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Income distribution policies

9.1. Definition; objectives

We will define as income distribution policies all intervention into the process of income formation with the general objective of changing income distribution. Intervention need not restrict itself to the income formation process proper, that is the forces of demand for and supply of labour of different types or other production factors such as capital. This type of intervention may be called *direct* intervention; well-known examples are the imposition of *minimum wages*, the limitation of *dividends* and so on. Such policies, if not based on a careful analysis of the operation of the markets concerned, may unexpectedly disrupt market equilibrium, possibly even to the disadvantage of those whom the authorities want to assist. A broader spectrum of policies are those which have an impact on the forces 'behind' the markets concerned; in German they are known as '*marktkonform*'. We will call them *indirect* policies. Their advantage is that they do not disrupt but rather shift the equilibrium, although the differences with direct policies are not as sharp as some authors have suggested. In one way or another income distribution policies are meant to change the free market order or *laissez-faire*, exactly because the outcome of such a completely free system is considered to be ethically unacceptable. This they have in common with a long list of modern public interferences, from the prohibition of child labour to the imposition of ecological standards.

Among indirect income distribution policies, intervention by educational, tax, social security, and technological research policies will be discussed, corresponding with our discussions in preceding chapters. While tax and social security policies have been applied for a long time in order to influence income distribution, so far educational and research policies have usually been pursued with other main objectives in mind. But we have found that their impact on income distribution might be of some importance.

While the general objective of income distribution policies may be said to be to reduce income differences, there are also other objectives; at present, for instance, to *reduce inflation* or price rises. Moreover, the degree of reduction in income inequalities aimed at is a matter of lively discussion. Several public opinion inquiries have confirmed more precisely the well-known fact that opinions on the present income distribution and on the direction in which it should be changed widely vary. It is precisely with this phenomenon in mind that in this study we have tried to give some more precise content to such concepts as optimal and equitable income distribution. It should be kept in mind, however, that our attempts have also confirmed that a definition of either of these concepts does not imply that the means exist to attain such distributions.

In the setup of this book the present chapter is intended to somewhat fill the gaps between the crude framework constructed in the preceding chapters and the *large number of details* which characterize practical income distribution policies. It is not our intention to add new points of view here but rather to remind the reader of the many gaps. In doing so we will draw heavily on what other authors, scientists as well as men and women of practical experience, have said or written. Our great debt to these authors will be clear to the reader on many occasions. If we do not attempt to quote many of these other authors it is because the setup of this book would not permit an equilibrated documentation of this kind.

9.2. Survey of means used in present income distribution policies

As already stated, a large number of policies, pursued by different institutions, are currently directed at the objective of attaining an income distribution more in accordance with what present-day public opinion considers desirable. In this section a quick survey will be given, in a more or less chronological order of the initiation of these activities. Our survey will cover a time span of more than a century, starting in the first half of the nineteenth century, but touching only upon the most important institutions and policies.

Trade unions were the first among the more important institutions which considered it their task to improve living conditions of their members with the aid of what the economist would call oligopolistic activities. Even though, according to some production functions, such activities cannot raise the portion of national product distributed to workers as a group, they may have had other types of impact on society, such as reducing traditional inertia and speeding up the formation of capital and technological development. According to other production functions, trade unions can indeed raise the workers' share in national income.

Social legislation is a second large complex of policies, usually administered by public or semi-public bodies, directed at helping the socially weak. A distinction can be made between social *insurance* and social *assistance*, but the dividing line is not sharp. Generally there has been a movement from individual insurance principles towards instantaneous redistribution. Both systems are characterized by the collection of contributions and the distribution of benefits. The pure insurance institutions are in addition the owners of a capital and as a consequence have a second source of income, interest on accumulated capital. The pure redistribution institutions aim at an annual balance between contributions levied and benefits paid out. There is also a good deal of variation with regard to eligibility for participation in an institution. Many of the earlier institutions of social security were set up for *employees* only or even for *state employees.*

They contributed little if anything to general social issues. The bulk of the later social security institutions were created for *wage earners* in manufacturing industry and services and were not accessible to agricultural workers or domestic workers. Still later their coverage was also extended to these groups.

The redistribution they effectuated was one *among* workers rather than between workers and the middle and upper classes. Deleeck [19] feels this is to a large extent still true in Belgium. Probably this is true to a large extent also in France and other Latin countries.

After the worst inequalities had been reduced, a number of social institutions were also made accessible to *small independents;* separate provisions were made for agriculture. Some of the latter hardly reduced inequality among agriculturists. This is true when the measures aimed at raising prices of agricultural products, as those taken during the Great Depression and in protective countries.

In the last few decades social provisions were organized benefiting *all citizens* in difficult circumstances, such as illness, or old age.

The subjects covered by social security are not exactly the same in all countries, but there is a good deal of similarity. Starting with provisions for victims of *accidents* or *professional diseases*, gradually such subjects as *unemployment*, *illness*, *hospitalization* or *old age*, were covered and provisions for *large families*, *widows* and *orphans* were introduced. Even if about the same type of measures have been taken, the quantitative extent of the benefits and hence of the necessary contributions sometimes differ considerably among countries. Two main elements determine the level of social provisions: the country's average income and its general philosophy or, in other words, its political tendencies. Thus, the United States introduced social security on a larger scale only during the Great Depression, when the prevailing *laissez-faire* philosophy went through a severe confidence crisis; in Western Europe most countries had introduced them long before.

Taxes have been used as instruments of redistribution since the beginning of the twentieth century; we begin with *direct* taxes, such as taxes on income, wealth and wealth increases, which because of their progressive character imply that relatively larger contributions were required from the well-to-do for financing the public sector. While for a long time *indirect* taxes were more or less proportional to expenditure and hence, by and large, to income, gradually they have been made progressive by the exemption of first *necessities* and the additional taxing of *luxuries*.

The social role of taxation became more outspoken when, step by step, the volume of *services* rendered to the general public *below cost* was extended. This applies especially to education, which was increasingly financed by public authorities and, moreover, expanded very quickly during the last century. Today it also applies to rail transport and, in some countries, to medical services.

While the largest volume of transfers made as a consequence of the policies summed up can be described as indirect income distribution policies, on a number of occasions governments have also applied *direct policies* as defined in Section 9.1. During the Great Depression, during both world wars, after these wars and in the last decade both *wages* and *prices* have been the subject of government interference, usually in consultation with the large organizations of the employees and employers concerned. Minimum wages, whether in particular branches of activity or in general, are one example. Wage stops for a limited period constitute another case. Prices of first necessities are subject to government control in several countries; alternatively, price increases need the authorities' permission. Inversely, as a means of protecting some groups of small producers in agriculture, small-scale industry, and retail trade, minimum prices for their products are currently being fixed.

In some countries, which were under foreign occupation during World War II, for quite some time after that war a system of *co-operation between government and the organizations of employees and employers* was in successful operation with the aim of maintaining some sort of temporary social harmony in order to speed up the economy's reconstruction from war damage. The Netherlands are probably the best-known case, but France and Norway knew similar forms of co-operation. In Holland and Norway two background factors were operative which might be revived in the future, provided the appropriate formulation of the 'common interest' can be found. One was a feeling of solidarity against outside forces; the other was an increased influence of economic science as a platform of rational discussion. For the last fifteen years these factors have weakened and the situation considered more normal in most countries has returned. In fact, the situation has become even more than before, one of *confrontation* of group and class interests.

9.3. Generalized inflation

Until around 1960 inflation was considered to be an abnormal phenomenon which had occurred in a number of developed countries as a particularly post-war problem and in a few developing countries, mainly Brazil and Chile, as a 'structural' problem. The famous case in developed countries was the *German* inflation of 1921–1923, described as 'galloping inflation', due to a particular combination of factors such as the imposition by the Allied powers of a war indemnity and a transition of power to a democratic socialist government anxious to meet the wishes of the workers. With the aid of a big stabilization loan and the return to normal financial policies the German government succeeded in the operation of price stabilization after the old mark had been depreciated to one-billionth (in the European sense of 10^{-12}) of its 1913 value. Even more serious depreciations occurred in Hungary, but they have attracted less attention. More moderate depreciations reduced the Belgian, French and Italian currencies, leaving these currencies around 1960 at about one-seventh, one-fiftieth and one-eightieth of their 1913 gold parities. As a consequence of the Great Depression the US dollar was devalued in 1933 and the British pound in 1931. Several smaller changes, sometimes revaluations, took place after World War II, among other countries in Germany, Switzerland and the Netherlands.

The long-lasting inflations and corresponding depreciations and devaluations in *Brazil* and *Chile* were the most spectacular examples in a number of developing countries after 1945, especially in Latin America but also elsewhere. The phenomena in Latin America were the source of a scientific discussion between two 'schools' known as the *monetarist* and the *structural* school. The monetarist school recommended, as the only real remedy to the continual price rises (often of about fifty per cent per annum), the adaptation of national expenditures to national income. It can be easily shown that such an adaptation implies equilibrium in the current items of the balance of payments. The monetarists understood that the main obstacle is this '*financial discipline*' which is difficult to live up to for countries with 'soft governments' which are desirous of investing large amounts in objects of development such as infrastructure or also state industries. The structuralists tried to point out that some features of the countries' structure constitute the obstacle to a healthier policy. In this author's opinion the real structural difficulty in carrying out the monetarists' counsel consists of the existence of so-called '*non-tradables*', that is, goods which cannot enter into international trade. Examples are buildings, roads, a large number of services and often electricity, as long as there are no interconnected networks. The adaptation of national expenditure to national income, as recommended by the monetarists, also implies a substantial reduction in the demand for non-tradables and hence a reduction in national income. While a reduction in internal demand for tradables creates an exportable surplus, this is not true for a reduction in the demand for non-tradables. The substantial reduction in national product and income implied by the monetarists' recommendation is the real stumbling block. Instead, a policy mix should have been recommended, including not only the adaptation of national expenditure to national income, but also a production-increasing device to compensate for the loss of income otherwise incurred: for instance, an expansion of the production capacity of exportables or import substitution of tradables [71].

An important further example of galloping inflation in a developing country is found in *Indonesia* around 1965. Here an outright lack of understanding of economic problems by President Sukarno, the country's cultural and political leader during its struggle for independence, was at the root of developments. Sukarno's merits in other fields are great enough to permit us to bluntly state this fact. The present government has succeeded in overcoming the worst part of inflation.

After 1960 developed countries got increasingly involved in a process of '*creeping inflation*', especially Western European developed countries. For some time the United States stayed out, whereas Japan, besides experiencing the most spectacular rate of real growth – some ten per cent per annum for about two decades – suffered from a process of worse inflation. Western Europe's creeping inflation was felt to be an almost unavoidable side-effect of its full-employment policy, which was successful for quite some time: in most countries the rate of unemployment stayed far below Beveridge's three per cent norm. The bargaining position of trade unions was automatically strengthened by this policy, which was not pursued in the United States and couldn't be applied yet in Japan with at that time a rural labour reserve.

Around 1970 the creeping inflation increased in momentum and at the moment of writing amounted to an annual ten per cent price increase. In reaching this level the problem of inflation has become an *important social problem* which only countries with a centrally planned economy have been able to keep under control. It represents an urgent challenge to the democratic Western countries and deserves some further analysis. Even some degree of undesirable unemployment, say of over three per cent, has not yet halted the rise in prices and wages and has led instead to situations known as 'stagflation' – stagnation with inflation. While definitely part of the problem resides, as before, in a lack of financial discipline, another and maybe the larger component is an aspect of income distribution, even of labour income distribution. We will consider first this latter aspect and turn to the distribution of wealth in Section 9.4.

The general point to be made first is that the present ten per cent per annum price rises can no longer be considered to be an advantage to *the masses.* One or two per cent rises have sometimes been defended as an element of 'lubricating oil' in the economy, helpful to new ventures and hence to the maintenance of employment. At the ten per cent level the situation can be better characterized as one in which all sorts of speculation absorb an indefensible portion of national product to the detriment of all those who make really productive contributions. If the well-known phrase 'getting richer while asleep' applies to clever capital owners, then it applies with fuller justification to the automatic enrichment of all holders of physical capital, whether they do or don't make an effort to intelligently use that physical capital.

The next point to be made is that present-day inflation is to a considerable extent '*cost-push*' inflation, distinct from 'demand-pull' inflation; which was already dealt with, in other words, when the monetary aspect was mentioned. Cost-push inflation becomes important when, as is true, most social groups simultaneously claim a larger piece of the pie of national product: workers, employees, farmers and most other entrepreneurs, all of them in turn. In nominal terms they ask for increases in their shares which add up to more than the real annual increase in production and increasingly more. Most of these groups are unaware of the consequence: that the price rises they cause by this unco-ordinated *hunt for more* decreases their relative shares to the advantage of speculators.

The only sensible way out of this maelstrom is an attempt to agree on some more objective yardstick for the future distribution. Of course, such a yardstick – accepted by a considerable majority of the citizens – may not be found. In order to facilitate an agreement on this subject, two elements seem to be useful. One is an awareness of the history of income distribution and its causes. The other is an ethical principle for the choices open to us. This study attempts to contribute to both elements; the emphasis must be on 'contribute' since the eventual agreement, if one can be attained, will have to rest on contributions by many students of the problem.

As for the mechanism of the history of income distribution, it seems useful to stress the almost monotonous *reduction in inequality*, attained partly through the mechanism of demand and supply. With regard to the ethical principle, a *more precise definition of equity* may be of some help. Of some help only, since the definition of equity does not yet warrant, as we saw, its materialization. It is only within the limits set by the policy instruments at our disposal that equity – when adhered to in the process of a dialogue – can be attained. Hence the importance of extending the arsenal of policy instruments.

The *type of agreement* conceivable in the present circumstances seems to this author to be a long-term (say, a five-year or ten-year) agreement on the increase in the portion of national product allocated to the lowest income groups. Such an agreement, once accepted, should be the framework of socio-economic planning. It should be accompanied by the acceptance, by parliament, of a solid financial discipline. A better financial discipline will be furthered by an intensified *integration*, first of all, of the European Community. National parliaments can be put under some pressure by the argument that international agreements are involved. But then the agreements should indeed be concluded, evidently a difficult thing for British and French politicians to accept.

In addition, the search for better instruments of income distribution policies should be intensified. Section 9.5 will deal with this subject. First the element of the distribution of wealth will be briefly discussed.

9.4. The distribution of wealth

Part of the income distribution clearly depends on the distribution of wealth, not only because unearned income derives from wealth, but also because wealth constitutes a reserve for its owner and so enhances his manoeuvring possibilities. This has been understood ever since Marx, and an enormous literature exists on the various alternative ways in which the impact of wealth on income and power distribution can be reduced. There is no point in even trying to summarize this literature. This author does not adhere to the theory that *complete socialization* is the best way of dealing with even productive wealth and that partial solutions are bound to fail. As support of this view it may be stated that, although wealth distribution is more uneven than income distribution, it is also becoming less unequal fairly quickly, as shown by Atkinson [1]. Partly as a consequence of the expansion of social security institutions and, for another part, of the expansion of private insurance companies, an increasing part of total wealth belongs to lower income groups. Trade unions are preparing schemes for workers' participation in enterprise capital and some of these are likely to come into operation.

A well-known difficulty of getting certain types of financial manipulations under control is the shiftability of unearned income into capital gains in order to profit from the low tax rate on the latter (or even the absence of such a tax). Kaldor's proposal [35] on how to administer an expenditure rather than an income tax seems to be important especially for developed countries and has had less support than it deserves.

While this author views further rises in death duties favourably and sees their link with the receiver's rather than with the donor's wealth, he has nothing to add to the debate on this topic.

9.5. Further proposals on income distribution policies derived from the present study

Alongside the policies described in the preceding sections of this chapter, a few more can be suggested on the basis of our present study.

(i) *Educational policies* deserve to be programmed not only with a view to improving education in the widest sense, but also in order to influence income distribution. In most of our results, perhaps clearest in Chapter 6, the equalizing consequences of extended education are reflected. Since the heart of the matter is to approach, as much as possible, equality between the demand for and the supply of the manifold types of labour, our recommendation is not simply a quantitative one, but requires many qualitative changes in education as well. Part of these may be approached from the demand side, as reflected in job evaluation, but an interdependence and a mutual impact of cultural elements on both the demand and the supply side may considerably enrich this complex of policies.

(ii) In order to create more clarity on the *aims* of income distribution policies, the elaboration of our concepts of welfare, is strongly recommended. A vast programme of further research and of exchange of ideas on these subjects seems to be called for and can be easily formulated.

(iii) Since *technological development* also affects the demand for various types of labour and needs a fresh look for reasons of environmental policies, a broad discussion of priorities in technological research looks promising also for reasons of income distribution. Now that the awareness of the multiple freedoms of choice in this field has grown considerably, the income distribution aspect of these choices should also be kept in mind.

(iv) As shown by simple examples in Chapter 7 and as is well known from welfare economics, a search for entirely different tax types, closer to *lump-sum taxes* and possibly based on human capabilities rather than on the results of their use, is imperative. Most important in this field clearly is the development of *psychotechnical testing*, the contribution of which is vital, whether negative or positive.