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**ECON 420: Development of Economic Thought**

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Income Distribution

The concept of money had changed the way civilizations engaged in trade. Moving away from the barter system using goods, money became a medium of making exchanges, a storage of value, units of account, and standard of deferred payment. Labor was then compensated with money instead of indenture or compensation of physical goods; laborers and employed personnel now had an income. Work is theoretically rewarded with income based on its value generated, and through different eras economists had formulated different ideas on income should be distributed fairly. These schools of economic thought stemmed from their historical context and how income distribution is viewed is based on the economic climate of the time. Through all the eras of economic thought, it is apparent that what is seen as fair in terms of value of work is disputed but people need the subsistence minimum to be able to live and support such ideas.

Classical writers such as Adam Smith, David Ricardo, Malthus, and Mill came from a time when economics was laying its foundations out of mercantilism and physiocracy. Subsequently, they were the foundation of modern economic views of income distribution. Ricardo believed in a functional distribution of income based on his notion of relative values for exchange. This means that relative values of goods are determined by relative quantities of labor involved in the goods production. Income would then be distributed based on amount of work which in this model would drive up the value of goods. However, Wages and Profits are then in an inverse relationship where wages going up would drive down profit. The exchange value of the good itself, based on quantity, would not be affected. Over time the theory of value is modified but Ricardo’s functional distribution of income continues to be something sought after as a fair method of income distribution. During the classical era, Thomas Malthus sought to address income inequality by blaming. He explains that population grows at a geometric rate while resources and income grow at an arithmetic rate. This was when he devised Preventive and Positive checks. Preventive checks are anything that reduced birth rates like abstinence and Positive checks are things that increased death rate like famine and plague. Malthus did not believe that higher wages would be a solution as it would lead to more children and bring wages back to subsistence level. He was against Poor laws and government welfare provisions that provided for people in poverty because that would only lead to a larger population that drains the income pool. Adam Smith, one of the most notable philosopher economists of the time, disagreed with Malthus and saw higher wages as beneficial. He asserted the idea that people need subsistence wages to live and higher efficiency wages would be based on performance. For these ideas, Smith was named the father of Economics. Stuart Mill also agreed with Smith from this time and saw workers benefitting from economic growth. Smith and Ricardo were Classical economists that diverged from Malthus and Ricardo who saw wages staying at subsistence levels with economic growth. Mill also saw a Diminshing Returns of Labor which contradicted the Ricardian model of labor determining value while also philosophically devising Utilitarianism, the greatest net good for the greatest number of people.

Income distribution was not always reliant on value in other schools of thought. Utopian socialists sought to base income solely based on labor, particularly the equal welfare of laborers individually. Karl Marx was a heavy critique of industrialization during his context of history. He termed his Marxian Theory of Exploitation where the capitalists would maximize profits at the expense of workers. He did not believe such distribution of income would be tolerated for long and this unsustainable income gap would lead to a worker class revolt towards socialism where everyone is paid the same amount. This method of income distribution was adopted most notably with the Soviet Union and its socialist influenced states as an appealing solution for the working class. However, this idea had failed in real world context as the quality of work and its value generated is severely overlooked. Furthermore, Marx did not predict capitalism generating worker unions and institutions within capitalist systems for social welfare like minimum wage laws and social programs to offset its systematic exploits. He also saw capital as a substitute for labor in production where more capital would equal less labor and wages for the population. Marx did not see that capital will be complements in production where more capital can be a complement for workers to be more productive which increases Gross Domestic Product and social welfare.

It was in the era of Marginalists and Monetarists succeeding Classical economics that value and income were more comprehensively modeled. John Bates Clark contributed his idea of Marginal Productivity Theory to economics where the hire of one additional unit of labor would contribute to additional output. Robinson advocated for welfare public policy like minimum wage and encouraged collective bargaining by unions for higher wages. He also warned against Monopsony power where a single firm that dominates an industry can control demand to pay lower wages than if there were more competitive firms. Neoclassical economists further added onto Classical notions of income distribution to explain social benefits of paying labor the right amount of wage for the value it generates.

As economics passed through different eras in history, so did social and economic situations. By the time of Institutionalists like Veblen and Galbraith, society at the time had seen prosperity and what it can do to obscure economic theory. Veblen, being immersed in a time when the purpose and necessity of banks and institutions was made apparent, developed his Theory of Leisure Class. He saw the wealth amassed by capitalists being funneled into “conspicuous consumption” where people would consume goods to be able to display income and wealth. This implied that Veblen goods contained a certain value to consuming those certain types of goods. People would be involved in “keeping up with the Jones” and obtained goods solely based on its price to show that they were just as well off as anybody else. This society of leisure class made possible an upsloping demand curve where something with higher price is more valuable. Galbraith further confirmed Veblen’s observations through his book “The Affluent Society.” In his book Galbraith divided the economy into the market sector and planned sector with stockholders answering to a board of directors which feeds its critique into firm Management to seek greater profits, unequally distributing income based on position instead of labor. Much like Institutionalists, the Chicago school also came from observations of much more contemporary issues in today’s economic and social context. Becker from the Chicago school coined his Theory of Discrimination where employers would have a taste for discrimination against a certain demographic like women employees which causes their wages to be lower for them even though they are equally as productive. This meant that income would no longer be based on labor and value but also on other independent variables like discrimination and social stature.

Over the course of four centuries, the issue of income inequality had been observed and attempted to be resolved through various historical contexts. Nonetheless, its understanding and foundation was built upon Classical economics with each succeeding school either antagonistically challenging or building upon it. To this day, Classical economists and its neoclassical successors have their economic roots embedded in what is seen to some as the fair way to distribute income. A subsistence level of wages must be met, and productivity is encouraged through efficiency wages. Income should be functionally distributed based on merit and amount of labor, and excessive wealth accumulation would lead to luxury and Veblen goods being sought after. Additional labor would naturally add to a marginal output leading to economies of scale, and minimum wages should be enforced especially when an industry has less competition like in a Monopsony. It is ideal that income is distributed on such fair basis, but the capitalist system today has its outliers of extreme affluence and severe poverty. This would in the future see more reform and proposition for solution in economic thought.

Works Cited

Brue, Stanley L., and Randy R. Grant. *The Evolution of Economic Thought.* South-Western, 2013.