

# THE CONCEPT OF ECONOMIC EQUALITY

Prof. P. T. Bauer



**FORUM OF FREE ENTERPRISE**

PIRAMAL MANSION, 235 DR. D. N. ROAD,

BOMBAY 400 001.

"Free Enterprise was born with man  
and shall survive as long as man  
survives."

—A. D. Shroff

1899-1965

Founder-President

Forum of Free Enterprise

# THE CONCEPT OF ECONOMIC EQUALITY

By

**Prof. P. T. Bauer\***

Why, in free and open societies are some people better off than others — not necessarily wiser, nicer, happier, or more virtuous, but better off? The causes of differences in income and wealth are complex and various, and people will always disagree on how they apply to particular societies, groups or individuals. But in substance, such differences result from people's widely differing aptitudes and motivations, and also to some extent from chance circumstances. Some people are gifted, hard-working, ambitious and enterprising, or had far-sighted parents, and they are therefore more likely to become well-off. But whatever the causes of the economic differences in an open and free society, political action which deliberately aimed to minimise, or even remove, these differences would entail such extensive coercion that the society would cease to be open and free. The successful pursuit of the unholy grail of economic equality would exchange the promised reduction or removal of differences in income and wealth for much greater actual inequality of power be-

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\* The author is a world-renowned economist, Professor of Economics at the London School of Economics, and a Fellow of the British Academy. This publication presents salient excerpts from a thought-provoking paper titled "The Grail of Equality".

tween rulers and subjects. There is thus an underlying contradiction in the declared objective of egalitarianism in open societies.

The appeal of egalitarianism is likely to persist. As Tocqueville observed, when social differences diminish — as they have diminished in the West — those which remain appear especially irksome and objectionable; and as he also pointed out, material advance is apt to engender discontent over failure to have achieved some other objective. The contemporary predilection for numbers and quantification, and also the emphasis on material conditions, have further helped to focus attention on economic differences.

The pervasive influence of the machine and of mass production points in the same direction. The criterion of uniformity for judging the efficiency of the machines used in mass production reinforces any philosophical appeal which egalitarianism may have. An efficient lathe, mould or press is designed to turn out identical products. Even small differences give grounds for criticism. This attitude may have had a powerful, if unconscious, influence on our attitudes to social matters.

In an open society, income differences normally reflect the operation of voluntary arrangements. The absence of coercive power in most forms of successful economic activity is recognised in Dr. Johnson's familiar observation that "there are few ways in which a man can be more innocently employed than in getting money". This conclusion is particularly evident in a modern open society. In these societies the accumula-

tion of wealth, especially great wealth, normally results from activities which extend the choices of others, as is clear from the fortunes acquired in, say, mass retailing or the development of the motor car.

People differ in economic aptitudes as they do in artistic, intellectual, musical and athletic abilities. In particular they differ in their ability to perceive and utilize economic opportunities. Readiness to take advantage of economic opportunities is of great significance in explaining economic differences in open societies. This should be evident on a little reflection. The opportunities seized by such men as Thomas Edison, Henry Ford, Lord Northcliffe or Sir Isaac Wolfson were open to most people in their countries. The same applies elsewhere; witness the many Chinese and Japanese **nouveaux riches** in the East. Income differences resulting from readiness to benefit from economic opportunities will be especially wide if there is rapid social, economic and technical change, including the development of new products and the opening up of new markets.

Chance often plays a part in economic life, and thus in the emergence and perhaps persistence of income differences. But this is no different from other fields of human endeavour. Pasteur's celebrated observation that chance visits the prepared mind applies as much to economic life as it does to scientific activity.

An unfounded belief in the basic equality of people's economic faculties has coloured the language of the discussion. If people are assumed to be equally endow-

ed and motivated, then wide economic differences suggest that some undefined but malevolent force has perverted the course of events. Of course, people are not equally motivated or endowed in their economic attitudes and attributes, and this explains substantial economic differences between them in open societies. This discrepancy between the unfounded belief (or assumption) and reality may partly account for the almost universal practice of describing differences as inequalities. Difference is plainly the more appropriate expression since it is neutral. It does not prejudge the issue — unlike the term inequality, which clearly suggests a situation that is unjust or otherwise objectionable. In recent years, inequality has come to be used interchangeably with inequity, and equality with equity. That difference is a more appropriate term than inequality is also suggested by the accepted practice of referring to people's physical characteristics, such as height and weight, as differences rather than inequalities, and under no circumstances as inequities.

On the other hand, the term inequality is appropriate in discussing political power because that power implies a relationship of command between rulers and subjects.

In contemporary parlance, social justice has come to mean substantially equal incomes. Why should this be so? It is not obvious why it should be just to penalise those who are most productive and contribute more to output, and to favour those who produce less. This conclusion is reinforced when it is remembered that relatively well-off people have often given up leisure, enjoyment and consumption, and that these past sacri-

fices have significantly contributed to their higher incomes. This is but one instance of a wider issue.

Advocates of redistribution propose that results of economic processes should be separated from the processes themselves, that people should share the fruits of economic activities in which they have not participated. The idea of equality over the past two centuries has progressed, or declined, from equality before the law, through equality of opportunity, to equality of result.

A given degree of concentration of income and wealth at a particular time has a very different meaning if the societies are fluid, such as, say, those of Malaysia or Western Europe, or more nearly stable or static as, for example, that of rural India. This rather basic consideration rarely enters into egalitarian rhetoric. Moreover, for a rounded view of income differences, incomes have to be considered beyond one generation. Economic differences may be extended or reduced, or rankings of individuals or families maintained or reversed, over a span of a generation or two.

Egalitarians often suggest that the incomes of the rich, or property incomes, have been received at the expense of other people, rather than earned by supplying valuable resources. A familiar instance is the use of the term unearned income, when in fact such income is no less earned than is any other income.

Incomes, including those of the relatively prosperous or the owners of property, are not taken from other people. Normally they are produced by their recipients

and the resources they own; they are not misappropriated from others; they do not deprive others of what those others had, or could have had, or should have had.

The misconception that the incomes of the well-off are somehow obtained by exploitation rather than earned has often had disastrous consequences: for instance, it has led to spurious justification of the expropriation, and even destruction, of economically productive groups. The same misconception is behind the familiar references to shares of different groups in the national cake, and behind assertions that certain groups have not shared in national or international prosperity assertions which do not ask how much these groups may have contributed to it.

In a market economy, the production and distribution of income are two sides of the same process. Income will be equally distributed when people's contribution to it will be equal. The term redistribution is especially misleading because what is being "redistributed" is not a pre-existing income. What happens in fact is that part of the income is removed from those who have produced it, and transferred to other groups.

The general proposition that incomes, including those of the well-to-do or of producers of services, are generated, produced and not taken from others, is subject to partial qualification. The incomes of some groups are often augmented by the exercise of monopoly power, which in most instances reflects barriers to entry, or other forms of restriction, erected or supported by the state. It has even been argued that state-supported



restrictions have contributed materially to the extent of income differences in some Western societies, a contribution which would be eliminated if market forces were allowed freer play.

The levels of income of particular groups do not by themselves indicate the presence or absence of restriction on entry. Successful businessmen, entertainers and athletes, for instance, can earn very high incomes even when they do not curtail their output, and when there are no contrived barriers to entry into their activities. Similarly, an expansion of demand can greatly increase the incomes of certain groups even when, again, there are no such barriers. On the other hand, even modest incomes of professional people, trade unionists, or farmers may be inflated by barriers to entry.

The policy termed redistribution benefits some people by confiscating part of the incomes of others. The beneficiaries may be poor, but this is by no means always so. Major beneficiaries of redistribution include its advocates, organisers and administrators, notably politicians and civil servants. This outcome promotes the self-perpetuation of the process. And once the notion is accepted that economic differences are somehow reprehensible, the door is opened to forcible intervention on any number of different and shifting grounds and criteria; these include differences in income or wealth, differences in their rate of change, and many others besides.

On the national level, the operation of the welfare state comprises two quite different forms of redistribu-

tion: wealth transfers between groups, and redistribution of responsibility between the agents of the state and private citizens. Welfare state policies do not always redistribute income between the rich and the poor. They do not necessarily redistribute income even among individuals. The same people may be taxed at some times and subsidised at other.

The substantial taxes, including direct taxes, paid by the poor in the welfare states of the West make clear that, contrary to what is widely believed, the welfare state is not simply an agency of redistribution from rich to poor. In Britain in 1978 a single man earning £25 a week (less than one-half of the average unskilled wage) paid direct taxes. Those who earn the average wage of manual workers and have two children pay substantial direct taxes. Both categories also pay heavy indirect taxes.

The substantial taxation of the poor in countries which have extensive provision of social services is one facet of the confusion of redistribution of income with redistribution of responsibility just noted. By now, egalitarians and other supporters of social services often recognize explicitly that state-financed old-age pensions, health care, education, subsidized housing and food, welfare and unemployment payments and other social services do not represent solely or even primarily transfers from rich to poor. Heavy taxation of the poor, together with extensive provision of welfare services, reflects the self-perpetuating character of redistributive policies. The case for these continues to be taken for

granted, even after it has become plain that to a considerable extent they benefit people other than the supposed beneficiaries.

There is a further result of large-scale redistribution of responsibility between the agents of the state and private individuals, a result which acts as an anomalous and even ominous force for perpetuating and extending the policy. Prudent people, even if poor, can normally provide for the contingencies of life by saving and insurance, but only if the value of money is reasonably stable. They are unable to do so when this condition does not hold. The heavy state spending on the welfare state promotes inflation, the erosion of the value of money, a risk against which many people cannot protect themselves, certainly not by saving and insurance. The difficulty, or impossibility, of protecting themselves effectively leads them to accept or to demand that tax-financed provision for these contingencies should be maintained or extended, even if this is recognised to be unsatisfactory.

International comparisons of the distribution of incomes are fraught with conceptual and statistical problems, some of them intractable. But there are evident wide differences in income in Communist countries after decades of Communist rule. And in the Soviet Union (a country often thought to be dedicated to the removal of economic differences), the differences in income and living standards are quite as pronounced as in some more market-oriented societies — and this after more than half a century of mass coercion.

## Equality of Opportunity

Equality of opportunity was until recently the principal theme of egalitarian ideology. For example, many Fabians, notably Tawney, thought that equality of opportunity would result in substantial equality of income; that any remaining differences would reflect merit, and would therefore be widely respected and readily accepted. These ideas bypass the fundamental and intractable problem behind the central dilemma of egalitarianism: granted that equals should be treated equally, how shall we treat those who are unequally endowed, motivated or placed? For instance, loving parents and a cultivated background benefit those fortunate to possess them. Good looks and other such advantages result in unequal opportunities.

Only the belief that everybody's aptitudes and motivations are the same — a belief which can have sinister consequences — supports the notion that an open society is practically synonymous with economic equality, or at any rate promotes or ensures it. It is extraordinary that this notion should have been entertained for so long, and is often still entertained, when the evidence to the contrary is both overwhelming and obvious.

The adverse effects of redistributive policies on economic performance are implied in such expressions as trade-off between efficiency and equity, or between social justice and efficiency. These formulations recognise to some extent that economic activity is not a zero-sum game. But they still disguise the extent to which

the outcome of economic processes depends on the performance of people — performance which can be promoted or obstructed by official policy.

It is by no means obvious why it should be unjust that those who produce more should enjoy higher incomes. And attempts to prevent them from doing so will affect adversely the average level of incomes. It will do so cumulatively because if everybody can expect to receive only something like an average of all incomes, this average itself will fall. A neat example of this process emerged from an experiment designed a few years ago by a teacher in an American university. The students demanded much greater equality in all walks of life, including the grading of their papers. In response to these demands, the teacher announced that from a given date the students would be given equal grades for their weekly papers, and that the grades would be based on the average performance of the class. The experiment brought about a rapid decline in average performance and thus in the average grade, because the incentive to work declined greatly.

Because wide income differences have not disappeared in open societies, pressures for their further reduction or elimination have also continued. Hence the demands for increasing the scope and level of what is misleadingly termed redistributive taxation. It is misleading because it is not a pre-existing income that is being redistributed; rather, part of the incomes produced by some people is confiscated for the benefit of other people, including those who derive political or

personal advantage from advocating or administering these arrangements. This last point, that the organisers and administrators of redistribution benefit from it, deserves attention. These beneficiaries are not poor and are indeed often prosperous, so that here also redistribution works in a fashion very different from what is usually assumed.

There may be another reason for the attempts to control and standardise the social and personal determinants of economic differences, as distinct from the attempts to equalise net incomes. An income serves two functions. First, it enables its recipient to buy goods and services. Second, it is an indicator of achievement, and a mark of recognition and status. The former role depends on net income; the latter depends in large measure on gross income. If differences in recognition or status are considered objectionable, this sets up pressure for equalising incomes before tax, and thus for controlling and standardising the factors behind them.

Attempts to minimize economic differences in an open and free society necessarily involve the use of coercive power. They politicise economic life: economic activity comes to depend largely on political decisions, and the incomes of people and their economic modus vivendi come increasingly under the control of politicians and civil servants. The extent of these consequences will depend on the degree of economic equality the rulers wish to achieve; and also on the capacities, ambitions and circumstances of the groups and indi-

viduals between whom economic differences are to be curtailed or abolished.

Extensive politicisation of life enhances the prizes of political power and thus the stakes in the fight for it. This outcome in turn intensifies political tension, at least until opposition is effectively demoralised, or forcibly suppressed. And because people's economic fortunes come to depend so much on political and administrative decisions, their talents and energies are diverted from economic activity to political life, sometimes from choice and often from necessity. These consequences are manifest in many societies, especially in multiracial societies.

In numerous countries, politicisation of life, often pursued in the name of equality, now means that the question of who are the rulers has become a matter of the greatest importance. The effect on people's fears, feelings and conduct is observable in many countries where there is some ethnic diversity, including the United Kingdom. It stands out starkly in the heterogeneous societies of the Third World, where the conduct of the rulers is often a matter of life and death for millions. The ferocity of the political struggle in many Third World countries cannot be understood without an awareness of the politicisation of life there. This process has been helped along by the slogans of equality, and reinforced by the idea that high incomes, especially of minorities, have not been earned but have been taken by them from other people.

When the inequality in political power between rulers and subjects is pronounced, conventional measurements of incomes and living standards cannot even remotely convey the substance of the situation. Such measurements greatly understate the realities of inequality in the society, in which the rulers can command the resources available practically at will. They may use their power to secure for themselves large incomes or they may choose austere forms of life. They still have vast power over the lives of their subjects, which they can use to secure higher living standards for themselves whenever they wish.

It is now widely urged that differences in income and living standards should be reduced or eliminated not only within countries but between them, and indeed even globally. There are the proposals for a New International Economic Order approved by the General Assembly of the United Nations. Because of the enormous and stubborn differences between peoples, policies designed to equalise their living standards would require world government with totalitarian powers. Such a government, to be equal to its ambitions, would be even more coercive and brutal than the totalitarian governments of individual countries.

Economic differences are largely the result of people's capacities and motivations. This is evident in open societies, and also where societies are not open. A disproportionate number of poor lack the capabilities and inclination for economic achievement, and often for cultural achievement as well. Weak members of a



society need to be helped. But large-scale penalisation of productive groups for the benefit of the materially and culturally less productive, and for the benefit of those who administer wealth transfers; impairs the prospects of a society. This outcome is especially likely when the less productive receive support without stigma and, indeed, as of right; and even more so when those who are more productive are made to feel guilty on that account. These are precisely the stances and attitudes prominent in the advocacy and practices of redistribution.

The terminology of the negative income tax reflects the acceptance of the principle of support without stigma. The payment of income tax is a statutory obligation. A negative income tax is the inverse: the right to an income regardless of performance, simply by virtue of being alive and poor.

Personal and group differences in economic aptitudes and motivations are likely to disappoint the expectation that guarantee of a cash income would make it possible to abolish specific welfare services. These services will still have to be supplied to the many recipients of cash payments who will nevertheless fail to provide for the contingencies of life. Such people are likely to be disproportionately represented among the recipients of negative income tax. In Britain this is suggested, for instance, by the prevalence of avoidable ill-health and dental decay among children of unskilled workers who own television sets.

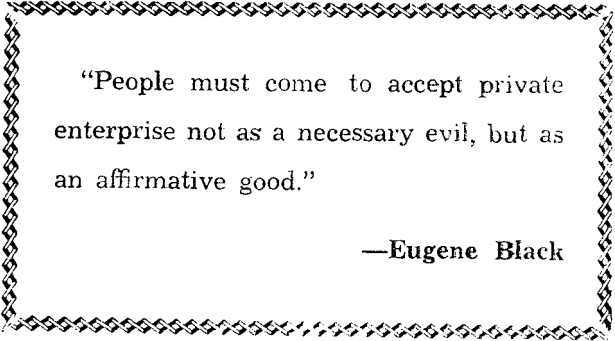
Redistribution of income and reduction of poverty are often thought to be interchangeable concepts. Indeed, it is often taken for granted that egalitarian policies necessarily improve the condition of the poor. This is not so. The promotion of economic equality and the alleviation of poverty are distinct and often conflicting. To make the rich poorer does not make the poor richer.

The advocates of egalitarian policies focus on relative income differences, or the relative positions of different groups. They thereby divert attention from the causes of poverty, especially the causes which underlie real hardship; and from the possibilities of effective remedial measures. Relief of poverty, especially the improvement in the position of the very poor, has nothing to do with the pursuit of equality. Egalitarian policies often ignore the poor, especially those who are self-reliant and enterprising.

In sum, the pursuit of economic equality is more likely to harm than to benefit the living standards of the very poor by politicizing life, by restricting the accumulation and effective deployment of capital, by obstructing social and economic mobility at all levels, and by inhibiting enterprise in many different ways.

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*The views expressed in this booklet are not necessarily the views of the Forum of Free Enterprise.*



“People must come to accept private enterprise not as a necessary evil, but as an affirmative good.”

—Eugene Black

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419

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