LECTURE 4

CAN WE REDUCE INEQUALITY FURTHER?

4.1. Taking stock

In this last lecture I propose to discuss income policies, and more particularly the question of whether we can further reduce inequality and whether there is a road towards an optimal and an equitable income distribution (the latter two defined as in section 2.1).

Before tackling these problems I propose to take stock of what we have learned from the recent research activities on the subject. A major change between 1850 and today is that around 1850 an estimated forty percent of national income went to owners of capital goods, and that very low taxes were paid in those days. This portion going to capi-

tal owners has fallen to almost half this percentage in France and fallen more in the most advanced European, especially the Scandinavian, countries, but also in the Netherlands. Part of the ten percent going to capital owners now reaches those who are benefitting from social and private insurance; the part going to rich people is heavily taxed. Can we say, perhaps, that the prosperous countries are close to being saturated with capital? Anyway the tophat capitalist of Albert Hahn's impressive drawings has had to yield, as Burnham has already taught us, to the managerial élite, an élite necessary also in Eastern Europe. Moreover a new type of capital, invested as training and education, has come to the fore; it has been invested mainly in those favoured by nature with either intellect or leadership. There are many other names for the latter endowment; we may call it independence, creativity, sense of responsibility, ability to communicate, etc. Characteristic of the two new élites is that they are not lazy. Their income is rightly called labour income; and by far the larger part of income inequality is inequality in labour incomes. If we want to, we may call this 'exploitation by human capital'. One aspect of it is that academic fees to be paid for university education are a very small part of the actual costs of that education to the community. One further characteristic of the academic élite is that percentage wise it has increased tenfold in a century.

Partly as a consequence of this broadening of the academic base, but also due to other factors, income distribution has become much less unequal, especially if we take incomes after complete redistribution and per consumer. For the latter the decile ratio in the Netherlands is now around 3. According to Wiles (1974), Sweden does better than Eastern Europe. Other figures have been mentioned already.

4.2. Aims of income policy

Notwithstanding the changes and the improvements noted, we know that these averages about the 10 percent most and least prosperous still hide inequalities which most of us do not like. Public opinion polls show that a clear majority of our population is in favour of less inequality. Economists and a number of politicians see limits to what can be attained, however, especially because part of the income differences are incentives to work and to learn and our general level of welfare might be unfavourably affected by further reductions in inequality. In the Dutch government's recent *Report on Income Distribution* a similar point is made and the need to reach a compromise between the two, partly incompatible, aims is expressed.

The problem of income distribution also has international aspects. Apart from the possibility of

migration of persons or capital to 'tax havens', the more important international aspect is the distribution of income between poor and rich countries. By way of exception I am not going to discuss this aspect today.

Rather, in the spirit of our earlier discussion (cf. sections 2.1 and 3.6), I want to ask what I see as the central question: can we reduce income differences to those which we felt to be justified, and which we called 'compensatory', that is, compensations for effort. Or, the other way around, can we *eliminate the scarcity rents* paid to individuals endowed with powerful productive capabilities? The rationale of such an elimination resides in the fact that these rents are not incentives: they are being paid for something that cannot be changed and hence cannot be stimulated, and need not either. This rationale is no guarantee, however, of our having available the means to eliminate these rents.

4.3. Means: Education?

Among the phenomena which, according to all research, do exert considerable influence on income distribution, education and training have been important instruments. From studies such as that by Dresch (1974) one may derive the impression that endowment reserves still have not been exhausted. We may conclude that further extension of the

access to education still constitutes a means to be used. Clearly it is not only a quantitative change, but also a qualitative change which makes sense. As an economist I prefer to leave the area to educationalists, with the recommendation, however, to try the utmost to bring education to all worth it and wanting it.

A highly interesting component of the problem should be mentioned nevertheless. It is the question whether noncognitive skills, and in particular the ones called independence or leadership, can perhaps also be learned, and if so, how. I am on *terra incognita* here, speaking for myself, but one way of eliminating part of the rents for independence or leadership may be more competition, by making more leaders – but can we?

4.4. Means: Technological development?

Another factor we found to have, in the past, an inequality-furthering phenomenon is technological development. But need it be? Increasingly we get the feeling that technological development is not simply something given, but that it may be guided, within limits. Having always tried to replace labour by capital and hence by energy, we already accept that in the future we must use energy-saving devices, or at least devices using other types of energy than those now mostly used. Is it not possible,

then, to further redirect research into a direction enhancing the demand for less qualified manpower in relation to more qualified? Some examples from the history of technological development may illustrate the point. The introduction of electric traction with railways developed the demand for less qualified engine drivers. Mechanical ginning of raw cotton results in a product of lower quality. Musicians have been replaced partly by disk jockeys (not my preference, though). In the apparel industry less qualified labour is used than in tailoring.

Of course, more aims can be added to a redirection of technological development. It would be very important to develop technologies enhancing the satisfaction derived from work.

4.5. Means: Taxes?

In the realm of taxes technological development can also be observed. Income, wealth or expenditure taxes require much more sophistication than excise taxes or import duties. Hence the preponderance of the latter in developing countries. So why could we not develop new types of taxes? Here in particular we must come back to the question of whether the socioeconomic optimum can be attained by taxes different from today's. It is well known that most of today's taxes are incompatible with the optimum conditions of welfare economics.

For a tax to be in line with the optimum it should not tax marginal efforts or marginal consumption, since such taxing induces each individual to wrong choices: social and individual criteria are being made different. Taxes of the sort needed are therefore lump-sum taxes. This means that the tax base must be independent from marginal increases in efforts or consumption. They must be based on the data of the choice problem of the individual; these data are our parameters, more particularly the strict ones, or the innate capabilities of the individuals. The use as tax base presupposes that psychotechnical tests can be so improved as to be reliable enough for a tax base. This, then, is a request to psychotechnical experts. It constitutes a socially highly relevant research proposal to that profession.

In support of this proposal let me, as an economist, try to depict the impact of such a 'capability tax', as I shall call it for brevity. Let there be a test, to be repeated every five years, say, in order to assess the innate capabilities, an assessment needed for job applications as well as tax purposes – this in order to reduce simulation. Instead of income tax, capability tax must be paid. This implies that all additional income obtained from extra efforts, including overtime, remains entirely available to the individual. The incentive to work or to learn will be reinforced.

Of great importance, of course, is the tax *scale*.

In the final stage – that is, after experiments with low rates have been successful – the objective of the tax is to 'tax away' the scarcity rent of innate capabilities. From the measurements of utility functions we can in principle derive the scale. In our two-entry table the horizontal income differences should be taxed away. This statement may give an impression of the level of the capability tax. But for the time being these estimates remain very primitive in comparison to what we hope can be accomplished by a considerable refinement of the type of research described. If my assumption, supported by the findings of Bouma et al. (1975), of no influence of innate qualities on utility is accepted, the difference between the capability tax to be paid for an $ 11,000 income and a $ 3,000 income would amount to something on the order of magnitude of half the income differences in the two-entry table. For the State of Illinois in 1959, this would have amounted to a difference of some $ 4,000 a year between the two types of individuals considered. Of course they should have been characterized not by their 1959 income, but by their abilities: for the yardstick chosen in that very preliminary analysis, they stood for people with no schooling at all and people with 18 years of schooling. The tax would be pretty stiff, of course: some $ 200 per annum for each additional year of schooling, since probably, because of intercorrelation between schooling and independence, the effect of

the latter quality is included in our estimate.

I want to repeat that everything I said should be seen as a provisional argument in favour of research on the possibility of finding a new tax base which could bring us closer to the social optimum and to an equitable distribution of jobs and incomes.

A second suggestion is that experiments could be undertaken with a tax of this type before a perfect test of innate ability had been found, if a small part of the income tax is replaced by a tax on ability with a much lower rate than the one mentioned.

4.6. Income policies in our time

Taking the phrase 'in our time' in the Chamberlainian way, income policies in our time stands for income policies in 1975 and 1976. From all I said so far it will be clear that this subject is outside the scope of these lectures: we have been dealing with much longer periods. But the listener (or reader) could accuse me of a lack of realism (which I expect anyway – I am accustomed to the charge) if I didn't stick out my neck and say something about income policies in the down-to-earth context of today. So, here we go!

It is commonplace to say that part of today's depression is cyclical and part structural. The *cyclical* component is often seen as the good old 'cycle' of business cycle theory. But in these cycles there

was the effect sometimes called an 'echo effect' – the temporary slack in *replacement* investments after large parts of the production capacity had been innovated. De Wolff (1929) used to emphasize this phenomenon, assisted by only a few others, among them Einarsen (1938) and Meuldijk (1940). My first statement then is that we need more statistics on the *age distribution* of our productive physical capital, or on replacement orders as distinct from expansion orders of capital goods.

Another cyclical component of our present depression is the effect of temporary nonspending of oil dollars. Here some estimates exist, but a regular statistical series would be most helpful.

Vis-à-vis cyclical shortfall of demand, Keynesian injections as undertaken by the Dutch, German and French governments, are perfectly justified and perhaps too small. In order to absorb unemployment of about 3 percent, annual injections on an order of magnitude of such a percentage of national income would be natural. They should be reduced *pari passu* with the disappearance of the cyclical shortfall of demand. This Keynesian component of an anticyclical policy should be carried out in concert with the United States, Japan and our companion countries in the European Community.

There is a structural component as well, and this is interwoven with our main modern economic problem in the prosperous world, *inflation*. Here

wage rise restraints are by far the best technical instrument, but also psychologically by far the most difficult one. Much depends on the wisdom of trade union leaders, whose task is tremendously difficult. I can only make two suggestions which may well be considered of a poor quality. First, isn't it best to have a coordinated international policy here, at least for the European Community, or, to start with, perhaps only for Benelux and the Federal Republic of Germany? But then, secondly, there must be a *quid pro quo.* Governments must give some assurances of a policy of further reducing inequality in general income distribution, partly along the lines set out in sections 4.3 and 4.4. For another part, a fresh attack on tax avoidance and *tax evasion* seems appropriate, even in countries where they are believed to be unimportant – which is not certain.

4.7. Further research needed

This brings me to my last subject, the fine escape clause in all scientific (real or pretended) production. I am simply repeating the refrain of us all: more research is needed. In my case the justification is simple enough. My presentation has been such a cumulation of preliminary work, of beginnings to something better and suggestions to others, that by definition more work has to be done if my

contribution is to have any value. Also, in the absence of the latter, I for one would hope that others will join; some of my audience are in fact working hard on the subject. I think there is no need for me to summarize, except that I want to repeat my desire for new research in this country on tax evasion.