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Equity

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Equity is a big word and a vague concept, and you may wonder what business have I, as an economist, to speak on such a topic. Economists usually pride themselves on being more down-to-earth, more rigorous, more scientific than most other social scientists; why then should an economist choose so nebulous a topic to discuss with his fellow economists?

My reasons are the following. An important part of the economist's task is to find out how well the production and distribution of goods and services conform to the public's wishes. The first thing to ascertain in this connection is what the public's wishes are. In the realm of private goods, economists have succeeded fairly well in doing this. The main function of the theory of consumers' demand is to deduce from consumers' market behavior what their preferences are; we have even renamed it the theory of revealed preference to remind ourselves and our students of this fact. But while a lot of theoretical speculation and empirical work has been devoted to the private sector of the economy, the public sector is very much neglected. Some economists are ideologically opposed even to the very existence of a public sector; and they, of course, have a fine excuse for not dealing with the subject. The rest of us have no such excuse. Collective goods, provided and paid for through the public sector are increasing in importance; but economists have done very little work on the subject, although there are plenty of problems, plenty of work to be done. It would be desirable to develop some machinery for ascertaining what the public's preferences are concerning collective goods, machinery for making these preferences known to those who decide on public expenditures, machinery to assure efficiency, adequate resource allocation, and the minimization of costs in the public sector. I believe that some of the most urgent and most important work of the economist lies in this field.

It would be desirable to know something about the public's preferences concerning the distribution of income and wealth -- a collective good similar in essentials to such other collective goods as public transportation, state parks and national defense. All collective goods have a common feature that distinguishes them from private goods and consists in their inability to accommodate personal differences in tastes. In the realm of private goods, the market enables one man to drink whiskey while another drinks tea, but collective goods do not and cannot cater to personal idiosyncrasies. Your national defense is my national defense; your public transportation is also my public transportation. Existing bus routes and schedules may favor your special needs more than they favor mine; but we share the same transportation system and there is no way of catering simultaneously to my preference and your distaste for buses.

The same way with distribution. Some people are in more fortunate financial circumstances than others; but we share the same degree of inequality of distribution and the same principles on which income and wealth are distributed. If the system of distribution is to conform to the public's preferences, it must conform to a consensus or to a compromise between different preferences. I propose to examine the nature of this consensus, or compromise, or mixture of consensus and compromise, and chose the title equity because it seems to stand for some minimum degree of equality people would like to see realized and on the nature of which they might be able to agree.

It is no accident that the English word equity comes from equus, Latin for equal. By equity people mean, if not equality, at least something that approximates it closely enough to satisfy them. The public is satisfied with something short of equality, partly perhaps because it is resigned to this being an imperfect world, and partly also because it recognizes the impracticability of perfect equality. The latter is unattainable as long as we need to provide economic incentive to produce the national product. Most of us believe that economic incentives are superior to most other incentives, such as coercion, or social pressure, or the threat of physical punishment; and society needs some incentive as long as the national product it wants is greater than what can be produced with the amount and kind of work the public regards and performs as play. While this has always been so, it need not remain so if automation goes very much further. Karl Marx's motto for communism: "From each according to his abilities, to each according to his needs" could describe a future economy of plenty, in which a puritanical limitation and satiability of wants coincides with so great an increase in the productive efficiency of work that the setting-up exercises of society, the tinkering of hobbyists with science, and the social services supplied by the young matrons of the junior league would be the only human inputs needed in an otherwise fully automated economy.

For the time being, we are far removed from such an economy; and with all the effort devoted to the creation of new wants we may never reach it. We still need incentive to get the national product produced, most of us prefer economic to other incentives, and economic inequality is the price of having an economic incentive.

When the economist realizes that inequality is the price of obtaining the national product, he instinctively asks: how huch national product for how much inequality? Is there an optimum point at which the marginal increment of national product just equals the marginal increment of inequality? The answer, for the time being, is no. We do not even know as yet whether, and if so by how much, progressive taxation lowers incentive; even less do we know the price of a dollar's worth of national product in terms of inequality; and, as I have argued, we have yet to devise machinery whereby consumers or citizens could express their preferences between a small addition to income and a slight easing of conscience over the inequality of man.

For the time being, all one can do is to guess at the public's feelings concerning equity. Differences of degree are obviously important here. The public will resent inequalities of income and wealth that are too great; and while it is hard to find the dividing line between what is and what is not too great, one can say something about the factors that determine the location of this dividing line. For one thing, society is more likely to tolerate inequalities if these are correlated with merit or people's contribution to society and its values. For another, inequalities are more acceptable to a person who feels that he has equal chances with others of reaching the top. Hence people's strong feeling against discrimination, the provision of free education in our society, and John Stuart Mill's advocacy of confiscatory (100 percent) inheritance taxes. A third factor is the well-being of those at the bottom of the ladder. The public will the more easily tolerate inequalities, the better-off are those least favored, the more nearly they are assured of subsistence and provided with the necessities of life. In the following, I shall concentrate on this last factor and neglect the first two, discussing only the relation between equity and the distribution of the necessities of life. Indeed, to simplify the argument, I shall not only hold constant the first two factors but pretend they are not there. In other words, I shall pretend that equity (that is, the acceptance as equitable of a given distribution of income and wealth) depends solely on the availability and distribution of the necessities of life -- admittedly an over-simplification but a useful one./

/ The argument of this paragraph owes much to comments of my friends, Professors R. Radner and H. Leibenstein.

In this connection it is helpful first of all to ascertain how goods and services are actually distributed under the market mechanism. The distribution of income and wealth determines the consumer's share in the consumable national product; his freedom of choice enables him to obtain his share in that combination of goods and services which gives him the greatest satisfaction. In other words, the market distributes goods and services in accordance partly with people's tastes and needs, partly with the distribution of purchasing power among them. It follows that if everybody's purchasing powers were equal, the distribution of each commodity would be egalitarian, by which I mean equal except for differences in tastes and needs; but it does not follow that if people's tastes and needs were identical, each commodity would be distributed uniformly with the distribution of purchasing power. For man's need of necessities is biologically limited and therefore much sooner and more abruptly saturated than his demand for luxuries. An unequal distribution of purchasing power therefore causes different commodities to be distributed very differently, ranging from the egalitarian or near-egalitarian distribution of the cheaper necessities to a distribution of the more expensive luxuries that is likely to be much more unequal than the distribution of income and wealth. The distribution of the cheaper forms of food is virtually egalitarian in a rich country like the United States; and the distribution of most necessities is much less unequal than the distribution of income and wealth. Similarly, the amounts spent on necessities by the rich and by the poor also differ less than the income and wealth available to them; and this implies that what they have left over to save, and to spend on luxuries, must differ by more.

We are now ready to attempt a tentative definition of equity. Public opinion seems to be very much concerned with the distribution of necessities; and the first dictate of people's consciences is that the prime necessities of life should be generally available and distributed in an egalitarian way. Even great inequalities of income and wealth will not be considered oppressive as long as necessities are cheap and plentiful enough to be generally available; whereas slight inequalities of income may be considered unjust if one or more necessities are short -- that is, scarce and expensive enough to become the privilege of the well-to-do. Different people's lists of necessities differ, of course, in both length and composition; but bearing these differences in mind, one can say that most people consider equitable an economic system or economic organization that leads to an egalitarian or near-egalitarian distribution of the necessities of life. / Once this definition is accepted, one can distinguish degrees

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/ This is admittedly a partial and incomplete definition, as pointed out in the last-but-one paragraph.

of equity according to the number of necessities distributed in an egalitarian way; and one can define social progress or progress in equity as an increase in the number of necessities available to all on an egalitarian basis.

These definitions of equity and social progress have a number of interesting implications. To begin with, one must note the absence of any simple one-to-one correspondence between the degree of equity and the inequality of distribution of income and wealth. Given the total income of an economy and given the relative scarities of different resources and commodities, equity will increase with a lessening of the inequalities of income or wealth; but there are other ways of increasing equity too. For example, given an unchanging distribution of income and wealth, equity will usually increase with a rise in per-capita income. Indeed, this latter is probably the main source of social progress in our society. Inequalities of income and wealth are probably no greater in the countries of Southern Europe than they are in the United States; and if in those countries inequities between the well-fed rich and the starving poor seem greater than in the United States, this is mainly due to the fact that the same inequality of income distribution creates greater inequities when incomes are low than when they are high.

Another peculiarity of our definition of equity is that not only does it depend on the absolute level of income as well as on its distribution, it also depends on yet a third factor, the relative scarcity or cost of production of different goods. Other things being equal, more equity results if necessities are cheap than if it is luxuries whose cost of production is low in relation to that of necessities.

To appreciate the importance of this last factor, it is useful to examine first of all a situation which public opinion regards as inequitable. Such a situation exists when some goods the public would like to see generally accessible are too expensive to become generally accessible, given the inequality of wealth and income. Such a situation can be remedied in either of two ways. One is to reduce the inequality of wealth and income distribution through progressive taxation and death duties. The other is to take the necessities whose unequal distribution through the market mechanism public opinion resents and to distribute them in an egalitarian way outside of the market mechanism.

The first is the obvious, natural and most efficient way; but it is also likely to be the less feasible politically. For a very far-reaching reduction of monetary inequalities may be necessary to assure the egalitarian distribution even of a single necessity if this is expensive and scarce in relation to demand. The second way is by far the less drastic, by far the less revolutionary whenever the number of such necessities is small. Hence the many examples in free enterprise economies of the egalitarian distribution of necessities more or less outside of the market system. Wartime rationing of food, clothing, gasoline, etc. is one example./ Public education, provided free and

/ Cf. my "The Political Economy of Consumers' Rationing", Review of Economic Statistics, Vol. 24, pp. 114-24, for a detailed discussion of this case.

paid for out of taxation is another. Such distribution, however, is often inefficient or administratively cumbersome -- problems I shall return to presently.

For the time being, let us look at the subject in the context of secular change and economic development. Development means a rise in incomes; and as incomes rise, the public feels that it can afford more equity and usually wants to spend part of its additional income on increased equity. In other words, development increases the demand for equity.

At the same time, development may but need not increase also the <u>supply</u> of equity. The rise in incomes stems from technological progress, which may lower the cost, improve the quality, or extend the range of the goods and services available. But only when it lowers costs, and lowers the costs of necessities, actual or potential, only then does technical progress automatically involve social progress as well.

It so happens that most of America's early contribution to technical progress was precisely of this nature. We made modest contributions to the advance of knowledge -- most scientific breakthroughs were of European origin -- but we made a large contribution to the simplification of products and improvement of manufacturing methods calculated to make possible mass production at low cost. This, more than anything else, explains why, in the half century before World War II, America was regarded as the land of the common man and American civilization as the civilization favoring the common man. Our standard of living rose, because more and more necessities, and goods coming to be considered necessities became cheap and generally available; and this meant social progress hand-in-hand with the rise in incomes.

Such development satisfies more or less the public's wish to obtain part of its additional income in the form of increased equity; but it is not the only form that economic development can take. Indeed, it is likely that since World War II, economic development in most Western countries has taken a different form, involving a rise in incomes with little or no increase in equity.

This latter kind of development results from the cheapening or improvement of luxuries, while some important necessities remain high or even rise in price. An important feature of post-war economic progress in the West has been the reduced cost and increased availability of kitchen appliances and other consumers' durables.[/] Although public opinion is gradually reclassi-

/ The effect on farm prices of the even greater increases in agricultural productivity has been largely offset by public policies aimed at protecting the farmer by maintaining farm prices.

fying many of these from luxuries to necessities, they cater to less urgent and less essential needs than do some personal services whose accessibility to the masses has increased little if at all. When development takes this form, the public may well be dissatisfied with its course and demand that additional necessities be made available outside the market system on an egalitarian basis. The main example is the demand for free medical care. The growing demand for comprehensive national health service or insurance has been voiced in most advanced countries since the war; and you may well ask why. After all, real per-capita income has been growing in all these countries at a very fast rate; more people than ever before can afford to pay for medical care as a result; why, at such a time, should the public be impatient with the progress already made and demand socialized medicine? There may be many reasons but one of the most important is the one mentioned above. The public seems impatient that the post-war rise in incomes was accompanied by less social progress than it had hoped for or anticipated on the basis of past experience. As though society would resent the kind of economic progress that puts a second car in every garage sooner than it makes available medical care for all.

Another and similar example of this newly arising demand for the free and egalitarian distribution of necessities not generally available before is the move, in the United States, for establishing the Office of Public Defender. This would provide the funds to finance and the attorneys to conduct the legal defense of those accused of certain crimes, and thereby give the full protection of the law to many who hitherto have not been able to afford that expensive commodity.

Yet another attempt at increasing equity through public action is the campaign of Governor Brown of the State of California to abolish the death penalty. For life is a necessity of life, and one which should be equitably distributed; whereas evidence shows that all inhabitants of death row come from low income groups, and that the well-to-do can get away with murder -- at least to the extent of escaping the death penalty. /

/ Cf. Clinton T. Duffy, 88 Men and 2 Women, Chap. 23; Edward B. Williams, One Man's Freedom, Chap. 14.

One more good that is coming to be considered a necessity that ought to be available to all is the assurance for one's old age of a standard of living commensurate to that achieved during one's active life. For a variety of reasons, this good is not likely to become generally available through the market mechanism and will probably have to be provided collectively. One reason is that its cost is likely to remain high or even rise, partly because life expectancy is on the increase and partly because the aged, often lonely and subject to chronic illness, require more than their proportionate share of personal services, whose price rises with the secular rise in labor productivity. The second reason is that the price of buying, during one's active life, a given standard of living for one's old age is greatly dependent on two unpredictable factors: one's time of death and the cost of living during one's old age. One can insure against the uncertainty of the first by buying a retirement or pension policy, against the uncertainty of the second by putting one's savings into a diversified portfolio of common stock; one can divide one's savings between the two; but one cannot insure against both risks simultaneously. This means that one cannot buy in the market a financially secure old age at a predetermined price; only the State can insure fully against the double hazard of rising prices and a long life./

/ The reason why insurance companies cannot insure against changes in the cost of living should be obvious. At the same time, they ought to be able to sell retirement policies tied, if not to the consumers' price index, at least to some stock index.

All the above examples illustrate the same point, which is this. The secular rise in the standard of living lengthens the list of goods society regards as necessities and wants to have distributed in an egalitarian way; and as this list becomes longer, it includes an increasing number of goods whose egalitarian distribution cannot be accomplished by the pricing system in the private sector and will therefore have to be effected outside of the market mechanism. Hence my prediction that future social progress (increase in equity) will probably have to be implemented by the public sector to a greater extent than was the case with past social progress. The same point is implied by much of J. K. Galbraith's argument in The Affluent Society, and also by the deliberate bias in France's last (fourth) Modernization and Equipment Plan toward increasing investment in collective services rather than in the private sector.

Having discussed the motives for and the likelihood of the future transfer of some services from the private to the public sector of the economy, it may be fitting to end with a reminder of the possibility of shifts also in the opposite direction, prompted by the already mentioned inefficiency and cumbersomeness of distribution outside of the market mechanism. Goods and services paid out of taxes and made available free will be equitably distributed but are also likely to involve inefficient resource allocation. This is so, because the demand for free goods is filled to saturation, which necessitates an undue diversion of scarce resources from goods that are not available free. The resulting loss of welfare may be a small price well worth paying for the equitable distribution of services whose social cost is low and the demand for which is quickly saturated. On the other hand, the free availability of services that do not meet these conditions may lead to resource misallocation too costly to be tolerated; and in such cases, ways must be found of restricting consumption without making distribution inequitable. Demand for free education is restricted (though perhaps not sufficiently) by making access to higher education conditional upon certain minimum achievement at lower levels. In the case of free medical care, British experience has shown that after an initial period of transition the physician's sensible attitude can restrain his patients from taking up his time and using his services for every trifle. Wartime rationing is another example of circumventing the market for the sake of equity and yet restricting consumption at the same time. This was accomplished partly by the administratively enforced equal distribution of specific commodities, partly by the issuance and equal distribution of a ration currency to circulate side-by-side with money./ The last mentioned is in many ways the best way of

/ Cf. my "The Political Economy of Consumers' Rationing", op.cit.

achieving both equity and efficiency but is far too cumbersome to be tolerated except under the stress of war. For peacetime use, no solution has yet been developed (apart from the two examples mentioned), although the need is likely to become more pressing. One reason for this is the increasing density of population.

The increased density of population and its higher standard of living mean that more and more people crowd in upon each other, generating ever larger quantities of noise, exhaust fumes and debris on their way. As a result, many amenities that used to be either naturally free or provided free by Government are in the process of being rendered scarce and expensive. Highways, metropolitan thoroughfares, unpolluted water, smogless air, places where man can commme undisturbed with nature are examples. To discuss just one of these, estimates of what city traffic will be 25 years from now in this country are totally incompatible not only with the nature but with the very concept of present-day cities. To solve the resulting problem, Professor Vickrey would restrict the use of city streets by charging a price for it -- just as he would use prices for solving many similar problems in other areas as well. / To reject such proposals as utopian shows a lack of imagination and inability to realize that we are entering a new world in which many of the good things in life we now take for granted and regard as part of nature will become carefully husbanded commodities whose use or consumption must be rationed. The only question is whether rationing them by price would not create problems of equity and whether it would not be preferable therefore to develop other means of rationing free from this objection.

/ Cf. William S. Vickrey, "Pricing in Urban and Suburban Transport", <u>American Economic Review</u> (PROCEEDINGS), Vol. 53, pp. 452-65.

Society is bound to insist on the equitable distribution of goods that were once free; and the larger the number of such goods to be rationed by price, and the greater their scarcity, the smaller the likelihood that the market will distribute them equitably. Indeed, bringing hitherto free goods or amenities into the realm of the pricing system has the opposite effect on the degree of equity from that of a rise in real incomes. To prevent a retrogression in equity therefore, hitherto free goods may have to be rationed through means other and more equitable than the pricing system. I have no new general principle to suggest; and ad hoc methods with no overall principle may well be the best solution. An example, additional to those already mentioned, may be worth discussing.

Consider a country or region in which unspoilt nature is getting scarce. As more and more people seek the great outdoors, the time will come when nature cannot both be free and remain unspoilt. The present tendency is for the State to hasten the spoiling of nature by providing better and wider roads, more and faster transportation; for society still believes in man's natural right to the free enjoyment of nature and the State's duty to fill to saturation the public's demand for highway capacity. But should people come to believe that free access to nature is not the better alternative and wish to ration it rather than letting it be spoiled, they would have the choice of either charging an entrance fee to nature or limiting access through narrow, winding or rough roads. The first would be efficient but inequitable if the fee had to be high in order to be effective. The second would limit access to nature to those who value it highly enough to put up with the inconvenience of a long or difficult drive; and while this too can create inequities (e.g., it discriminates in favor of good drivers and people with much time on their hands), these are likely to be less resented than those created by the inequality of income and wealth distribution. More problematic is society's willingness to tolerate unsatisfactory roads as a rationing device.

Yet, we may increasingly be forced to accept and learn to live with such ad hoc methods of restraint on our freedom to consume if increasing population and its increasing affluence reduce our elbow room much further.