage scales controlled by collective bargaining' (Pigou, 1932: 487). This principle also held regarding low wages from exploitation. Pigou found that 'in occupations where the workpeople have been able to organise themselves into strong Trades Unions, supported by a reserve fund and bargaining for their wages as single collective wholes, it is not even probable' that unfair wages would exist (Pigou, 1932: 559).

When wages were fair, that is, equal to the worker's marginal product, Pigou opposed intervention in labour markets. In this case, he directly challenged the notion of the living wage. He indicated this by considering the claim that when fair wages (equal to value-added) were low they 'ought to be raised far enough to yield a decent subsistence to the average worker'. He then reviewed legal efforts in the UK and Australia to define and mandate such a living wage. Such efforts and popular discussion of them, he went on, were confused by a poor definition what a living wage meant. He wrote:

> A living wage implies, for workmen of normal capacity in any industry which enjoys it, a 'living income.' This, of course, is not so. A living wage, as ordinarily conceived, for a man, is a wage that will enable the person who receives it, if he has an average family to maintain and if he has average good fortune in the matter of sickness, to earn an income sufficient for a good life. But a rate of wages that will achieve this end in these conditions will not achieve it for a man with a family in excess of the average or subjected to an unusual amount of sickness. Nor can the 'living wage' take account of the fact that some workpeople need to support parents who are past work as well as their own children, or of the further fact that the wives of some workpeople contribute nothing towards the family income, while those of others contribute largely. Moreover, a wage for the breadwinner, which would provide a 'living' for his family at one stage of its growth, would be quite inadequate at another stage. (Pigou, 1932: 599–600)

The living wage was not easy to define in terms of all the complexities of life that it must account for.

Pigou then considered a possible case of a negative externality that dealt with low wages when he appraised a contention that payment of low wages indicated businesses were being subsidized when low-wage workers were helped by family members. Those businesses, the contention held, were using up human capital and causing harm to the community. He found the argument to be 'invalid' because it depended on the meaning of the term 'use up'. He agreed that 'if the setting to work of people at some industry wears out and destroys productive powers which, had they not been set to work in that industry, would be available to augment the national dividend, then the destruction of this productive power ought to be strictly debited against that industry. Its social net product falls short of its private net product to that extent'. If those workers had been employed in other low-wage industries, however, there was no loss of human capital. In this very limited case, it can be argued that Pigou included a low-wage externality as part of his analysis, but not as a 'general presumption'. Indeed, he did not see this as a general case, writing:

> The thesis that industries which pay less than 'fair wages' ought to be forbidden by law to do this, even though such prohibition involves their destruction, is quite different from, and lends no support to, the thesis that industries which pay less than a 'living wage' to workpeople who are in fact worth, for all purposes, less than a living wage, ought to be subjected to a similar prohibition. This common argument, therefore, breaks down, and our problem must be studied without reference to it. (Pigou, 1932: 600)

Unfair wages had to be addressed by government or unions but a wage that was below a 'living wage' because of the low value-added of workers should be ameliorated by some other policy than intervention in labour markets to set wages.

For the same reason, Pigou found that measures to raise wages by a national minimum wage had limited efficacy. Workers earning low wages had low productivity, and a minimum wage would force them out of work. A minimum-wage law had to be supplemented by training programmes to enhance the skills of workers who lost their jobs as a result (Pigou, 1932: 616). Pigou also questioned efforts to establish 'a national minimum standard of real income' through transfer payments, because it would diminish the incentives for workers to work effectively and to look for better paying jobs. He worried about the costs involved in setting the standard. Still, he supported some subsidies for low-wage workers as long as they improved the capability of the workforce (Pigou, 1932: 746–51). The problem with using those subsidies to establish a living wage was that it might involve government dictation of what an income subsidy should be used to purchase to do the most good for improving the capability of the workforce. Pigou believed that giving low-wage workers a living wage carried with it an obligation that they use that wage wisely. He recognized that government programmes that carried such an obligation were intrusive, writing, 'It is a very delicate matter for the State to determine authoritatively in what way poor people shall distribute scanty resources among competing needs' (Pigou, 1932: 786). Even though he resisted the idea of a clear standard for a living wage, Pigou believed that the best rule for how much a minimum standard of living to provide workers was that the larger the per capita income in a country, the higher the minimum that could be set (Pigou, 1932: 786–97).

Pigou also found a positive externality in improvements in working conditions. With regard to hours of work, for example, he observed, 'after a point, an addition to the hours of labour normally worked in any industry would, by wearing out the work people, ultimately lessen rather than increase the national dividend'. Given all the varieties of work experience and conditions, it was hard to establish a rigorous connection between working hours and the national dividend. Nevertheless, Pigou found that 'the evidence is fairly conclusive that hours of labour in excess of what the best interests of the national dividend require have often in fact been worked' (Pigou, 1932: 462–5). Employers had bargaining power 'in matters of the hours of labour', which they might abuse. Pigou quoted one employer who revealed that the employer had no interest in sustaining the workforce, because, 'What he wants is a sufficient supply of efficient labour to meet his immediate demands; and though ultimately this supply will be curtailed unless the whole nation allows a margin for wear-and-tear and for the stimulation of progressive efficiency, he cannot afford, under our present competitive system, to take a very long view' (Pigou, 1932: 466–8). The possibility that the pressure for excess work reduced the national dividend was a real one to Pigou, and to have established it, he concluded, was to make a direct case for government intervention.

Pigou also added an element to the discussion of the living wage that is now becoming increasingly important, globalization. As a free trader, Pigou remained steadfast in the view that a country benefited from international trade. But global trade often brought in cheap products produced by low-wage workers in other countries. Those cheap products might cause a country to require lower wages of its workers in order to remain competitive. This was a period where English industry was losing its economic leadership to foreign competition from the US and Germany and protectionism was on the rise. One justification for protectionism, then as now, is to maintain the standard of living of domestic workers from foreign workers who earn low wages. To Pigou, this problem meant that a country could not intervene to raise its national minimum standard of living or improve its working conditions without looking at what other countries were doing. He argued that policies to attain a living wage might cause capital to leave the country and damage economic welfare through a reduction in total production. One way to intervene would be to impose tariffs on imports from countries that did not pay workers a living wage, but that would offset the gains from free trade and reduce the total welfare of the country. Instead, Pigou recommended extension of the higher standard by 'international labour legislation' (Pigou, 1932: 764–5). While we still do not have clear international labour legislation, efforts to eliminate 'sweatshop conditions' in poorer countries through product boycotts and social pressure have this aim. Pigou would find them to be a weak alternative.

When it came to determining who would pay to increase the living standard of workers through subsidies towards a living wage, Pigou had few qualms about having the rich to help the poor but he also saw limits to that help, due to adverse reactions of the wealthy. He especially worried that the resulting reduced income might impair their ability to save and invest. There were limits to how much the rich would be willing to pay either through reduced profits to pay a living wage or higher taxes to pay for subsidies to low-wage workers. If that limit was passed the wealthy might stop investing and that would reduce total production. The problem was finding that limit for any country at any time. One way to avoid this problem was through voluntary acts such as charity, and Pigou thought that acts of private charity could help low-wage workers. Overall, however, he thought that those workers should have a strong voice in whatever programmes were planned for their improvement. Efforts to establish a living wage need to include dialogue between employers and low-wage workers as to how a living wage can be accomplished. As had Mill, Marshall and J.B. Clark, Pigou believed that unions were the best way to bring about this dialogue, although he followed Marshall and Clark in worrying about unions that attained the monopoly power to set wages above the value-added of their members.

JOHN MAURICE CLARK: THE SOCIAL COSTS OF LABOUR

John Maurice Clark (1884–1963), as the son of John Bates Clark, appreciated his father's achievements and dedicated his most prominent book, *Studies in the Economics of Overhead Costs*, to his father 'as a very small contribution toward realizing his conception of a dynamic economics' (Clark, 1923: preface). He also acknowledged being greatly influenced by Pigou, indicating that 'Pigou's *Wealth and Welfare* (1912) . . . put "Welfare Economics" on the map relative to social productivity vs. private acquisition' (quoted in Seligman, 1962: 203). He was also influenced by Thorstein Veblen (see Chapter 2) and respected his work (Clark, 1950: 31). In his synthesis of these thinkers, Clark took from his father the notion that there was a fund of social labour and added to this Pigou's appreciation that this fund had to be maintained or else a negative externality would be incurred. The final element was Veblen's idea that business institutions could not foster the social responsibility needed to take care of any negative externality that arose. He referred to a negative externality as a social overhead cost but here we will continue to use externality as the overarching term for what he meant.

To highlight the negative externality of labour, Clark started with the idea that the more the fund of social labour (the total amount of labour available to an economy) was used in production the faster it would depreciate. The depreciation of this fund was an overhead charge to society that was not accounted for in the overall costs of production. Clark stated the case as follows: 'There is a minimum of maintenance of the laborer's health and working capacity which must be borne by someone, whether the laborer works or not' or else 'the community suffers a loss through the deterioration of its working power' (Clark, 1923: 16). Workers were responsible for their own sustainability and capability. When their wages were not adequate to maintain them and if the community did not make additional provisions for them, members of the labour force might deteriorate.

Clark did not see a market solution to this problem, due to the prisoner's dilemma paradox. Employers who considered paying workers a premium above the going wage to cover the externality of labour would not do so without assurance of being compensated with higher productivity. If they did, they would risk having higher costs, which would place them at a competitive disadvantage and reduce profits. Clark wrote: 'The overhead cost of labour is a collective burden upon industry in general, but the market does not allocate to each employer the share for which his own enterprise is responsible' (Clark, 1923: 372). Under the institutional framework of capitalism, businesses shifted many of the costs of maintaining the social fund of labour on to society through layoffs and wage reductions, leaving it to society to help sustain the workforce. Clark had discovered a contradiction in assuring that the fund of social labour was maintained. What was a fixed cost for society was a variable cost for business. The reliance on markets allowed business to shift its burden on society as an externality. The problem related to unequal bargaining power between business and labour. Clark pointed out, 'In an economy based on the division of labour, people are not self-sufficing, and if others will not exchange with them, they cannot live at all' (Clark, 1923: 37, 42).

Wage bargains were of unequal strength and where his father had looked for unions negotiating with local plants as a solution, Clark saw it as a national problem requiring government intervention. He justified that intervention on the basis of a public interest in reducing a negative externality of labour. He stated the case as follows:

> Whether through ignorance, inertia or sheer necessity, workers will work under conditions that will shorten their work lives or injure their future efficiency, and they are not able to charge any adequate premium for such kinds of work. This might perhaps be treated as nobody's business but the workers', save for the fact that their children and other dependents have an interest in their working – efficiency, also their future employers, or the taxpayers or contributors to charity who must pay for the rescue work which may become necessary, or the business out of whose product the funds for relief must come – in short, there is a 'public interest' in the avoidance of such wastes. (Clark, 1926: 130)

Clark believed that low wages and overwork for all types of workers imposed costs on others. The cases Pigou had made for pregnant women and certain low-wage workers were transformed into a general principle.

To put this principle into practice Clark sought government intervention to mandate a 'social minimum' in terms of a standard of living (Clark, 1926: 176). Policies to help the working poor, he argued, might 'actually pay for themselves in the long run by increasing the working efficiency of the personnel', giving another early version of the efficiency wage theory. But even if they did not, ending the system that permitted uncompensated damages to the workforce was crucial to economic efficiency. Clark justified his support of minimum wage laws on the following basis: 'An industry which does not pay a living wage is really imposing part of its costs on other industries, since it is out of those industries that the living expenses of the underpaid workers must be made up, if they are to be made up at all. And if not, there is a loss of working-power which falls as a diffused burden, often handicapping succeeding generations' (Clark, 1926: 451–3). Firms that did not pay a decent wage were creating costs that fell on society at large.

Clark's point was that through the shifting of costs on to society, individual businesses were receiving a subsidy. To give a current example of what he meant, firms that do not provide health benefits for their employees receive a subsidy when those employees are restored to health and their bills are paid by government agencies or the health insurance of a spouse. The prices those firms charge can be lower than other firms. That was how Clark saw the problem but his concept of a social minimum that would shift the costs back to business ran foul of meagre data, in his case lacking a system of social cost accounting. A proper social cost accounting system 'would undertake to set a true social value on all the human values and costs of industry' (Clark, 1926: 100). Clark's proposals for a social minimum and social accounting were intended to provide insights into a basic problem, defining the standard of living in terms of goods and work levels. That definition required answers to two questions: What wants should be supported and 'should added wages be granted subject to the condition that recipients made proper use of them?' (Clark, 1926: 213). To provide answers to these questions Clark proposed a system of social planning using national councils. To him the issue of a living wage was a national one and it could not be solved by local activities.

Clark would later change his views on the efficacy of national planning due to his interpretation of how poorly it worked during the Great Depression under the National Recovery Administration (NRA) of the New Deal. The NRA had been designed to foster industry councils with membership from business, labour and government to plan production and regulate wages and prices. In practice, business had too much power, labour was weak and government administrators often proved ineffective. Business dominated the councils and the labour representatives were union leaders whose character Clark questioned. More important, Clark found a conflict in his own thinking, because he now believed that modern working conditions rendered workers incapable of participating in a system of planning on an equal footing with business. He wrote: 'Modern life demands the highest qualities of character, personality and citizenship, economic and political, if it is to work successfully; but it shows no clear tendency to develop such qualities, and some tendencies in the other direction' (Clark, 1939: 489). Here Clark questioned the beliefs of Mill, Marshall, his father and Pigou that unions could be a positive force for improving the capability of workers. Using a concept similar to Marx's alienation, he put the blame on the negative impact of working conditions. He defined the working conditions that would build character as, 'A good job is one that makes fairly exacting demands on a worker . . . one that does not, fails to develop his capacities and to contribute his healthy status as a human being' (Clark, 1950: 17).

Recognition of the alienation inherent to modern work and the impact it had on workers' capability placed Clark in a theoretical bind. Work had a negative externality that included the costs associated with alienation. Planning was needed to shift those costs on to business. To be effective, that planning needed input from labour. Due to its alienation, labour was not capable of contributing that input. One negative externality of work was that it diminished workers' collective capability and made it difficult to control the negative externality of work.

In 1950, Clark, took a further look at labour in unions and found that while it was strong enough to counter business in a system of planning, its character was still not developed. He accepted that 'the union is the worker's chief anchorage in the economic community' and higher wages due to unionism had been 'prevailingly good for the health of the community'. Unions had countered the power of business, but 'now the balance might be tipping in the other direction' (Clark, 1950: 25). As had his father, Clark agreed that the union remained the best form of protection for workers in a capitalist society but worried that they had gotten too strong. Consequently they were becoming too self-interested to collaborate with government and business in ensuring the proper allocation of the cost of preserving the fund of social labour.

It was their self-interest that concerned him, for they were acting much as business had in only taking care of their members, a point reminiscent of Veblen's views. For planning to be effective, Clark argued that there needed to be mutual obligations in the relations among individuals and the community as represented by the government. He wrote: 'It is socially safe for individuals to concede the supremacy of the community only if the community is the kind that finds its life and welfare in those of its members and in their sound relations to one another. And it is safe for the community to regard its welfare as consisting in that of its members, and accordingly to give their individual purposes large scope, only if they are social animals and not self-seeking monsters' (Clark, 1950: 20). This statement brings us back to Smith's moral economy where members of a community sustain each other from 'love and esteem'.

Clark did not follow Smith in thinking that a market economy would suffice when the moral economy was not feasible. He wrote: 'We have deluded ourselves with the idea that irresponsible self-interest could organize a community in which men not only progress, but could live in dignity and harmony while doing it. We have trusted to a mechanical market, which promotes goods and neglects people' (Clark, 1950: 150). Markets could organize production, but not a community. Clark sought a society that featured greater responsibility towards the community by those individuals and groups. That he found no groups with that sense of community responsibility does not diminish his perception of the consequences of that lack (Clark, 1950: 3–6). That such groups still do not exist is the major difficulty faced by advocates of a living wage.

SOLOMON BARKIN CALCULATES A LIVING WAGE

Solomon Barkin (1906–2000) does not have the prominence of most of the economists in this book but his inclusion is warranted by one singular contribution: he calculated a living wage in practical terms on several occasions during his 25-year career as a researcher for the Textile Workers Union of America. In addition, the calculation was influenced by the way J.M. Clark applied the concept of externality to labour.

Barkin wrote many articles that dealt with issues he and his union were concerned with at the time, but there was a common theme in his writings: work carries with it a series of externalities that are not taken into account by market-determined wages, and the best way to ensure that wages cover them is to have a system of labour relations that enables unions and business to work together to resolve them, with the help of government when needed (Stabile, 1993: 4). In terms of the conceptual themes of this book, we can see that Barkin relied heavily on the theory of externality to explain the consequences of low wages on workers (he used the term 'social costs'). He often referred to the goal of unions as gaining a social cost wage for the members. The idea is that there are both direct and indirect costs that workers must cover with their wages, from basic needs to emergency health care. If the worker's wage does not cover all of the costs, especially the indirect ones, they are covered by someone – the worker, government or society at large. Because they were often borne by society at large, Barkin called them social costs instead of a negative externality, but for consistency I will continue to employ the term 'externality'. In the same manner, his social cost wage equates to our interest in the living wage and I will employ the latter as well.

Throughout his career with the Textile Workers Union Barkin tried to answer two questions about the living wage and the negative externality a failure to pay it created. How do we define the living wage and how do we ensure that workers earn it? He had ample opportunity to answer these questions in the public arena. Sidney Hillman, one of the organizers of the Congress of Industrial Organizations (CIO) that led the way in forming unions among unskilled industrial workers in the 1930s, had encouraged Barkin to join the union movement because unions needed professional expertise to combat the experts management hired, and to add the status of professionalism to union testimony before governmental bodies. Barkin filled this need admirably and served as the CIO's in-house intellectual who could argue persuasively before government bodies and counter the arguments of management. It was there that he refined the concept of the living wage.

For example, during World War II the federal government in the US controlled wages and prices in an effort to avoid the building up of inflationary pressures. Wage increases had to be approved by the War Labor Board. During the war Barkin appeared before the board to argue in favour of wage increases for textile workers on the grounds that their existing wages were substandard. To make his case, he started with a basic minimum standard of living as had been defined by the 1935 Emergency Subsistence Budget produced by the Works Progress Administration. He then re-priced that basic standard of living using prices derived from three New England and two Southern textile communities. He also surveyed textile workers to see if their household incomes were high enough to pay for the basic standard of living, that is, whether they had a living wage for the household. From this approach he argued that textile workers did not earn a living wage. By adding in data on textile company profits to show that the companies could pay higher wages, Barkin convinced the Board to grant textile workers a wage increase (Barkin, 1944).

When it came to justifying higher wages at other times in his career, Barkin continued to utilize the externality approach. In 1955, as chair of the CIO's Fair Labor Standards Committee, he testified before a senate committee on the need to raise the minimum wage in the US. He argued that because of low-wage industries:

> Injury has been done not only to those persons in low-wage industries, but also to the nation itself. We, as a country, and particularly our local communities, have established a special 'welfare economy' for the low-wage industries. The public and the government [are] subsidizing these laggard employers, whether through direct grants or through the high cost of the social and human neglect created by low wages. (Barkin, 1955: 3)

As we have seen, economists who were supportive of higher wages for workers, such as J.B. Clark and Pigou, believed that the wage workers earned was based on a market calculation of the value a worker adds to production. Payment of wages above that amount would have negative consequences in terms of who would pay for the increase. It might be that consumers would have to pay higher prices or that some workers might lose their jobs as a result of higher wages. Higher wages might also force businesses to go bankrupt.

Barkin set forth a variety of answers to these objections. First, his externality argument indicated that low wages already had negative consequences for society. Many small businesses, for example, do not offer health benefits to their workers because they cannot afford it. But the costs of healthcare do not go away as a result. If those workers need healthcare, they will likely have it paid for by government programmes or charitable organizations. That is what Barkin meant by having the public and government subsidize low-wage industries. The true cost of a product or service should include its production costs including wages plus the externality involved in that production. If businesses cannot pay those total costs and still make a profit, then they are misusing resources. As we saw in Chapter 2, John Stuart Mill opposed low prices based on mistreating workers and Barkin would agree.

Barkin, however, was confident that businesses could pay those true costs of production. When faced with higher wages that reflected the true costs of labour, that is, wages plus the negative externality, businesses would have an incentive to improve the productivity of workers by becoming more efficient and unions could help them do so. In addition, higher wages would turn workers into better consumers, causing the economy to expand. With expanded demand, businesses might be able to take advantage of economies of scale and increase production at a lower cost. Low wages were the easy way to attain profits, and we should question the managerial performance of any firm that relies on them to attain higher profits (Stabile, 1993: 37 and 87).

Another issue that payment of a living wage raises is whether it will put a business that pays it at a competitive disadvantage. Barkin recognized this question and addressed it. The basic problem is the one of the prisoner's dilemma. If one firm in an industry volunteers to pay its workers a higher wage, it will be at a competitive disadvantage compared with other firms and risk lower profits and bankruptcy. In the same way, a firm where workers form a union and bargain for higher wages will also suffer a competitive disadvantage. Barkin drew on his experiences in the textile industry to point to the problem and its solution, writing, 'The industry used to be chaotic. Each employer would say, "Well, I can't pay you decent wages because the other man is cutting wages and prices." The union came in and said in effect: "From now on everybody is going to have the same labor costs"' (Barkin, 1946: 7). To achieve this result, unions had to attain industry-wide collective bargaining that treated each employer fairly.

Indeed, Barkin went so far as to indicate that a national system of collective bargaining might be needed to make sure that non-union industries did not gain a competitive advantage over unionized ones (Stabile, 1993: 53).

When national collective bargaining could not be brought about, Barkin believed that the federal government had to produce a national standard of wages through legislation of the minimum wage. We must remember that at the time Barkin wrote in the 1940s wages in the South of the US were notoriously low, giving firms there a competitive advantage and inducing other firms to move there. A national minimum wage would diminish the competitive advantage firms in the South had and offset the incentives businesses had for moving there. Workers in the South had proven difficult to organize into unions, as Barkin knew, and government assistance was needed to help workers there gain a living wage.

The difficulty of organizing workers in the South contains another lesson Barkin has for us. In 1948, the prominent labour economist Sumner Slichter had written, 'The American economy is a laboristic economy or at least is becoming one'. To him this meant that 'employees are the most influential group in the economy' (Slichter, 1948: 4). For the next 30 years economists followed Slichter in believing that unions were gaining a great deal of social power, including John Kenneth Galbraith with his idea of the 'countervailing' power of unions keeping business in check (Galbraith, 1952) and Milton Friedman as described in Chapter 2. Even J.M. Clark, as seen above, believed that unions were getting too strong. Given these attributions of power to unions, one would have thought that Barkin would be confident that unions could gain a living wage for their members and from competitive forces for all workers. He was not, believing instead that unions had nowhere near the power being attributed to them.

In 1961 he wrote a small book, *The Decline of the Labor Movement and What Can be Done About It*, arguing 'The anomaly of the day is that opponents of trade unions are seeking to restrain the economic and political activities of unions at a time when their growth has been halted' (Barkin, 1961: 5). He found the reasons for the decline in the growth of unions to be complicated, including management resistance, the changing structure of the economy, problems within unions, and businesses taking better care of workers through improved methods of human resource management. As a result, workers would see their wages decline and their political influence through their unions diminish (Stabile, 1993: 192–220). Unions for Barkin were essential for attaining a living wage for workers and their decline has made that attainment difficult. A living wage movement can endeavour to serve as a substitute for unions in getting workers a living wage. Barkin would have found it to be a poor substitute and would have urged such a movement to lend their support to unions.

RONALD COASE: WHO SHOULD PAY THE EXTERNALITY?

Arguments using the concept of externality raised a sticky issue for proponents of a free market economy. Markets sometimes did fail and Pigou's example of an externality was commonly accepted as one of those failures. To give two examples of the acceptance of Pigou's argument by free market economists, let us consider the views of Hayek and Friedman. Hayek wrote:

> The price system becomes similarly ineffective when the damage caused to others by certain uses of property cannot be effectively charged to the owner of that property. In all these instances there is a divergence between the items which enter into private calculation and those which effect social welfare; and, whenever this divergence becomes important, some method other than competition may have to be found to supply the services in question. (Hayek, 1994: 44)

This statement resembles Pigou's definition of an externality, given above, and Hayek agreed that this principle established cases where regulation of market activity was needed. Friedman agreed that externalities, he called them 'neighborhood effects', could not always be solved by voluntary exchanges. The problem was in finding where to draw the line. Friedman certainly would have drawn that line short of seeing a negative low-wage externality. Instead, he would have categorized it as an example of how the concept of an externality could be 'used to rationalize almost every conceivable intervention. In many instances, however, this rationalization is special pleading rather than a legitimate application of the concept' (Friedman, 1982: 30–1).

The subject of this section, Ronald Harry Coase (1910–), determined what made an externality special pleading. In his classic article, 'The Problem of Social Costs', Coase objected to Pigou's definition of an externality as well as his way of resolving the problems it caused. Pigou had set up his example of an externality in terms of persons A and B having a transaction that affects person C. If C is damaged, the other parties to the transaction must either stop the damaging activity or reimburse C. To stop the damage, government can regulate the activity or impose a tax that either covers the damage or motivates A and B to take care of the damages. In Coase's view, the problem with this approach was that it ignored the possibility that there was mutual responsibility for the damages and that the parties could reach a mutual agreement for how to assign that responsibility (Coase, 1960: 2).

From a perspective of economics as a neutral science, Pigou's version of an externality incorporated a value judgement by assuming it was easy to determine which party was damaged and by whom. By adding in the idea of mutual responsibility, Coase determined that it was not easy to place blame for the damage. In his example, person A is presumed to be doing something that damages person B. He wrote: 'To avoid the harm to B would inflict harm on A. The real question that has to be decided is: should A be allowed to harm B or should B be allowed to harm A? The problem is to avoid the more serious harm' (Coase, 1960: 2). Suppose A produces pollution that damages B's house. If the government makes A stop, A will be damaged as might consumers of the product A produces. The question Coase asked is why do we have this bias towards helping B? To put numbers on it, if the damage to B is $100 but A will lose $10 000 if forced to stop the activity, shouldn't we reconsider our way of handling the problem? Wouldn't it be better for the parties to get together and resolve the problem on their own? In this case, A could pay B $500 and still be better off. Coase provided numerical examples of how, if there were no costs involved with negotiating contracts, A and B could get together and reach a contract that minimized the costs of the externality in 'a mutually satisfactory bargain' (Coase, 1960: 4).

The process of negotiating contracts can be costly, however, due to the time involved in bargaining and the work needed to make sure the bargain is kept. When he removed the assumption of costless negotiating, Coase had to provide examples of other ways to resolve the issue of damage. He offered government regulations as one alternative, but worried that government faced no pressure to try to minimize the costs of taking care of the problem. Government regulations could improve economic efficiency in taking care of a negative externality, but there should be no presumption that it would. A market approach to resolving an externality might be an attractive alternative. To Coase, the issue was 'one of choosing the appropriate social arrangements for dealing with harmful effects' (Coase, 1960: 18).

To accentuate his idea that there were alternatives besides government regulation for taking care of an externality, Coase interpreted resources as bundles of rights that delineate how the resource can be used. Government policies that changed those rights would also change how resources would be used. Telling a manufacturer that it no longer has a 'right' to pollute will alter how the managers use the factory. A better way is let one of the parties have the right and then allow the other party to negotiate to prevent the damage. It did not matter who had the right. If the manufacturer had the 'right' to pollute, the party exposed to the pollution might be willing to pay it to stop. If the party exposed to pollution had the 'right' to be pollution free, the manufacturer might pay that party to permit the pollution to continue. Either way, the two parties would get together without the government and find an agreeable solution to taking care of the damage. The government is essential because it establishes which side has rights that the other must buy out, but once the government has assigned the rights its job is done.

Coase is one of those rare examples of an economist whose ideas have changed the way the world works. The US now has a system where pollution credits are bought and sold in the marketplace. Firms that have eliminated pollution beyond some established standard receive credits which they can sell to others who add pollution above the standard. If environmentalists want an end to emissions of carbon dioxide, they should purchase all the credits they can and hoard them. Businesses unable to purchase those credits will have to eliminate their pollution. Coase described this possibility as follows: 'If rights to perform certain actions can be bought and sold, they will tend to be acquired by those for whom they are most valuable either for production or enjoyment' (Coase, 1988: 2).

By arguing this way, Coase held out the alluring possibility that an externality could be taken care of by free market transactions. While he might have approved of this interpretation of his work, he reminded his readers that his idea worked best when there were no costs in negotiating contracts or transacting exchanges of rights (Coase, 1988: 15). When those costs were taken into account, the party who held the right had a bargaining advantage. Markets could not be relied on to be the most efficient way to take care of the problem of an externality. Indeed, when the damage done by the externality was widespread, there might be too many parties involved to negotiate a contract or to set up a system of buying and selling externality reduction credits. The Coase Theorem might be more effective in the small communities of Aquinas's day or in Smith's moral economy than in the urbanized, industrial world.

What implications does Coase's work have for the living wage? Let us suppose that we have a group of workers earning a wage below the living wage, however defined. In this case we can define it as not having health benefits, surely an essential element of a living wage. When those workers become seriously ill, they may seek medical care in hospital emergency rooms and never pay for the care they receive. In this way their low wages have apparently imposed a negative externality on the hospital and low-wage workers' employers have received a benefit in having their workers restored to good health at someone else's expense. Using Pigou's approach, the government might mandate that all employers provide medical insurance or it might impose a tax on employers which would motivate them to provide medical insurance to avoid the tax or if they paid the tax the government could use the funds to cover the losses of the healthcare system from treating uninsured workers.

Coase's challenge to this idea is that we too readily assign blame to the employer for the damage caused by their not paying for medical insurance for the employers. After all, the provision of health insurance by employers in the US was a historical accident of wage controls during World War II; the War Labor Board let employers attract workers with medical coverage without calling it a wage increase. Given the arbitrary nature of employer-provided medical benefits, Coase might ask, do workers not have some responsibility to take care of their health? To be sure, if their health is impaired by an infectious disease, it might be society that should be held accountable for the damage. If the health problems came from poor nutrition caused by starvation wages, the employer may have responsibility but even that is not clear (if low pay reflects low capability the worker may have some responsibility). And if the worker's health is impaired by careless behaviour, then the worker may be the one responsible. The challenge Coase raises is that it is not always easy to decide who should be liable for the damage related to an externality.

In a world where contracts were easy to negotiate, monitor and enforce, making them low cost, everyone involved with the health of the worker, employers, family, healthcare providers, the government, and so on, might be able to work out a contract where the costs of restoring the health of the worker were apportioned in an effective way. But given the complexities of every individual case and the number of parties involved, such contracts would very cumbersome. Moreover, healthcare is just one element of what a labour contract that aimed at providing workers a living wage would have to resolve and there are still free-rider problems related to persons who would benefit from the negotiated contract without having to contribute to the bargaining costs. More to the point, could workers even negotiate based on the concept of the negative externality of low wages? If workers suffer an externality from low wages because of their weak bargaining power, how would additional negotiations help them? If that externality of low wages is passed on to society how do we ensure that society is represented in the negotiations? Still, Coase has raised a crucial challenge of the importance of deciding who is being damaged, is the damage reciprocal, and how should the costs of the damages be apportioned. Is the health of low-wage workers more important than low prices to consumers or high dividends to stockholders? Did the low wages cause damage to the health of workers? Did workers contribute to the damage? Will a living wage ensure that workers take care of their health or do employers have a right to monitor it? These are all questions that Coase would want advocates for a living wage to answer before they justified payment of a living wage on the basis of an externality.

ARTHUR OKUN: EQUALITY AND EFFICIENCY

Arthur Okun (1928–1970) brought the issue of externality, wages and community to a social level with his analysis of the trade-off between equality and efficiency (Okun, 1975). In a democratic society, humans are considered equals in terms of political rights and freedoms. The market economy, however, renders those same individuals unequal in terms of the income they receive from their market activities. This inequality of income, as many economists surveyed in this book have argued, promotes efficiency. Higher income is the reward for productive activity, and when political activities, such as granting a living wage to low-wage workers, alter that reward structure they lead to inefficiency. To be sure, Okun argued, not all activities that promote equality of income will result in inefficient production in the market economy. In cases where more equality did lead to inefficiency, society had to set a priority over which was the more important goal, equality of income or efficient production of goods and services. He wrote:

> The contrasts among American living standards and in material wealth reflect a system of rewards and penalties that is intended to encourage productive activity. To the extent that system succeeds, it generates an efficient economy. But that pursuit of efficiency necessarily creates inequalities. (Okun, 1975: 1)

This trade-off meant that society faced compromises in the pursuit of programmes to help the poor, because measures to attain equality had a cost in terms of lost efficiency. Regarding a living wage, its implications, as has been spelled out earlier in this book, is that granting workers a living wage will give them less motivation to improve their capability (human capital) and thereby earn a living wage through market activities.

To highlight the way equality can lead to inefficiency, Okun examined the realm of political equality. In that realm, every person has an equal right to vote, to free speech, to public education, to police protection, and so on regardless of the cost or the capability of the individual holding those rights. Our justice system, for example, will spend the same amount of time and money resolving a suit involving \$50 000 as it does one involving \$50 000 000. Moreover, Okun observed that we do not base such rights on capability and do not agree with John Stuart Mill's argument to base voting rights on the idea that the more capable person should have more votes. Finally, these rights are not for sale in the market. If I am indifferent between two candidates for an office I cannot sell my vote to someone who keenly favours one of the candidates, at least not legally. These are all examples of the way equality can cause inefficiency as economists would define it (Okun, 1975: 3–8).

Okun offered several reasons for why society set up these inefficient rights. The ones of interest here are externality and community. Specifically, Okun argued that interferences in the marketplace were needed to avoid the externality problem and to make certain that market activities were limited to those areas that were in the community interest; society must avoid an all-encompassing market system where 'everything could be bought and sold for money' (Okun, 1975: 12). The problem in extending such rights is in knowing where to draw the line between the market and rights, between efficiency and equality. One influence in drawing that line is resource costs, and Okun recognized that it cost fewer resources 'to fulfil the right to free speech than a "right" to free food' (Okun, 1975: 16). Society might expand such rights, but must realize that they cost resources directly and created indirect costs (externality) to efficiency.

Regardless of those costs, Okun believed that there was a compelling case for a right of survival. He wrote: 'The assurance of dignity for every member of the society requires a right to a decent existence – to some minimum standard of nutrition, health care, and other essentials of life' (Okun, 1975: 17). While agreement on this right had not always held true in society, he felt that most persons in the US at the time he wrote accepted a right to survival. Such a right would set a minimum level of consumption of those necessities and then leave it to the market to provide them. Enforcement of such a right was part of the social limitation of the market that did not completely eliminate the efficiencies of the marketplace. Another limit on the marketplace tied to the right of survival was to ban unfair trades due to large differences in bargaining power and the desperation of the persons who are on the receiving end of those unfair trades. Here we may recall Adam Smith's view that when faced with low wages from unequal bargaining power, workers would 'act with the folly and extravagance of desperate men' (Smith, 1976b, vol. I: 74–6, 158–9). Since Smith's day, government had legislated against such desperation by banning indentured servitude, child labour and unsafe working conditions and by establishing minimum-wage laws (Okun, 1975: 20).

Okun paid special attention to minimum-wage laws because economists had such a hard time understanding them. As mentioned earlier, economists such as Pigou and Friedman found that such laws hurt workers by causing unemployment. To Okun, those laws signified that any worker taking an extremely underpaid job must be acting out of desperation. Such desperation might result from lack of information or alternative opportunities for work, but Okun argued that 'it should be kept out of the marketplace'. To do so, society had to maintain a commitment to provide jobs that were not 'woefully underpaid'. He recognized, however, that society had left that commitment 'regretfully unfulfilled' (Okun, 1975: 21).

In terms of our interest in a living wage, Okun can be interpreted as supporting it based at least in part on the externality argument. To avoid the low pay that comes from desperation, workers should be banned from accepting jobs at low wages. This meant that they had a right to jobs with wages that included the right to survive with dignity. Moreover, workers cannot be allowed to bargain away that right due to desperation because of the harm it might do to others. Okun did not make this argument explicit, however. He did argue that no one could be permitted to sell their right to call the fire department 'because his neighbour would be made worse off' (Okun, 1975: 11). While that example of a right to fire protection is not quite the same as a right to a well-paid job, a case can be made that low wages contain an externality. Okun neither made such a case nor did he consider what it would take to provide workers with jobs that paid a living wage. He pinned his hopes on transfers of income by government policy. Still, his writings on that topic have some lessons for us.

Okun challenged the idea that when wages equalled value-added they were fair. To begin with unequal bargaining power might result in wages below value-added. In addition, wages and other forms of income were a result of capabilities derived from genetics, capabilities due to personal and family assets such as wealth, the amount of effort a worker puts forth (from cultural and genetic differences), the degree of cooperation with other workers needed to complete the job and from unpredictable changes in supply and demand. Most of these factors were outside the control of the individual worker and it would not be reasonable to penalize the worker with low wages when those forces turned against the worker. For efficiency reasons, however, Okun did not object to using self-interest to channel human capability into productive activities. The reward of extra income from market competition was essential to that channelling (Okun, 1975: 41–9).

Persons who were left behind in that competition should be helped, however. In determining the amount of help they should get, Okun set forth a simple standard based on his reading of public discourse. He wrote, 'the subjective threshold of deprivation most often mentioned is half of the average income of American families' (Okun, 1975: 95). Here we have a clear and easy to calculate standard in terms of a definition for a living wage. Again, Okun did not use it as a standard for a living wage preferring instead to investigate policies for governmental income transfers. To put those transfers into the perspective of his efficiency/equality trade-off, Okun used a hypothetical example of 'the leaky bucket experiment'.

Suppose, he asked, we wish to transfer money from the rich to the poor through taxation of the rich and subsidies for the poor. We still have a problem in that the money must be carried in a 'leaky bucket'. The bucket would leak money due to the costs to the government to administer the programme, the impact higher taxes would have on the incentives to work, save and invest of the wealthy, the impact the subsidy would have on the incentives to work of the poor, and social factors such as the impact on attitudes towards government by the rich and poor and their undermining a feeling of self-reliance on the part of the poor (Mill's paternalism affect). These leakages would reduce the amount of help that the poor received from a given amount of taxes collected from the rich. The big question, Okun observed, is how much leakage should we tolerate? (Okun, 1975: 91–100). His answer was that the amount of tolerable leakage will depend on the values of each individual in terms of whether efficiency or equality should be a priority. Persons who value equality will tolerate more leakage than persons who value efficiency. It will also matter from whom the bucket is filled. If the money to help the poor comes from members of the middle class, we might not tolerate as many leakages as we did when the money came from the rich (Okun, 1975: 91–95).

In this way, Okun has tried to find a middle ground in terms of our interest in a living wage. We might have to sacrifice some efficiency to provide a living wage, but that sacrifice would be acceptable as long as the efficiency costs were tolerable. In Okun's case, he stated that he would accept a 60 per cent leakage if the money came from the wealthy but only a 15 per cent leakage if the money came from the middle class. In the trade-off between efficiency and equality in granting a living wage, it matters who will pay it as well as how much the living wage will be. Still, Okun concluded, 'The fulfillment of the right to survival and the eradication of poverty are within the grasp of this affluent nation. And within our vision is the target of half the average income as the basic minimum for all who choose to participate in the community's economic life' (Okun, 1975: 117). To do so might require that the rich and middle class sacrifice 'beachfront condominiums', 'second cars' and 'college slots' for children with low academic talent to avoid the deprivation of the poor that barred their entrée 'to first homes, first cars and college slots for solid students' (Okun, 1975: 118). In reaching this conclusion Okun followed a long line of thinkers who started with Bentham in arguing that items of 'mere enjoyment' can easily be given up with no loss of security for those who give them up. Rather, since the security from subsistence for the poor adds to the security of society the sacrifices of the affluent may pay for themselves.

CONCLUSION

The primary issue with the concept of externality is whether it is appropriate to apply it to labour and wages. The question of appropriateness arises in part because only two of the economists in this chapter, Clark and Barkin, consistently applied the concept of externality to labour and Barkin learned the concept from Clark. To be sure, earlier thinkers had loosely identified cases where labour market activities might have a negative impact on society, but only Clark made it clear that there was a 'public interest' in taking care of a labour market externality (Clark, 1926: 130). Clark's use of the externality approach to justify a public interest in working conditions did not have much influence, however.

Not long after Clark advanced it the market economists featured in this book began having more influence on economics. They agreed that an externality could be construed as a market failure, following Pigou, but not in the case of labour. The question raised regarding a living wage is whether to revive the approach of applying the concept of externality to labour. In that case, however, advocates must respond to the issue of mutual responsibility raised by Coase. At several places in the chapter I have indicated that the concept of an externality was intended to replicate the mutual obligations of Smith's moral economy. Coase took the issue of mutual obligations seriously to the extent that when it is not easy to assign responsibility for an externality, which he thought was most of the time, it might be more effective to establish mutual responsibility and have those responsible negotiate their respective burdens. If those parties followed the golden rule, which Coase never argued they should, they would include each other's needs in determining the most effective solution to the externality. From this perspective, the living wage should be negotiated among employers, workers and the community. From Mill to Barkin, thinkers in this book set forth unions as the best representatives of workers; they also believed that unions could represent the community interest, since workers formed the bulk of the community. None of them envisioned that self-appointed community groups, such as advocates for a living wage, would try to represent the interests of the workers and the community.

5. Lessons from the history of economic thought

INTRODUCTION

From Adam Smith down to the institutionalists such as Ben Seligman economists have supported the idea that low-wage workers should earn a living wage as defined by the standards of the community in which they lived and worked. These economists often referred to the living wage as a subsistence wage but they never meant that workers should earn a wage that merely enabled them to survive. The subsistence wage to them stood for an amount that was the least workers could make and still feel they were valuable members of the community. As an indicator of how they viewed the community, I have pointed to ways in which nearly all of them held to a version of what I have called Smith's moral economy of 'mutual assistance' as an ideal to which they might aspire.

These economists recognized that their ideal of a moral economy did not exist and that members of the market economy had to develop moral character before that ideal moral economy could be approached, if not realized. They were vague as to how moral character would develop; Smith thought higher wages and education would help, Mill counted on unions to do it for workers, Marx proclaimed that a working-class consciousness would somehow arise from the chaos of capitalism and Veblen believed working with technology would make workers more socially aware. They may have disagreed over how the moral character of workers would arise – think of how Mill and Marx differed over the role of unions – but there were few disagreements among these economists over the need for workers to have a living wage as a necessary but not sufficient component of the enhancement of that moral character.

The disagreement came with the development of a robust version of market economics. The free market economists surveyed in this book not only recognized that Smith's moral economy was an ideal, they also believed that it could never exist and was not even desirable. Moral character could not be counted on to develop in a world dominated by self-interest. These economists had as their ideal the economic model of perfect competition, a conceptualization of the market system that is as utopian as

Smith's moral economy. In it, rational consumers and many small business owners acting on their self-interest and armed with perfect information interact in the market to make correct decisions of what to produce and sell, where to work, what to purchase, and what the proper selling price will be, such that the outcome is an optimal allocation of resources and a Pareto optimal distribution of income. This ideal economy also gives workers the wages the value-added of their work earns them, no more and no less, despite arguments by J.B. Clark, Davenport and Commons that there were limits to the application of the marginal product theory of wages. Despite such arguments, these free market economists consistently claimed that their interest in this ideal model was purely scientific, as it served the same function for economics as an idealized model of the structure of an atom did for physics.

Because the concept of a subsistence or living wage did not fit into this idealized model of the market economy, the market economists did not find it to be a useful analytical concept. Thus we have a figurative debate between the moral economists and the market economists over the role of a living wage in two versions of an ideal world, the moral economy of mutual assistance and the perfectly competitive market economy. Because the market economists have had the most recent and socially persuasive words in the debate I have given more words to the moral economists. In this chapter I will give both sides equal footing in the debate by summarizing what lessons the debate has for a living wage. Since both sides of the debate agreed that the moral economy did not exist, they did not use moral arguments in their debate. Rather as I have indicated in the previous chapters the debate has revolved around the concepts of sustainability, capability and externality.

SUSTAINABILITY

The starting point in the sustainability argument is with Smith's writing that if wages were not sufficient, 'the race of such workmen would not last beyond the first generation' (Smith, 1976b, vol. I: 76). Smith lived in a time when starvation for the poor remained a social problem and it continued to remain one for the next century; Bentham, Mill and Marx continued to worry over the issue of the sustainability of the workforce. Smith anticipated that economic growth would take care of the problem of starvation and eliminate absolute poverty, but again we must recall that a subsistence wage for him and all the other moral economists meant more than fighting off starvation and sustaining the workforce. Hence they also began thinking in terms of relative poverty, poverty as related to the standard of living of the wealthy, as Marx described it. By the time of Alfred Marshall, the worries over starvation had abated and we have seen that by the 1960s Ben Seligman agreed that a pure sustainability argument without a decency component 'would equate poverty with hunger and since no one in his right mind would assert that hunger is rampant in the United States, *ergo* there is little or no poverty to be observed' (Seligman, 1968: 33).

The diminished need to worry about bare subsistence is reflected in the writings of the market economists. Bentham had argued that utility calculation began only after subsistence was provided, and Marshall agreed. The market economists made this argument implicit by setting forth theories of utility that did not bother to take the need for subsistence into account. Without this assumption that subsistence had been provided, they would have had a difficult time working out their ideal of perfect competition. It is hard to imagine a starving person acting rationally and with perfect information. Could Pareto optimality have coexisted with starvation? Would it really have been difficult to make an interpersonal utility comparison between a wealthy person and a starving one? Are humans free to choose, as Milton Friedman would say, or are they bound by constraints of deprivation and coerced into making a tragic choice, as Stephen Marglin has written (Marglin, 2008: 223). These are all questions market economists have been able to avoid.

In a similar way they have avoided the difficulties sustainability would have caused for their theory of labour markets. The moral economists worried that unequal bargaining power that favoured employers over labour might keep wages below a subsistence level; market economics treats unequal bargaining as a special case of monopsony and even in that case they do not indicate whether the resulting wage is below subsistence. Otherwise, the market maintains equal bargaining power in labour markets and competition equates wages to the value-added by workers. Even though he gets credit for this approach, John Bates Clark had also argued that workers would need to work the first hours of the day to provide their subsistence and then could consider working additional hours for comfort and luxury. Think of what affect this argument would have on the supply curve of labour. If workers were in Clark's 'subsistence zone', say wages were so low they had to work all day to earn a subsistence, then a decrease in wages would mean they would have to work more hours to earn that subsistence. This argument would offset the upward-sloping supply curve of labour and its implication that if wages decrease, workers would rather take leisure because the pay for their work would not be worthwhile in terms of the luxuries they could buy. The labour-leisure trade-off can only take place when workers are sure they will be sustained.

Given that workers in the US, in much of Europe and in parts of Asia, can be sure they will be sustained, does that mean we can give the points on the issue of sustainability to the market economists and give up on this argument as justifying a living wage? The answer to this question depends on why workers are sure they will be sustained and how sure they are. One of the reasons the moral economists worried over the sustainability issue was that they believed that bargaining power in labour markets favoured employers. Starting with John Stuart Mill, two generations of economists argued that unions were necessary for workers to get the higher pay a growing economy should produce for them. Market economists argued that the market automatically gave workers the higher pay economic growth has allowed and that unions were not a part of it. Unions in the US are in decline in the private sector, a trend Barkin and Seligman forecast, and if the wages of workers who formerly would have joined unions fall back to basic subsistence, as the moral economists might predict, then the issue of sustainability will be back on the table. This is not to predict that those wages will fall back to a bare subsistence or to assert that they already have – these issues are highly arguable. Rather, the possibility that sustainability might reappear would worry moral economists more than market economists.

Moreover, in the global economy the sustainability issue continues to be vital. Low-wage workers throughout the world, and they are the norm, barely make a sustainable wage and in many cases it takes an entire family's wages to sustain the family. In such cases we may follow Smith's hope that economic development can increase those wages but that outcome would depend on how economic development changes the bargaining power between workers and employers and whether it is accompanied by the development of institutions that place limits on how employers treat workers and how governments intervene in the economy. Until those institutional changes are in place, sustainability will be an issue for most workers around the world. To the extent that these workers compete with low-wage workers in the industrialized world, they have the potential to cause sustainability to remain a global issue.

CAPABILITY

The capability approach starts with the premise that human beings have many functions to carry out as members of their society. In terms of a living wage, the capability approach means that we need to take into account whether the wages workers earn and the working conditions they face enable them to improve their abilities as workers and as members of society and to enhance those abilities in their children. We can start with Smith on this issue, for he worried that the numbing affect of work under the division of labour would make a worker 'not only incapable of relishing or bearing a part in any rational conversation, but of conceiving any generous, noble, or tender sentiment, and consequently of forming any just judgment concerning many even of the ordinary duties of private life. Of the great and extensive interests of his country he is altogether incapable of judging' (Smith, 1976b, vol. II: 302–3).

Smith wanted to see the reverse take place, to see workers able to live a noble life as citizens and to be able to judge the interests of their country. He anticipated that higher wages might help workers gain that capability, as would education. Other moral economists followed him and elaborated on what was necessary for workers to enhance their capability. They all made higher wages a component of enhanced capability, but only if workers spent their increased income on the right items of consumption. John Stuart Mill went further and looked for other social forces to enhance the moral character of workers. He was especially interested in unions because he thought they allowed workers to develop their own moral character without anyone else and especially the government telling them what to do. As long as unions were free from government interference they enhanced democracy. Two generations of moral economic thinkers held the same viewpoint that not only were unions needed to give workers higher wages, but the process of forming a union and bargaining for wages would improve the moral character of workers. To be sure Marx and Veblen dissented from this viewpoint on the grounds that they thought unions would develop too much of a particularistic perspective and not necessarily enhance the moral character of their members, but even Veblen thought they might.

Market economists have less concern with the capability argument. To them, humans already have the capability to be rational, self-interested individuals able to make informed decisions. The decisions that concern market economists are economic ones and the only capabilities that concern them are productive ones. Given that workers make rational self-interested decisions about what to buy with their incomes, there is no sense in telling them that they need to choose wisely in what they consume in order to enhance their capability. In addition, in choosing what skills to acquire and what jobs to pursue, they also make informed choices. Whatever job and wages a worker winds up with, that worker's choices are what got them there. The market economists assume away the problem of capability by taking for granted that people's productivity is fixed prior to wage determination

When workers make the choice to join a union, it has nothing to do with enhancing capability as far as market economists are concerned. To them, workers choose to join a union only if the costs are less than the benefits, that is, only if the union can gain greater wages and benefits for its members than the dues it collects from them. In addition, since unions cannot gain higher than market wages except by taking money from someone else, unions cannot be counted on to take a broader community interest nor an interest in enhancing the capability of their members to be better members of the community. Following Bentham, market economists are sceptical that there is such a thing as a community.

Consequently, the market economists express little concern over the capability of humans as citizens and moral actors. This attitude, however, puts them in a constrained intellectual position. Recall from Chapter 2 that Milton Friedman worried that individuals could use political freedom to promote governmental policies that reduced economic freedom through coercive measures, and thus argued that a reliance 'on voluntary co-operation and private enterprise' was needed to counter the potential abuse of power by the government (Friedman, 1982: 3–4). Politicians and intellectuals might upset market results by pandering to workers with promises of income redistribution, such as a living wage. Their ability to do so, however, would depend on the capability of those workers and other voters who might follow the populist rhetoric of politicians. By not looking further at the impact market activities have on the capability of workers, market economists have avoided the issue so clear to later writers such as Seligman and Sen, that effective political democracy depends on the capability the members of society gain from their economic activities. Whether unions can be a vital component in building that capability is an issue market economists could never consider.

The debate between moral economists and market economists over whether or not unions can enhance the wages and capability of their members and whether or not there is a community has important lessons for a living wage. First, if workers do not earn a living wage is it because that is all the market will allow them, or is it because they are in a poor bargaining position? The moral economists took the second position while the market economists accept the first. In making a case for a living wage it is important to be able to give a reason for why workers do not already earn one.

Second, does anyone have the wisdom to tell workers how to spend their money in ways that will enhance their capability? The moral economists believed that how workers spent their income mattered in terms of enhancing their capability, but were leery of having anyone tell those workers how they ought to spend their income – they wanted to avoid paternalism and anticipated that workers would develop the capability to make spending decisions that would further enhance their capability as workers and citizens. The market economists find this issue to be beside the point. Still, it is an important issue. If workers get a living wage, what will those workers do with their additional income? Will the extra income be beneficial for them?

Third is the issue of unions themselves. The moral economists believed they would become moulders of the character of their members, but they did not research this issue very well. Solomon Barkin and Ben Seligman, the only economists featured in this book who had first-hand experience with unions, had high ideals regarding how unions might function but accepted that they should at least gain higher income for their members. Market economists see unions as only getting higher wages for their members and not doing that job very well. They raise the question of who pays for the higher wages any worker gets, either from a union or from a mandated living wage. Finding the right balance between higher wages and the needs of the persons who must pay for the higher wages requires a broad-based system of wage negotiation and it is not clear that unions are sufficient as a way to achieve this type of negotiation.

Finally, there is the issue of having the government impose a living wage to ensure that workers develop their capability. The moral economists opposed this approach for two main reasons. First, starting with Adam Smith, they recognized that it mattered who controlled the government. Recall from Chapter 2 that Smith believed that in his day regarding wages, 'Whenever the legislature attempts to regulate the differences between masters and their workmen, its counsellors are always the masters' (Smith, 1976b, vol. I: 74–6). For most of the nineteenth century this belief was credible and the moral economists did not look for government help. In the twentieth century in the US a government friendly to workers passed the National Labor Relations Act and thereby made it easier for unions to organize their members, but a less friendly series of governments have since chipped away at that Act. Second, the moral economists recognized and feared the paternalistic and coercive nature of government. The imposition of a living wage on employers would have been coercive and they did not see how coercion could be consistent with moral character and economic justice. Equally coercive would be imposing requirements on workers for what they had to do with their living wage. The moral economists did not see unions as being coercive as long as they engaged in voluntary negotiations.

The market economists go further to raise the issue of the efficiency of government programmes. Even if the government were well intentioned, they would argue, it cannot get things done in a timely and effective manner. It is better to trust the market they would argue, and they would indicate that Smith's hope that economic development would increase wages has largely come true. Indeed, they would find it ironic that minimum wage laws have been passed in many parts of the industrial world only after their effects would be minimal, that is, only when an overwhelming number of workers earned above the minimum wage. This view is consistent with their acceptance that sustainability is no longer an issue in free market capitalism. The number of workers in the US who would gain from a living wage would be small and the best way to help them is to enhance their human capital (capability) through market activities.

EXTERNALITY

The primary issue with the concept of externality is whether it is appropriate to apply it to labour and wages. Every transaction can be construed as having an unintended side effect on a third party. The problem is in drawing the line between meaningful side effects and those that do not need to be addressed. The issue of appropriateness is further complicated because only two of the economists surveyed in this book, John Maurice Clark and Solomon Barkin, explicitly applied the concept of externality to labour. To be sure, Smith argued that a consequence of low wages was 'Want, famine and mortality would immediately prevail in that class [workers], and from thence spread to all of the superior classes' (Smith, 1976b, vol. I: 82) and other moral economists such as Marx agreed with him.

The economists in the moral group continued to develop the externality idea, with that development culminating in J.M. Clark's classic statement:

> Whether through ignorance, inertia or sheer necessity, workers will work under conditions that will shorten their work lives or injure their future efficiency, and they are not able to charge any adequate premium for such kinds of work. This might perhaps be treated as nobody's business but the workers', save for the fact that their children and other dependents have an interest in their working-efficiency, also their future employers, or the taxpayers or contributors to charity who must pay for the rescue work which may become necessary, or the business out of whose product the funds for relief must come – in short, there is a 'public interest' in the avoidance of such wastes. (Clark, 1926: 130)

Clark's use of the externality approach to justify a public interest in working conditions did not have much influence, however. Not long after he advanced it the market economists began having more influence on economics. While they did retain the idea of externality as part of their analytical approach, they did not apply it to labour. The question raised regarding a living wage is whether to revive the approach of applying the concept of externality to labour. If it is revived, there are a number of secondary issues that need to be considered.

First, who has responsibility for taking care of a negative labour market externality? The usual approach has been to place the responsibility for paying a living wage on employers but Coase has indicated that placing responsibility for a negative externality is not always easy. In this case, employers might argue that they take their workers as they find them. If those workers have low productivity in terms of the value they add, they must accept low wages as a condition for getting a job. By forcing the employers to pay higher wages to those workers to eliminate an externality, we would give them the responsibility for improving the productivity of those workers to make it worth while to keep employing them. Do workers have any responsibility for improving their productivity? Do taxpayers have a similar responsibility? For example, suppose a worker has low productivity because that worker had a poor education at a public high school. Does the government that provided that education share in the responsibility for the low wages that worker will earn as well as the negative externality those low wages would create for others? Does the worker bear a similar responsibility, especially if the worker neglected his or her schoolwork? And what of damage done to the worker through work? Even J.M. Clark, the leading advocate of applying the externality approach, wrote that it was through 'ignorance, inertia or sheer necessity' that workers might 'shorten their work lives or injure their future efficiency'. Ignorance and inertia would imply that workers were not taking care of themselves and had a share of responsibility. Given the complexities of assigning responsibility for a negative externality related to low wages and poor working conditions it is certainly easier to place the burden of a labour market externality on the employer but that does not mean it is more efficient.

Second, the problems caused by a negative externality are not readily solved by a piecemeal effort. If we place the burden for negative labour market externalities on employers one at a time, we place individual employers in a weakened competitive condition. For example, a few local governments in the US have tried to use regulations to compel Wal-Mart to pay higher wages to its workers. Had they succeeded, they would have placed Wal-Mart at a competitive disadvantage compared with other big-box stores in that area. A national regulation that applied only to Wal-Mart would severely diminish its competitiveness. If there were a national regulation that applied to all big-box stores, they would be placed at a competitive disadvantage compared with smaller stores. This problem is why in the US there is a national minimum wage that applies to all employers and that is the strategy in the quest for a living wage. A national regulation, however, does not take into account local conditions; by using such a broad-based approach we might be helping workers who do not need help.

Third, as this last issue indicates, it matters how we take care of the problem of a negative externality caused by low wages. The economic thinkers featured in this book devised a number of approaches for handling the problem of a negative externality as it might be applied to labour. The basic idea is to give businesses incentives to internalize the externality by making them part of their cost structure. Once the full costs of all the resources used in production become part of a business's operations the business will attain economic efficiency. Policies to achieve this internalization include voluntarism where firms recognize the damage they are doing and take care of it themselves (Adam Smith), regulation from some government agency that tells businesses what to do (J.B. Clark, J.M. Clark and Seligman), use of taxation (the Pigou tax) to give business the incentive to avoid the tax by taking care of the externality (Commons), following the Coase theorem by having both parties negotiate the allocation of the cost of the externality with unions negotiating for workers (Mill, Ely, J.B. Clark, Marshall, Pigou, Seligman and Barkin) and doing nothing in hopes that the market will find a way to solve the problem.

The problem of handling a negative labour market externality is even more complicated due to an issue that Pigou raised, global trade. In a global economy low-wage workers in the US must compete with even lower-wage workers in other parts of the world. By paying higher wages in the US, its firms are placed in a weaker competitive condition compared with firms in other countries. To avoid that weaker condition, firms may relocate overseas or use 'outsourcing' to remain competitive, eliminating the jobs of low-wage labour. It is also possible that a living wage in the US will attract immigrants to he US in large numbers, putting downward pressure on wages in general. That is how global markets work. Advocates for a living wage may well be among the protesters who decry the costs of globalization and they may also be among the persons lobbying to end low wages and sweatshop conditions in other countries, but Pigou would have found such efforts to be ineffectual when weighed against the sweep of the forces behind globalization.

Fourth, one of the problems in solving any negative externality is in determining that the entity charged with taking care of it is actually doing what it takes to eliminate the costs associated with the externality. In terms of a low-wage externality we need to monitor employers to ensure that they are paying their workers the living wage they agreed to pay. We also would need to monitor workers to confirm that they are using their increased pay to take care of the costs of the externality. This approach would require a high degree of monitoring costs. It would also be highly intrusive into the lives of workers either by employers or by the government, as Pigou, Commons, Friedman and Becker indicated. Economists now refer to this as the 'agency problem' because it involves the difficulty employers have in monitoring or controlling their 'agents'. Higher wages for low-wage workers will eliminate a negative externality only if workers use those wages in the right way.

To some degree, the externality approach is the economic substitute for Smith's moral economy. In that moral economy, individuals would be aware of costs they imposed on others and, following a communitarian value system, would voluntarily take care of those costs to avoid the damage to others as part of a network of mutual assistance. That same network would encourage the persons being damaged to act on such mutual assistance in ways that did eliminate the externality. The global economy, however, is far removed from Smith's moral economy and becomes even further removed as the global economy expands. Mutual assistance on a global scale presents daunting problems. To retain any semblance of that moral economy, the global economy must develop new institutions to handle the externality problem, and as Commons and Mises argued, developing new institutions is not an easy task. Advocates for a living wage face a heavy responsibility in turning the living wage into a social institution with the capacity to take care of labour market externalities in a global economy.

DEFINING THE LIVING WAGE

However one justifies a living wage, there remains the vexing problem of defining it. Let us start with Adam Smith. He argued that a subsistence (living) wage should enable a worker to buy the necessities of life. He included a decency component in his definition:

> By necessaries I understand not only the commodities which are indispensably necessary for the support of life, but whatever the custom of the country renders it indecent for creditable people, even of the lowest order, to be without. (Smith, 1976b, vol. II: 399–400)

Modern advocates for a living wage, such as Jerold Walthman, who defines the living wage 'as a wage which would provide someone who works full-time year-round with a decent standard of living as measured by the criteria of the society in which he/she lives', have followed this definition (Waltman, 2004: 4). Among early economists, Bentham and Mill followed it as well. Mill, however, took a consequentialist viewpoint when he added in the concept of productive consumption that looked at how the wage added to the productiveness of workers.

Marx advanced the definition in two ways. First, he argued that the 'custom of the country' was established by the consumption patterns of the wealthy. He wrote:

> The rapid growth of productive capital brings about an equally rapid growth of wealth, luxury, social wants and social enjoyments. Thus, although the enjoyments have risen, the social satisfaction they give him has fallen in comparison with the increased enjoyments of the capitalist, which are inaccessible to the worker . . . Our desires and pleasures spring from society; we measure them, therefore, by society and not by the objects which serve for their satisfaction. Because they are of a social nature, they are of a relative nature. (Marx, 1849: 180)

The subsistence a living wage should purchase was a relative concept and Thorstein Veblen's theory of conspicuous consumption as based on emulation helped to explain how that definition of 'desires and pleasures' was socially constructed. The problem this causes in defining a living wage is that it must be a very loose definition that can adapt to changing times. It is difficult to define a concept that is always changing. The automobile may have been a luxury when it was first introduced, for workers had alternative means of transportation; it is now a necessity and few would deny it as a component of a definition of a living wage.

Marx also recognized that economic development made it feasible for women and children to take up industrial work (Marx, 1977: 517). The addition of women and children to the workforce redefined the subsistence wage as the amount the whole family earned. The necessary and decency level of the subsistence wage might remain the same, but more than one family member had to work to earn it. As the decency component of the subsistence wage increased, more members of the family might have to work to keep up with a decent standard of living. Hence a living wage needs to take into account household income and whether multiple members of the household are working to keep up subsistence or to keep up to a standard of conspicuous consumption.

Marx's multidimensional definition of a subsistence wage – working conditions, time to be worked, household members who must work, capability of individual workers, the relativity of the wage to the wealth of the capitalists and location and climate – indicates the difficulty in defining a living wage: Should it be based on an individual worker or on a household? If it is based on an individual's income but all members of the household earn it, they may gain a level of affluence well above a living wage. When all members of the household must combine to earn a living wage, the household will be in serious trouble if something happens to one of its members. As new items of consumption enter into the living wage, it must increase to allow for their purchase. If the prices of some items of 'subsistence' change, the living wage must be adjusted. Since price changes might depend on geographic location and climate as do the items that enter into the 'subsistence' a living wage must purchase, there will be regional variation in the living wage as well.

Given that all these factors must enter into the definition of a living wage, it is not surprising that the economic thinkers featured in this book, from Adam Smith to J.M. Clark, did not try to present a rigorous definition of the living wage. For them it remained a theoretical concept that they used as part of their analytical argument. The only economist encountered in this book who had to put the theory of a living wage into practice was Solomon Barkin. His study of wages in five textile communities (see Chapter 4) compared them to a theoretical budget, but also asked workers how well their wages enabled them to live.

The problem is that one broad measure of the living wage cannot take into account all of the nuances that go into defining a level of subsistence. One solution would be to follow Rose Friedman and define subsistence based on calories. A different approach would be to follow Okun and define it as a percentage of some economic variable such as median household income. Another approach would be Ben Seligman's suggestion to establish a range of incomes to constitute a living wage and place low-wage persons somewhere within the range depending on their personal conditions. Placing them in the right place within the range, however, might require extensive and intrusive investigation of their total income from all sources, lifestyle and consumption pattern, and number of dependants. That type of investigation would require an elaborate and costly cadre of investigators, however. For this reason Milton Friedman proposed his negative income tax. Workers whose taxable income fell below a standard, as verified by the tax collectors, would be given a subsidy from the government. Their wages plus the subsidy would then give them a living wage, at least approximately. Seligman, who was certainly no ally of Friedman, found his negative income tax to be a worthwhile approach to solving the problem of poverty among low-wage workers (Seligman, 1966: 295), even though he recognized that the community would be subsidizing low-wage jobs when its task should be to eliminate them.

The complications that arise in defining a living wage make it a difficult concept to promote. Especially important to most of the thinkers in this book, workers should be involved in any effort to give them a living wage. First, they would know best what constituted a living wage for themselves and for other workers in their condition. That is why John Stuart Mill and others included in this book supported unions as a way to enable workers to gain a living wage for themselves. To them government was not a substitute for mutual assistance and the moral economy. Second, the moral economists believed that the use of unions as a negotiating body would develop the moral character of workers, both as responsible negotiators and as the electorate who put those negotiators in charge. In doing so, unions would avoid the paternalism that helped workers but did not advance their capability. Given this encouragement for unions among moral economists, it is not surprising that John Bates Clark used the wages established by local unions negotiating with competitive firms as the best standard of when wages were fair.

As a result of their pro-union position, the moral economists would have been likely to join the market economists in being sceptical of the movement for a living wage. John Stuart Mill had been critical of the persons in his time who insisted that employers should pay workers a sufficient wage, with 'the test of sufficient wages being their own feelings, or what they suppose to be those of the public' (Mill, 1909: 361–2). Workers might get a higher wage from unions but that wage would be what the market accorded them. Marshall was as sympathetic as anyone towards the plight of low-wage workers yet I have never found any reference in his work to the living wage movement that existed in England during his lifetime and was written about in *The Economic Journal* (*Economic Journal*, 1894: 365). Perhaps he thought its efforts were too paternalistic. Pigou, Marshall's student, analysed efforts to secure a living wage for workers and argued that it could not work with low-wage workers due to their low productivity (Pigou, 1932: 599–600).

In addition, both the moral economists and the market economists would ask advocates for a living wage how they would pay for it. As a general rule, all of our economic thinkers adhered in some degree to the idea that wages should be based on value-added. Before the marginalists refined the concept of value-added, economic thinkers had a very loose definition of what it meant. We can see this in Mill's view that society had cause to regret 'the large share [of income] which falls to the lot of persons who render no equivalent in return' (Mill, 1909: 53). The wealthy did not always add value in correspondence to their incomes. That meant it was acceptable to have them pay for a living wage to the extent that they were giving up pineapples (luxuries) so workers who were adding value could have potatoes (subsistence). The moral economists recognized that someone had to pay to give workers a living wage, and as long as it was the idle rich they approved.

The problem is making it clear how we should pay for a living wage and who will do the paying. The moral economists might agree with a living wage if it were the idle rich who were paying, but market economists beg the question of 'justice' for those who must do the paying. Thanks to arguments such as those provided by Schumpeter's theory of the entrepreneur, market economists are more confident than the moral economists that high incomes are a sign of high value-added. The earners of high incomes would wonder what theory of justice can be used to take away the fruits of their effort, no matter how they choose to spend it, and market economists would agree. The living wage must include a clear standard of justice for all members of society.

There is another aspect to the justice argument that can be derived from the writings of the moral economists. Starting with Adam Smith, these economists always recognized that there was a structure of wages based on skill, trust, responsibility and many other capabilities. These capabilities are what market economists call human capital and the moral economists recognized their value, if not their name. The accumulation of human capital takes time and sacrifice, however, which is one explanation for why workers who have high levels of human capital earn a higher wage than workers who do not have as much. They would not develop their capability as workers unless there was a payoff to the human capital that equates to that enhanced capability. The problem this hierarchy of wages based on human capital poses for a living wage is that these workers with human capital may not be supportive of a living wage, because they might suffer from Bentham's 'disappointment.' Recall that Bentham argued that reducing the wealth of the rich to help the working poor might cause disappointment to the rich. Now higher-paid workers might not have their incomes reduced to help pay for a living wage, although this is not clear, but they will find the premium they gain from their human capital reduced, which might cause them the same type of disappointment. After all, they will have put time and effort to rising up in the wage structure only to find low-wage workers gaining on them due to their being given a living wage. Arthur Okun cited an example of this attitude in a survey where a lower-income person disparaged efforts to equalize income as follows: 'I wouldn't want it. If I work harder than somebody else, why should I share . . . Or why shouldn't I be able to . . . live better . . .?' (Okun, 1975: 34).

Perhaps only an economist would think of such a scenario, but he would do so to point out that 'justice for all' in economic matters is not easy to determine. Behavioural economists have found that in an 'ultimatum game' where a pot must be split, individuals would give up money if they felt that their share of the pot was unfair. Moreover, when behavioural economists ask a survey question: Which would you prefer, earning a high wage when similar workers in your workplace earn more than you do or earning a lower wage that is higher than similar workers in your workplace earn, many participants pick the latter. Apparently one's status in the pecking order counts for more than the level of income in terms of a fair wage. Giving raises to low-paid workers to provide a living wage might very well upset a sense of fairness among all workers.

CONCLUSION

At first glance, the symbolic debate between the moral economists and the market economists described in this chapter appears to be one of 'mutual assistance' versus voluntary exchanges by individuals. If that were simply the case, then we would find the moral economists were supporting the movement for a living wage and the market economists opposing it. The difference between them is much subtler, however.

From Adam Smith on, the moral economists (except for Marx) determined that the voluntary exchanges of the market were a workable substitute for the moral economy of 'mutual assistance' in most cases. In the cases where voluntary exchange did not work effectively, they looked for a solution based on 'mutual assistance'. The case where they particularly looked for such 'mutual assistance' was with low-wage workers. When voluntary exchange did not give workers a subsistence wage as loosely defined by sustainability, capability and externality, then 'mutual assistance' was necessary to achieve it. Starting with Mill, they saw unions as a way for workers to provide that 'mutual assistance' to each other, but only if workers and their unions developed the right moral character. To them, 'mutual assistance' had to be based on the same type of voluntary cooperation as a voluntary exchange, that is, it had to include a sense of mutual obligation. When workers are given a living wage, the moral thinkers would ask what sort of obligation those workers have incurred to the persons who have given them the living wage. Without this sort of mutual obligation, they would argue, you cannot compel employers to pay a living wage without turning workers into dependants of the state and thereby increasing the power of the state.

The market economists determined that the moral economy of 'mutual assistance' and 'mutual obligation' could never exist and there is no point in pretending that it does. The only way for society to produce what it needs to sustain itself, and to increase the capability of its members is through voluntary exchanges. Wherever possible the market should be used to determine what is to be produced and how incomes will be distributed. In cases where the market does not work well, we should try to find ways to improve the way it works. If the market does not allow a group of workers to earn a living wage, we must investigate why. When workers earn low wages because they add low value to production, ways must be found to enhance the value they add to production. If that is done, then the voluntary exchanges of the market will earn them a living wage. You cannot, they would conclude, pay workers a living wage without the coercion that causes harm to others.

In between the two groups stands Arthur Okun reminding them that there is a trade-off between equality and efficiency, between morals and markets. The problem is in knowing where to draw the line between the moral economy and the market economy. Advocates for a living wage for low-wage workers have drawn the line, but they need to recognize that they have drawn it and to explain to us why they have drawn it where they have. We can tolerate some inefficiency in the market to attain an additional dose of morality. The question is how much inefficiency we can tolerate. In raising this question, I have brought us back to Adam Smith's moral sentiments and his belief that 'How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortunes of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it' (Smith, 1976a: 9). The market economy should contain elements of the moral economy and fairness matters even if it cannot be defined with precision.

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