

**THE THEORY AND PRACTICE OF WAGE SUBSIDISATION: SOME  
HISTORICAL REFLECTIONS**

ESRC Centre for Business Research, University of Cambridge  
Working Paper No. 201

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June 2001

This Working Paper forms part of the CBR Research Programme on Corporate  
Governance, Contracts and Incentives

**Abstract**

Economists explain welfare dependency of the unemployed and in-work poverty by the low labour market quality of the poor. Work can be made to pay by working family tax credits. But these might lower wages and price non-recipients out of the market, widening the eligibility for the wage supplementation and raising social welfare bills. This was precisely the effect of the Speenhamland system of wage supplementation of the early 19<sup>th</sup> Century which permanently affected labour markets, and attitudes to welfare and the poor. The possibility of working family tax credit having a similar effect cannot be ruled out.

**JEL Codes:** J58, J78, J4, I38

**Keywords:** Wage supplementation, welfare to work and labour markets.

# THE THEORY AND PRACTICE OF WAGE SUBSIDISATION: SOME HISTORICAL REFLECTIONS

## 1. Introduction

The view in government circles is that the economy has now been bought under control by prudent macroeconomic management. A major remaining problem is the high level of poverty resulting from the persistence of high unemployment and the growth in the number of the working poor. The policy response to this is to make the payment of social welfare dependent on labour market participation by a variety of means, including topping up earnings to some minimum level by means of *tax credits*. The idea of in-work benefits as an answer to unemployment and in-work poverty has its roots in the belief that it is *unemployability* at the wages demanded by workers rather than *unemployment* that explains joblessness; and that it is poor labour quality combined with family size which explains in-work poverty rather than exploitation. Attaching benefits to work, it is asserted, makes the offer of jobs affordable to employers while making work pay for prospective employees. This helps break the cycle of welfare dependency by creating greater incentives for the poor to work by making up the difference between their household needs and the market valuation of their capabilities.

In-work-benefits had been out of policy favour between 1834, when the Poor Law Reform put an end to the Speenhamland System which similarly mixed wages and welfare benefits, and 1971, when Family Income Supplement was introduced as an anti-poverty measure. Their policy importance increased as unemployment grew after 1979 and when, in 1988, Family Income Supplement was replaced by Family Credit (Deakin and Wilkinson, 1991). Attaching welfare benefits to labour market participation has since become a central focus of the current Labour Government's welfare to work strategy. The more generous Working Family Tax Credits has been substituted for Family Credit, and the plans are to extend eligibility to include households without children. There is now such a strong consensus in

support of welfare-to-work as a solution to unemployment and in-work poverty that any discussion of its drawbacks or of alternatives is muted.

The consequences of going further down the road towards a general in-work benefit strategy are sufficiently uncertain to warrant a public discussion about all the possible issues involved. This paper is a contribution to this debate. Its purpose is to assess present-day policy from the point of view of historical experiences of, and arguments about, wage subsidisation, the lessons of which are being, unaccountably, forgotten. The second section briefly re-examines the debates surrounding the Speenhamland system of wages subsidisation and how it impacted on poverty and the working of the labour market. Sections 3 to 6 chart changes in labour market theorising and how these relate to the ebb and flow of unemployment and poverty, and their social and political consequences. Section 7 outlines contemporary arguments in favour of wages subsidisation. Section 8 outlines an alternative perspective on the labour market and how that might be used in the teaching of the lessons of history, and for designing effective labour market and social welfare policies.

## **2. The Speenhamland System: an experiment in wage supplementation**

### *i. The pauperisation of the poor in the Eighteenth Century*

During the Eighteenth Century the enclosure of land, its consolidation into large holdings, the elimination of small-scale farming, the exclusion of the poor from common land, the loss of customary rights, and the decline of domestic industry had a major impact on the structure and working of labour markets. The loss of land and customary rights increased wage dependency. The decline in the traditional paternalistic employment relations and the move to arable farming, with greater seasonal variation in labour demand, increased job insecurity. Alternative employment, and particularly that of women, disappeared with the loss of domestic industry, customary rights (eg. gleaning), and access to common land and the *wastes*.

Together, these reduced the standard of living of those in work, increased unemployment and under-employment, and generally impoverished a growing proportion of the working population. The burden of this growing poverty fell upon the local *poor rate*, a local tax levied on property holders, out of which *Parish Relief* was paid to the destitute under the provisions of Elizabethan Poor Law legislation. This, together with Statute of Artificers, provided a legal framework for the labour market which imposed a duty to work on the poor (backed up by draconian anti-vagrancy laws), a responsibility on the parish to find work for the unemployed and a right to subsistence for the impotent poor (the widows, orphans, sick and aged). Despite legislative and less formal attempts to enforce the duty to work, either in workhouses or by public works, the main burden of the burgeoning poverty in the second half of the 18<sup>th</sup> Century fell on outdoor relief (Slack, 1988, de Schweinitz, 1961, and Geremek, 1994).

The Poor Law was administered by the parish officials under the supervision of the Justices of the Peace. Entitlement to Parish Relief was regulated by the Settlement Laws which provided access to social welfare only in the parish in which individuals were *settled*. The Settlement Laws, which were increasingly strictly interpreted with the growth of rural poverty (Deakin, 2001), impeded labour market mobility beyond the immediate locality. This protected parishes from pauper migrations and secured the supply of labour for the local employers but, by geographically segmenting labour markets, closed off possible escape routes for the unemployed and those who were trapped in low paid employment.

An important way by which settlement was achieved was by annual hiring. But this fell out of favour both because of the risk of further burdening the local tax payers, and because the increasingly important arable farming required a more flexible workforce to meet the seasonal pattern of its labour demand. This growing gulf between the interests of capitalist farmers and their landless labourers further eroded the traditional paternalist employment relations and added to job and income insecurity, a tendency accelerated by the Napoleonic

War-time boom (Hammond and Hammond, 1947). With casualisation, the Poor Law became increasingly a means of supporting able-bodied workers laid-off by their employers who ‘hired as little and as briefly as he could, relying on the parish to maintain the unemployed’ (Hobsbawm and Rude, 1993, p.72).

*ii. The emergence of Speenhamland*

The effects of labour market restructuring on poverty levels was exacerbated in the 1790s by high and rising prices resulting from a series of poor harvests and the Napoleonic War inflation. Various solutions were proposed to relieve the distress of the poor, including dietary changes towards cheaper food, the provision of allotments to restore to the poor a degree of pre-market self sufficiency, a minimum wage to insulate wages against rising prices, and wage subsidies (Hammond and Hammond, 1947). Dietary changes proved impractical and the value of land was rising too rapidly for it to be re-parcelled out, so the main debate centred around the imposition of a minimum wage (which the Justices could fix under then existing legislation) and the extension of Parish Relief to those in private employment. In 1795, Whitbread unsuccessfully introduced a Bill into parliament to re-activate the obligation of the Justices to protect living standards by fixing minimum wages. In opposing the bill, Pitt argued in favour of the free market for labour and against the legal minimum wage. He added:

‘By the regulation proposed, either the man with a small family would have too much wages or the man with a large family who had done most service to his country would have too little. So that were the minimum fixed upon the standard of the large family, it might operate as an encouragement to idleness on one part of the community; and if it were fixed on the standard of a small family, those would not enjoy the benefit of it for whom it was intended. What measure then could be found to supply the deficit? Let us, said he, make relief, in cases where there are a number of children, a matter of right, and an

honour instead of a ground for opprobrium and contempt. This will make a large family a blessing, and not a curse; and thus will draw a proper line of distinction between those who are able to provide for themselves by their labour, and those who after having enriched their country with a number of children, have a claim upon its assistance for support' (Quoted in Schweinitz, 1961, p.73).

In this speech Pitt recognised that the benefits of children ultimately extended beyond their immediate family and marshalled arguments which have a familiar modern ring: the market determination of wages, ineffectiveness of the minimum wage for relieving poverty, the rights of individuals (and especially families) to social welfare, the importance of targeting social welfare and its possible disincentive effects.

The Speenhamland System of wage supplementation emerged from the debate over alternative ways of relieving poverty. The meeting at the Pelican Inn, Speenhamland on 6<sup>th</sup> May, 1795 was originally convened to fix a minimum wage after concern had been expressed at the General Quarter Sessions about the 'miserable state of the labourers and the necessity of increasing their wages to subsistence level, instead of leaving them to resort to the parish officer for support for their families' (Hammond and Hammond, 1947, p.138). However, the resolution proposing a minimum wage was not carried and what emerged from the meeting was, in modern parlance, a minimum income guarantee linked to the price of bread by a sliding scale. Thus, 'when the gallon loaf of second flour, weighing 8lbs. 11oz. shall cost 1 shilling, then every poor and industrious man shall have for his own support 3s weekly, either produced by his own or his family's labour or an allowance from the poor rates, and for the support of his wife and every other of his family 1s 6d. When the gallon loaf shall cost 1s 4d, then every poor and industrious man shall have 4s weekly for his own, and 1s 10d for the support of every other of his family' (Hammond and Hammond, 1947, pp. 159-160). Thus, the minimum weekly income was to rise or fall by 3d. for the man and 1d. for every

other member of his family with every 1d. increase or reduction in the price of a gallon loaf of bread, and any difference between this level and the weekly wage was to met from parish funds. The Speenhamland System was buttressed later in 1795 by an enabling amendment to the Poor Law which permitted His Majesty's justices to order relief 'to any industrious poor person or persons; and he, she, or they shall be entitled to ask and to receive such relief at his, her or their homes' (Hammond and Hammond, 1947 p.73).

Of the Speenhamland system Polanyi (1957) wrote:

'No measure was ever more universally popular. Parents were free of the care of their children, and children were no more dependant on their parents; employers could reduce wages at will and labourers were safe from hunger whether they were busy or slack; humanitarians applauded the measure as an act of mercy even though not of justice and the selfish consoled themselves with the thought that though it was merciful at least it was not liberal; and even the ratepayers were slow to realise what would happen to the rates which proclaimed the 'right to live' whether a man earned a living wage or not' (pp.79-80).

### *ii. Speenhamland in operation*

The Napoleonic War boom lasted until 1815 and as long as prices kept up, the full implications of Speenhamland remained hidden. The incomes of the poor were insulated from rising prices by the Speenhamland allowance, but this also served to keep wages down by checking demands for their increase. Therefore, although the working poor were to a degree protected against rising prices by the Speenhamland system, they failed to share in general prosperity which enriched those in receipt of profits, rent and tithes: capitalists, landlords and the Church of England parsons respectively. The ending of the war bought deep recession, with rapidly rising unemployment and falling prices and profits, although poor harvests kept food prices high. It was then that the full potential of Speenhamland for



generating poverty and destitution became apparent (Hobsbawn and Rude, 1993, Chapter 4).

In the Speenhamland era there were four ways by which able-bodied workers were aided outside the workhouse: the allowance in relief of wages (supplementation of wages by parish relief), the *roundsman* system, the *labour rate* and *public works*. Allowance in relief of wages was the application of the Speenhamland principal to those already in employment, and the other three applied to the unemployed who looked to the parish for help. The *roundsman* system included various ways whereby the parish provided workers to local employers and made up the difference between what the employer paid and a minimum income. An unemployed person could be sent round by the overseers to the households in the village to seek employment at terms which were supplemented from the rates. In other places, the parish acted as labour only contractors for whatever price they could get and the participants were paid out of the rates. Elsewhere, the hiring rate (and hence the make-up to the minimum income from the rates) was fixed at auction. The *labour rate* located the responsibility for creating work directly with the employers. The parish set the rate and parcelled out the unemployed to employers who were required either to find them jobs or pay higher taxes. *Public works* was a relatively rare means of creating employment. In 1832 barely 5% of relief expenditures was accounted for by make-work schemes, including road work and that in the workhouses (de Schweinitz, 1961, p.75).

An immediate effect of the Speenhamland System was to put upward pressure on the number on outdoor relief by throwing subsidised workers into competition with independent labourers, and forcing the latter onto parish relief. Workers with small amounts of property were also discriminated against. The administrative rules of the Poor Law made property owners ineligible for support so that those with only scraps of land could get neither relief nor compete for work with those in receipt of the Speenhamland allowance. The pressure was then on for them to qualify for relief by selling what they had. By

these processes the supply of labour increased relative to demand and this drove wages down. A Committee on the Agricultural Wages, chaired by Lord John Russell, reported in 1824 that wages in the North, where Speenhamland had not taken full hold, were substantially higher than in the South where wage supplementation was widespread (Hammond and Hammond, 1947, pp. 180-181).

Under the pressure of the widening coverage of in-work benefits, the related fall in wages and the resulting growing burden on the rates, the conditions for receipt of Parish Relief was continuously made more degrading, and allowances were reduced (Hobsbawn and Rude, 1993, Chapter 4). By 1830 the value of the minimum weekly income guarantee for a family of four had fallen to five gallon loaves from the seven and a half guaranteed by Speenhamland (Hammond and Hammond, 1947 pp.181-182<sup>1</sup>). The cumulative processes of falling wages and cuts in parish relief increasingly humiliated the labouring poor and condemned them to abject poverty, a plight from which they were powerless to escape. This, together with their loss of independence, was destructive of motivation, ambition and productivity.

The effect of the fall in wages was therefore to transform the wage supplementation into a direct subsidy to employers. They also became dependent on Parish Relief to make up the difference between what they paid their workers and what the latter needed to live on. Any employer that failed to take advantage of this subsidy was put at a competitive disadvantage in the product market, in much the same way that independent workers were in the labour market. However, any advantage of cheap labour to the employer was offset, at least in part, by the increased local poor rate they had to pay. This net advantage varied between employers to a degree determined by the rateable value of their properties compared with the size of their workforce. It therefore tended to favour large scale producers with many employees and discriminate against those who relied on their own and their family's labour. These advantages were increased by the political power exercised in the parishes by the large employers

and landowners. And, the system was further corrupted by its lay administrators who could turn the levying of the rate, the provision of relief and the allocation of the labour of the parish poor to their own and their friends' advantage.

For the workforce, and especially the rural workforce in arable farming areas, pauperism, degradation, desperation and discontent were universal and this fed the rise in crime and social unrest. From 1810 economic crimes, especially poaching, rose continuously except in years of better harvests when the plight of the poor was temporarily eased. Machine breaking and arson were more sporadic and coincided with times of deep distress, reaching a peak in the 1831 and 1832 with the rise in social unrest associated with the *Swing riots* (Hobsbawn and Rude, 1993).

The rising wave of crime and social unrest was met by increasingly Draconian responses in what can be regarded as a social *arms race*. As the plight of the poor worsened they resorted to more desperate means, to which the law responded by ever more savage measures. This reflected the feeling in governing circles that economic and social degradation had eroded the deterrent effects of judicial punishment. A view 'founded on the belief that as human wretchedness was increasing, there was a sort of law of Malthus, by which human endurance tended to outgrow the resources of repression' (Hammond and Hammond, Vol.I, 1947, p. 201).

There is general agreement that Speenhamland had the effect of economically and socially degrading the poor and adding to their increasing exclusion by widening the social distance between the haves and the have-nots. This was quite the opposite to its original intention:

The Speenhamland law which had sheltered rural England, and thereby the labouring population in general, from the full force of the market mechanism was eating into the marrow of society. By the time of its repeal huge masses of the labouring population resembled more the spectres

that might haunt a nightmare than human beings. But if the workers were physically dehumanised, the ruling classes were morally degraded. The traditional unity of a Christian society was giving place to a denial of responsibility on the part of the well-to-do for the conditions of their fellows. The Two Nations were taking shape. To the bewilderment of thinking minds, un-heard of wealth turned out to be inseparable from unheard-of poverty. Scholars proclaimed in unison that a science had been discovered which put the laws governing man's world beyond any doubt. It was at the behest of these laws that compassion was removed from the hearts, and a stoic determination to renounce human solidarity in the name of the greatest happiness for the greatest number gained the dignity of a secular religion (Polanyi, 1957, p102).

### **3. Political economy, politics, policy and the 1834 Poor Law Reforms**

The assault on the Speenhamland System came from political economists who theorised that it breached the natural laws of supply and demand. There were two sides to classical political economy's labour supply side theory and its explanation of poverty. From the late 17<sup>th</sup> Century, poverty was regarded by many European writers as a stick needed to get from the growing population of labourers the work necessary to make wealth productive (Geremek, 1994).<sup>2</sup> However, the pauperisation of the later 18<sup>th</sup> Century spawned an alternative theory, popularised by Townsend and systematised by Malthus. This had it that poverty resulted from population growth, driven by a lack of moral restraint on the part of the poor, pressing on the food supply. Food supply grew less rapidly than population because of the diminishing marginal productivity of land so ultimately starvation kept the labour supply in check. It was further supposed that the demand for labour was constrained by the *wage fund* - a fixed part of

aggregate capital set aside for the payment of wages – which meant that if employment was to rise wages would need to fall.

Therefore, according to classical political economy, what determined the well being of the mass of the population was the natural fertility of the soil, the willingness of the poor to work, their propensity to breed, the rate of accumulation of the capital and the fixed *wage fund*. These operated through supply and demand for labour determining the level of wages and employment.<sup>3</sup> Any attempt to interfere with these *natural laws* by, for example, attempting to alleviate poverty is countered by increasing population which absorbs any surplus and generalises the poverty. The fixing of a minimum wage above that determined by supply and demand reduces employment because the wage fund is fixed. Countering the resulting unemployment by job creation out of taxation (forced saving from the rich which effectively increased the wage fund) would only increase population and, if persisted in, ‘taxation for the support of the poor would engross the whole income of the country; the payers and the receivers would be melted down into one mass’ (Mill, 1909, p.364).

The Speenhamland system<sup>4</sup>, Mill argued, provided a wage subsidy at the expense of parish rate payers and this resulted in the system’s generalisation. By providing families with higher benefits than single people it offered a direct incentive to breed. But in addition to this, it was just another way of fixing a minimum wage ‘however numerous they (the workers) may be’ and it removed ‘positive and prudential obstacles to an unlimited increase’ (p.367). And, argued Mill, it had an additional absurdity; it reduced the wages paid by the employer by what it added in wages supplementation. The labourers, Mill argued, were habituated to living on the pre-allowance wage so that the effect of the allowance was to ‘people down’ (p.368) the wages paid by employers by increasing the supply of labour (through increasing the population or by mobilising surplus population trapped in workhouses). These labour supply effects were so strong that the wage plus allowance fell to below the wage level prior to Speenhamland. Mill summed up: ‘When the labourer depends solely

on wages, there is a virtual minimum. If wages fall below the lowest rate which will enable the population to be kept up, depopulation at least restores them to the lowest rate. But if the deficiency is to be made up by a forced contribution from all who have anything to give, wages may fall below starvation point; they may fall almost to zero' P.368.<sup>5</sup> Mill concluded 'All subsidies in aid of wages enable the labourer to do with less remuneration, and ultimately bring down the price of labour by the full amount, unless a change can be wrought in the ideas and requirements of the labouring class; an alteration in the relative values which they set upon the gratification of their instincts, and upon the increase of their comforts and the comforts of those connected with them' (p.369).

The *natural* laws of labour supply and demand resonated with the rising middle classes. The idea that poverty was caused by the poor and that relieving it threatened progress allowed a comforting sense of moral outrage and denial of responsibility. To the politician and administrator, '*laissez faire*' ensured law and order at a minimum cost and effort. 'Let the market be given charge of the poor, and things will look after themselves' (Polanyi, 1957, p117). Further, the idea that how things turned out depended on the degree of restraint exercised by the poor allowed the shifting of responsibility to those denied any political power.

The theories of classical political economy were quickly put into policy practice after the 1832 constitutional reforms had brought the middle classes to power. The work of the Poor Law Commission was directed by classical political economy and its findings were tailored to justify this theory's predictions. The Commission's report 'placed the burden of destitution upon the shoulders of the individual. Poverty was regarded as essentially an indicator of moral fault in the person requiring relief. He was held very little short of exclusively responsible for his condition' (de Schweinitz, 1961, p126). These findings were rushed into law. The 1834 Poor Law Act abolished wage subsidies but stopped short of abolishing all social welfare. Rather, a right to subsistence was retained but was 'only made

available on terms which made the recipient *less eligible* than the lowest paid person in the labour market and on conditions which were so restraining and humiliating as to be tolerable only to those in the most desperate need' (ibid). In effect, the poor lost any right to subsistence above the very meanest level and retained only the duty to work.<sup>6</sup>

#### **4. The refutation of the Classical 'iron law' of wages and the reconstruction of labour market theory**

Classical political economy united Malthus' population theory, notions of the *natural* indolence of the poor, Ricardo's theory of diminishing marginal productivity of land and the wage fund theory into what were conceived as natural and immutable laws of labour supply and demand which condemned the mass of the population to abject poverty. However events progressively weaken the empirical foundations of these laws and cast growing doubt on the 'Iron Law' of wages. The scourge of famine was lifted by technical progress in food production and transport which opened up new fertile land for cultivation. With this increased supply of food its price fell, real incomes rose but the predicted population explosion did not happen because family sizes fell. The decisive nail in the 'Iron Law's' demand side came with the refutation of the wage fund theory in the 1860s, which showed that the idea of an invariable fund for the payment of wages to be a nonsense.

The wage fund theory had constituted a powerful propaganda tool against wage fixing by law or by trade unions. 'On the authority of that doctrine, employers and their political spokesmen could argue that trade union action was not simply economic nonsense, but that it ran against the true interest of an ill-advised and ignorant workforce' (Biagini, 1987). Its refutation lifted the political economy objection to institutional wage determination and this played a part in the campaign by trade unions and their middle class supporters which eased many of the legal constraints on trade union activities in the 1870s. But this relief for working class organisation from the

strictures of political economy was short lived. The demise of the wage fund theory and the threat posed by Marx's exploitation theory of distribution<sup>7</sup> triggered the development, in the 1880s, of the *neo-classical* theory of wages.

This extended Ricardo's theory of diminishing marginal productivity of land to labour. But, whereas Ricardo's theory was based on the natural variability of the fertility of land, the restraint on the productivity of labour is technical. The increase in the employment of equally productive labour relative to the amount of capital causes the output per head to fall. If then, employers are to employ more labour profitably, wages must fall in proportion to the fall in labour productivity. This reconstitution of the demand for labour theory reinstated the primacy of the market in determining wages and employment. If the market is free there is no possibility of capitalist exploitation because excess profits will be competed away. At the same time, any worker can enter the market provided they are prepared to accept a wage equivalent to their marginal product. By this theoretical rejigging the central role of the market in ensuring the greatest happiness for the greatest number was reinstated.

The advantage of marginal productivity theory to economic orthodoxy is clear. It disposes of the thorny problem of income distribution between competing claimants by linking it to their contribution. However, it has little or no empirical support. In fact, "the pro-cyclical pattern of productivity movements has been solidly established in dozens of empirical studies" (Okun, 1981, p16), precisely the opposite to what is predicted by diminishing marginal productivity theory. This revealed tendency for labour productivity to rise as output and employment increases is readily explained by the fact that the level of efficiency of the operation of plant and machinery is higher the closer it is to technically and organisationally determined full capacity of operation. Any increase in output beyond full capacity requires investment in new equipment which can be expected to incorporate the latest techniques. This *embodied* technical change further enhances productivity and is more likely to come into



operation when demand and output are growing. This means, as the evidence implies, that there are increasing rather than diminishing returns to labour input so that the idea that wages must necessarily fall if employment falls, because of diminishing marginal productivity theory, has no more credibility than the wage fund doctrine. Nevertheless, despite this fatal weaknesses, neo-classical wage theory has retained its place as the orthodox explanation for how the labour market works.

This reconstitution of wage theory rehabilitated the conclusions of the wage fund theory, that wages need to fall if employment is to rise, with one major difference. Wages were now directly linked to the productivity of labour, which determines what employers can pay, and which declines as employment grows. Any institutional impediment to the downward movement of wages to this level creates unemployment as does any social welfare benefit which provides a credible alternative to wage income. Marginal productivity theory therefore under-scored the principle of less eligibility in the administration of social welfare and put *laissez faire* on a more 'scientific' basis. Unemployment and poverty could once again be blamed on trade unions, misguided charity givers, wrong-headed protective legislation and especially the poor and unemployed themselves.

This reassertion of key beliefs gave renewed vigour to the central idea of Victorian social policy that the solution to poverty depended on the individual effort of the poor. Their need was to follow the example of *liberal economic man* who 'is remarkable for his foresight and self-control'. But 'in the residuum (the mass of really poor families) these qualities are entirely absent' (Mrs Bosanquet, quoted in Briggs, 1961, p.21). The salvation of the poor therefore, required them to be 'turned into "liberal economic man", and once they were converted they would, of course, cease to be poor' (Briggs, 1961, p21).

The notion that the poor were responsible for their own plight was challenged by the research of Booth and, especially Rowntree, who

demonstrated that even with exemplary behaviour 10% of the poor of the population of York could not reach even the lowest possible subsistence level. This refutation of Malthusianism opened the way to the development of economic theories supportive of Rowntree's recommended solution to poverty: high wages, full employment and social security (Briggs, 1961)

## **5. The Keynesian revolution, involuntary unemployment and social citizenship**

The high levels of unemployment and poverty of the inter-war years cast increasing doubt on *laissez faire* and laid the foundation for a revolution in economic theory which was carried into policy practice by the social accord engendered by the Second World War. This ushered in a commitment by governments to full employment and the welfare state. This policy revolution was based on the Keynesian notion that unemployment is caused by too low effective demand, which can be countered by government intervention, supported by a political belief in *social citizenship*: that having a job, decent health provision, a good education and social protection is the right of all (Marshall, 1992).

Supported by the *grand accord*, Post-World War II Keynesianism combined progressive taxation with benefits designed to provide a minimum social wage. This served to reduce income inequalities and to prevent the marginalisation of those on low incomes. This redistributive tax-benefit system helped to underpin aggregate demand in the economy, and hence the achievement of full employment and higher economic growth. This, in turn, widened job opportunities and led to progressive labour market upgrading, especially amongst those hitherto deprived. (Tarling and Wilkinson, 1997). It was therefore not coincidental that the golden period of Keynesianism, from around 1950 to the early 1970s, witnessed historically high rates of economic growth and declining income disparities. However, the golden age of social citizenship underpinned

by rapid economic growth ended with the rapidly escalating prices and rising unemployment in the second half of the 1970s.

## **6. The neo-classical counter reformation and the return to mass poverty**

The response of the economic orthodoxy to this crisis was the abandonment of the core Keynesian belief that without intervention labour market could not be relied upon to guarantee full employment. This retreat to neo-liberalism rehabilitated marginal productivity theory of wages and its central proposition that if employment is to rise real wages (money wages deflated by product prices) need to fall. Unemployment, the neo-liberals reasserted, results from trade union wage pressure and restrictive practices, government labour market regulation and too high social welfare benefits. These labour market imperfections create a *natural*, non-zero level of unemployment and any attempt to lower it below this level merely crowds out existing employment or adds inflationary pressure. The state's contribution to full employment is therefore confined to prudent macro-economic management, deregulation to eliminate labour market imperfections and parsimony in the provision of out-of-work benefits

Neo-liberalism, which was progressively adopted as policy from the mid-1970s onward, predicts that monetary control will contain inflation, and that labour market deregulation combined with regressive tax and benefit reform will secure full employment. The expectation is that the more unequal redistribution of income and the freeing up of markets will dramatically improve economic performance, and that the benefits of this higher rate of growth will *trickle down* the income distribution, benefiting everyone. But, although the conditions for this *renaissance* were created, by cuts in the relative pay of the lowest paid, extensive deregulation of labour markets, the weakening of trade unions, cuts in of welfare benefits and reforms to make them more conditional on active job search, the promised improvements have failed to materialise (Wilkinson, 2000). Unemployment has remained high and relative poverty has increased

dramatically. Deindustrialisation and continuous downsizing by increasingly unregulated firms have eaten into the number of jobs in the middle range of incomes and therefore the job prospects of workers trapped in poorly paid jobs or in unemployment. The polarisation of economic opportunities has been exacerbated by the growth of jobs at both extremes of the earnings distribution. Meanwhile, productivity growth has slowed, the balance of payments on the current account has progressively worsened despite the benefits of North Sea oil, real interest rates have been forced up as borrowing abroad has been used to prevent a collapse of sterling, and manufacturing investment has shrunk as a proportion of GDP.

Despite these policy failures, the confidence that policy makers and their economic advisors have in the monetary control of inflation and market deregulation to improve economic performance has not wavered. Rather, the growth of poverty is explained by a deterioration in the quality and motivation of the poor because of the deskilling effects of unemployment, obsolescence of traditional skills, low levels of education, limited work experience and so on.

## **7. The case for wage subsidisation and wage supplements**

Neo-classical theory of the labour market has two core beliefs. Firstly, that left to itself the market will establish equitable pay and conditions of work in the sense that they will reflect the quality and quantity of the labour input of individuals. Secondly, providing workers are prepared to accept the wage on offer, and meet employers' skill and effort requirements, anyone can get a job who wants one. The wide dispersion of wages, some of which may be insufficient to sustain a reasonable standard of life, is a demonstration, neo-classical economists would argue, of how widely dispersed are individual capabilities (Hirsch and Addison, 1986). They attribute unemployment to a reluctance to work, unemployability because of poor labour quality, trades union bargaining and legally imposed minimum wages which raise wages above the market clearing level, labour market regulation which adds to labour costs and social welfare benefits

which, by raising out-of-work income, discourages labour market participation.

These core beliefs underlie the arguments for wage subsidisation. Labour market imperfection (social welfare benefits and institutional barriers to wage reductions) combined with poor skills and motivation has, it is argued opened a gap between the supply price of labour, based on the income needs of the poor, and the demand price of labour, based on their low marginal productivity. A longer-term solution may be to raise productivity by education and training, and to inculcate an improved work ethics. But a shorter term solution is to either pay a wage supplement to workers to bridge the gap between their income needs and their marginal productivity, or a wage subsidy to employers to lower the cost of wages demanded to the level of the marginal productivity of perspective employees.

Even if marginal productivity theory were a valid explanation of the determinants of employers' demand for labour, unless wage subsidies are carefully targeted at supply side imperfections they may introduce imperfections of their own. For example, if low pay results from a demand side imperfection (e.g. *monopsony* [employer buyer power]), a wage subsidy/wage supplement will compound the imperfections by further lowering the price of labour below its marginal productivity. In this case, the appropriate action is to raise wages by establishing minimum a wage or the encouragement of the countervailing power of trade unions. Moreover, if unemployment is involuntary, subsidisation risks merely replacing those currently in employment rather than creating new job opportunities. Serious doubts can therefore be entertained about the validity of the neo-classical case for wage subsidisation. There is clearly no overwhelming theoretical reason for supposing that high levels of unemployment and in-work poverty can be readily countered by topping-up wages for workers or marking-down costs for employers - a conclusion supported by the evidence of considerable dead weight effects and labour market *churning* associated with such policy interventions. And, once neo-

classical theory is left behind the objections to wage subsidisation become fundamental.

## **8. The alternative perspective**

There is something profoundly pessimistic about the idea that the ills of an economic system can be explained largely by the quality and motivation of an *underclass* comprised of the poorest of the population. This is particularly so because this *residuum* apparently disappeared between the 1930s and the 1970s only to reappear in the 1980s. What can possibly explain this social improvement followed so quickly by the social degeneration? The explanation can be found not in the phenomenon itself but in how the phenomenon has been theorised and portrayed. What is particularly instructive in this respect is that Keynes, as he formulated his theory of unemployment, progressed from neo-Malthusianism to *involuntary* joblessness as the explanation for poverty (Toye, 1997). The return journey to theories of voluntary unemployment and unemployability involves a regression to neo-Malthusianism. This U-turn is explained by the renewed belief in the efficacy of markets. If it is to be taken to be self evident that providing individuals are prepared to accept market judgement on their value, labour markets clear, it becomes convenient to identify the *imperfections* of individuals as the reason for non-market clearing and income inadequacy.

But there is clearly nothing ‘natural’ or inevitable about the allocation of income and resources arrived at through the play of market forces. There is no such thing as a ‘free’ labour market, and the idea that market equilibrium can be restored through deregulation is an illusion. The roots of social and economic disadvantage are found not in the differing capacities of individuals, but in the way markets work. In particular, relationships in the labour market are permeated by inequalities of bargaining power, structural barriers to mobility and by institutionalised discrimination, which together lead to the systemic *undervaluation* of the labour of disadvantaged groups, the value of whose work is not socially recognised. Whether or not there is an

‘ideally’ efficient free labour market system which can be theoretically modelled is of little relevance to the formulation of policy in a world where the distribution of income and economic opportunities is largely determined by power relationships and institutional forces.

From this alternative perspective the events of the 1980s and 1990s are easily interpreted. The change in policy in the late 1970s shifted the balance of power against the weakest in society and intensified their exploitation, triggering a downward economic and social spiral. Far from becoming welfare dependent by some unspecified social process, an increasing number of people have been forced into poverty and away from self-sufficiency as a consequence of the undermining of the job market and a progressive erosion of employment and social rights.

In the neo-classical story, wage subsidies and wage supplements benefit society by counteracting labour market imperfections, but they increase the imperfections of labour market which are deeply segmented. In such labour markets, the freedom afforded to women, ethnic minorities, older workers and others who are socially and economically disadvantaged and who lack bargaining power is the freedom to be discriminated against and to be exploited. As a result, they are employed at wages well below their value<sup>8</sup>. In effect, these labour market imperfections already provide subsidies which keep inefficient firms in business, add to the profits and stock market valuations of some of the largest firms, keep the prices of consumer goods and services down and allow essential public services to be supplied on the cheap to the benefit of the tax payer. Wage supplements risk adding to this hidden levy and its redistributive consequences if, as seems likely, the weak bargaining power of the lowest pay fails to prevent the wage top-ups being passed on in lower wages and forward into higher profits and lower prices.

The Speenhamland experiment is instructive of the risks involved in subsidising wages in segmented labour markets. The Settlement Laws

divided the parish labour forces into non-competing groups and this was reinforced by declining employment in arable farming throughout South and East. Long distance migration was needed to secure alternative work and this was impeded by the risk of loss of relief in their parish of settlement and the possibility of their forcible repatriation back from the parishes of destination. In the industrialising north, Speenhamland had little impact because demand for labour pressed hard on supply and, despite the illegality of combination, workers were better organised (as they showed later when they resisted the workhouse). In these areas, lower levels of unemployment and more dynamic labour markets meant higher wages and less need for parish relief. In a similar way, until 1815, when the Napoleonic War boom finally broke, high demand for labour, even in the arable farming areas, prevented the full springing of the Speenhamland trap. However, the allowance system had “taken away the labourer’s safest guarantee, a living wage, and substituted the much weaker one of a minimum family income for paupers” (Hobsbawn and Rude, 1993, p.72). After 1815, the pernicious effects of subsidising undervalued labour became only too apparent. The excess supply of labour drove wages down and the cost of wage supplementation and the resulting pressure on the rates led to a cut in allowances and the attachment of more humiliating conditions for eligibility.

The response to this coincidence of growing social and economic degradation and the rising fiscal costs of its increasingly inadequate relief, was to hold the victims responsible for their own poverty and to use this argument to support policies to cut the cost of social welfare. As a consequence, the 1834 Poor Law reforms threw the poor on to the mercies of the *free* labour market, an act which completed the emerging class structuring of British society. The social effects of the dramatic events of the early 19<sup>th</sup> were only slowly ameliorated as the political and economic power imbalance in favour of capital was gradually redressed by the political and industrial organisation of labour and as empirical research and development in social and economic thought undermined the theoretical basis of *laissez faire*.



This progress has been reversed over the past 30 years with the neo-liberal revival and there are important parallels between these events and the unfolding of the Speenhamland catastrophe. Since the late 1970s the labour market has been progressively restructured with an increasing polarisation of job opportunities, earnings and wealth. This growing divide is widened by the high levels of unemployment, economic decline and growing poverty in the old industrial areas and inner-cities where the poor are trapped by the multiple disadvantages which include the high costs of mobility imposed by regional house price disparities and other costs of relocation. Meanwhile, the reforms of social welfare away from universal rights towards means testing and the greater coercion of the unemployed have progressively stripped the poor of their social citizen right, rendered them *less eligible* and caught them in poverty and employment traps. These symptoms of increasing market segmentation have been partially disguised by periodic economic up-swings which have done nothing to address the underlying problems. As a result, poverty and denial of economic and social opportunity were more entrenched in the early 1990s than the 1980s, and there can be no expectation that the next recession will have any different effects.

The slippery slope towards Speenhamland has been greased by sociological theories of the *underclass* and economic theories which exalt the market and warn against pampering the poor. The immutable economic laws and utopian visions of monetarists and free marketeers serve to mystify the underlying problems and provide politicians with the justification for concentrating the cost of economic crisis on the *have-nots* whilst salving the conscience of the *haves* by reassuring them that although the income distribution is unequal, it is efficient. The twin neo-liberal notion that higher incomes are required to motivate the rich whilst lower wages *and* cuts in out-of-work benefits and lower wages are needed to motivate the poor have been used to justify a more unequal distribution of income and cuts in taxes on high incomes. The adoption of these views as the conventional economic wisdom has lifted responsibility for unemployment and

poverty from the government and shifted it on to the jobless and the poor themselves.

The idea that a more unequal distribution of income is superior on efficiency grounds also forms the basis for an opportunistic alliance between vote-seeking political parties offering tax cuts and market deregulation, and the rent-seeking contented classes, who stand to benefit from the tax cuts, the availability of low paid labour and the opportunities for profits created by deregulation (Galbraith, 1992). Four reinforcing processes have strengthened this alliance. First, the victims of the downward economic and social spiral triggered by neo-liberalism have become increasingly alienated from the ‘democratic’ process, so that political exclusion has been added to economic and social exclusion. Second, this political exclusion has been progressively reinforced as political parties of the Left have abandoned their traditional loyalty to the poorest in society and embraced the new economic and social orthodoxy to compete for the so-called political centre ground. Third, the growing problems of long-term unemployment, poverty, crime and social dislocation over the past two decades have increasingly polarised society and the contented classes have found themselves more and more threatened by the *dangerous classes*. Fourth, those promoting the conventional economic wisdom to policy practitioners have continued to justify their failed predictions by developing theories explaining unemployment, under-employment and poverty in terms of labour market imperfections, welfare state dependency and the low quality and poor motivation of the unemployed, the under-employed and the working poor. By doing so they have raised the possibility of denial of social citizenship on the grounds of economic unworthiness and provided continued justification for socially and economically damaging policies by the age-old expedient of blaming the victim (Ryan, 1971).

The apparent failure of the poor to respond to incentives and stimuli in the way predicted has led to greater insistence on the need to impose on them a duty to work. Experimentation with attaching a

work test to welfare provision has shown signs of success and is encouraging pressure for its extension. But the job creating capabilities of these new measures are greatest in the South where conditions in the labour markets are now approaching full employment, and much less so in the old industrial regions and the depressed inner-city areas where unemployment remains high. (Peck, 2001) It is here where the risks of the Speenhamland effects are greatest and where the compulsion to worked sugared by wage supplementation are most likely to trigger a downward spiral of pay and an upward spiral of the cost of welfare. But these effects are likely to become much more widespread as wage supplementation programmes are extended and the economy slips into recession.

The risk of the Speenhamland Effect being triggered is greater: (1) the more closely social welfare benefits are dependent on labour market activity; (2) the weaker is the bargaining power of the recipients of social welfare in the labour market and therefore the greater the chances are that social welfare will enter into competition and drive down wages; and, (3) the higher is the level of unemployment and therefore the greater the possibility that workers with subsidised wage will be substituted for those without. The answer to (1) lies in the design of tax and benefit systems. The answer to (2) lies in providing greater protection for workers in low paid labour markets by effective trade union representation, legal minimum wages and other form of legal protection. The answer to (3) lies in full employment macro-economic policies. There is no doubt that training has a part to play, particularly for workers in need of rehabilitation after years of unemployment, harassment by government agencies and make-work experimentation. But without a redesign of the tax and benefit systems, effective labour standards and full-employment, subsidised training is as likely to enter into the competitive process as any other form of subsidisation.

If wage supplementation is generalised, if there is the expected recession and if the Speenhamland trap is sprung with all its disastrous consequences, what then? The workhouse?

## Notes

- <sup>1</sup> See also Hobsbawn and Rude, 1993, p.76-77
- <sup>2</sup> Bellers, a Quaker and early advocate of co-operative production, argued that an abundance of labour was needed to make wealth productive: ‘The labour of the poor being the mines of the rich’ (Bellers. 1696, quoted in Polanyi, 1957, p105). Soon after Mandeville from a less sympathetic perspective added: ‘All men are more prone to Ease and Plenty than they are to Labour, when they are not prompted to it by Pride and Avarice, and those that get their Living by their daily labour, are seldom powerfully influenced by either: So that they have nothing to stir them up to be serviceable but their wants, which it is prudent to relieve, but folly to cure. The only thing then that can render the labouring man industrious, is a moderate quantity of Money, for as too little will, according as his temper is, either dispirit or make him desperate, so too much will make him Insolent and Lazy’. (Mandeville, 1970, pp. 209-210)
- <sup>3</sup> For a coherent statement of how these interacted, see Mill, (1909), Chapter XII.
- <sup>4</sup> Described by Mill as: “Sentiments of humanity, joined with the idea then inculcated in high quarters, that people ought not to be allowed to suffer for having enriched their country with the multitude of inhabitants, induced the magistrates of the rural districts to commence giving parish relief to persons already in private employment” (1909, p.367).
- <sup>5</sup> Mill went on to argue that providing the poor with allotments to grow their own food had an effect analogous to that of Speenhamland. Allotments had the beneficial effect of increasing production and allowing the poor to improve their position by their own effort. But their effects on wages and population was precisely the same as Speenhamland: population

increased and wages fell. “The only difference in favour of allotments would have been, that they make the people grow their own poor rate” (Mill, 1909, p.370).

- 6 Polanyi argued that: ‘The abolition of Speenhamland was the true birthday of the modern working class, whose immediate self-interest destined them to become the protectors of society against the intrinsic dangers of the machine civilisation. But whatever the future held for them, working class and market economy appeared in history together. The hatred of public relief, the distrust of state action, the insistence of respectability and self reliance, remained for generations characteristics of the British workers’ (1957, p.101).
- 7 Bohm-Bawerk, one of the pioneers of the marginal productivity theory of wages, said that the Marxist theory of distribution constituted ‘the focal point about which attack and defence rally in the war in which the issue is the system under which human society shall be organised’ (Campus, 1987, p.320).
- 8 For example, detailed studies show that only 25% of the difference between male and female earnings is explained by difference in skill, while 75% is accounted for by lower pay for the same level of skill. For detailed analysis of the male/female wage differentials see Lissenburgh (1995). See also Sachdev and Wilkinson, (1998).

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