THE GEORGE BOOLE FOUNDATION LIMITED

Strategic Review
SEEL-Systems Engineering Economics Lab

Living Income

For some 30 years economies have struggled to maintain the advance in real incomes.

Constituent wages as a proportion of national production has fallen while the proportion contributed by profits has risen.

The real growth and more equitable distribution of incomes achieved in advanced economies in the period 1945 through to 1975 has been replaced by a period of increasing income disparity.

Although globally millions have been elevated from poverty, today investment and productivity are falling and slowing up this vital process.

Accumulating evidence points to inappropriate macroeconomic policies as a cause of this decline.

There is increasing reference to “Living Income” as an essential basic reference for what can be considered to be a minimum necessary level of disposable income.

This discussion, in previous times, was more related to development economics and lower income community and country development initiatives. Now, it has become a central issue in discussions on alternative economic policies in high income countries. This is because of the trends in the decline in the purchasing power of the currency and therefore an increasing inability of the lowest income segments to purchase their essential needs.

In the cases of low and high-income countries, a relevant domain of economic analysis on this topic is the Real Incomes Approach to economics. This approach is also referred to as RIO-Real incomes objective.

Unlike conventional economic analysis that applies the Aggregate Demand Model (ADM), RIO is based on the Production, Accessibility & Consumption Model (PACM). The “accessibility” components refer to the essential need for:

- access to reliable information on product quality characteristics
- accessible unit prices
- continued access to sustainable supplies

In essence, living income relates mainly to the accessibility of unit prices in relation to disposable real incomes.

Inflation

When it comes to low income economic units and the ways owners support their families by being able to afford their basic needs, there is a need to analyse, not only the variation in the prices of their essential needs, but to also account for the variation in the prices of the inputs to their business activity, since changes here will determine the capacity of their livelihood to support, at least, a minimum living income.

It is notable that most discussions on Living Incomes, in the context of low-income rural communities and small farmers, seem to omit consideration of this reality. Corrections for inflation tend to limit consideration to consumer price items but not business input price inflation. Therefore, the insistence on the need to maintain the minimum living income as an objective, becomes disassociated from the means of earning enough to support the level of income necessary.

So far, the way living incomes are adjusted to allow for inflation is to apply the Consumer Price Index (CPI) which is an “average” consumer basket adjusted to actual proportions of purchased items in the economy. However, this includes by default, the whole population of high and low-income constituents. Because, for example, food items constitute a higher proportion of expenditures on low income families and also the makeup of their “basket” contains lower-priced and poorer quality items (in relation to health and nutrition) it is readily apparent that the CPI estimate of inflation, as it relates to low income groups, is likely to be unrepresentative. The lack of logistic infrastructures can result in many low-income rural communities paying higher prices for certain food items which further undermines the applicability of the CPI.

There is, unfortunately, a tendency for governments to weight CPI formulae and the content of the consumer item “basket” content, to lower estimates of inflation making the use of the CPI for handling adjustments for “cost of living” somewhat arbitrary.

Better standards

The use of Food Balance Sheets that relate to nutritional content of foods and detailed household survey data is the best basis for estimating the purchasing power of available income from all sources. Many low-income agricultural families carry out a variety of other occupations such as charcoal burning and ad hoc employment to maintain their incomes, all of which need to be analysed. However, the “terms of trade” are also an important measure in any year and this measures the relative movements in input prices to the economic activity against the movement in unit sales prices of their output. Here, in terms of inputs there tend to be a constant inflationary pressure whereas on the side of farm gate prices, prices can vary up or down by a factor of 2.

Therefore, the reality is that living incomes, in order to become a viable means of ensuring people have a basic minimum purchasing power to satisfy basic needs for survival, needs to be based on a more realistic set of assumptions that are supported by methodologies that can secure a sustainable and a less precarious state of affairs.

Using the immediate evidence-base is more reliable

Once the effort to collect a data set on the circumstances of an economic unit’s inputs and prices, output unit prices and resulting feasible income have been collected, the most reliable basis for adjusting income is to repeat the data collection each year with the same economic units and families making use of a standardised data set and not rely on “official figures” and such indicators as the CPI.

By repeating this exercise data collectors become more acquainted with the finer details of the reality facing such families and this can result in a refinement of data sets and collection methods. To achieve such granularity and relevance by relying on “official statistics” as “alternative sources” of information is an exercise of doubtful validity.

Towards a more viable basis for living incomes

For many years, a source of inflation has been the implementation of the monetary policy target of an inflation rate of 2% as being equivalent to “price stability”. This is the equivalent to a currency devaluation of 18% each decade, which for lower income groups is somewhat disastrous. However, the development work under RIO provided evidence in 1976[1] that the monetary policy instruments of money supply and interest rates do not control inflation directly as the Quantity Theory of Money (QTM) predicts. Indeed, John Maynard Keynes was of the same opinion.

Proof of this came with the introduction of quantitative easing (QE) after the 2008 financial crisis. QE has been in operation for over a decade while in Japan it has been in operation for over 30 years. Low interest rates and a significant rise in money volumes, based on debt, have resulted in falling demand, investment and productivity. RIO explained this policy failure[2] by analysing the monetarist's QTM identity, pointing out that basic equation does not include two of the most important variables of "savings" or "assets" which are non-circulating components of money supply. Therefore, the flow of money into assets such as land, real estate, precious metals, corporate shares and offshore accounts has drained the real or supply side economy of circulating funds thereby reducing any ability to invest and pay higher real incomes.

Because macroeconomic policies continue to promote the ADM based on the QTM to this day we will see continued instability under an ever-increasing reliance on QE.

This has fundamental implications of those who wish to support the concept of a living income; it is a valid concept. However, at the moment, relying on own efforts to collect the relevant information on an annual basis so as to introduce realistic adjustments, even on the basis of stratified sampling techniques to lower costs, is likely to be too onerous for most NGOs or volunteer groups.

There is a need for a major re-alignment of macroeconomic policies towards RIO, that is, making real incomes the macroeconomic policy objective, so that a general rise in real incomes can help initiate a transition within which NGOs will be able to afford to collect data on an annual basis. And with sustainable growth help remove the needs for a large segment of the world's population to be so reliant on the concept of the need for a minimum living income.

Until macroeconomic policies are reoriented towards making real incomes the objective of policy, it is unlikely that living incomes can be implemented with ease. Indeed, macroeconomic policies need to be reoriented to stimulating real incomes to such an extent as to remove the need for the living income concept being a matter of concern.

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[1] McNeill, H. W., "*The Real Incomes Approach*", Rio de Janeiro, 1976.
[2] McNeill, H. W., "*A Real Money Theory*", Charter House Essays in Political Economy, HPC, July, 2020.